

**IN THE INCOME TAX APPELLATE TRIBUNAL
CHENNAI BENCH 'D' : CHENNAI**

[BEFORE DR. O.K. NARAYANAN, VICE-PRESIDENT AND
SHRI HARI OM MARATHA, JUDICIAL MEMBER]

I.T.A Nos. 2297, 2298, 2299 & 2300/Mds/2008
Assessment year : 2001-02, 2002-03, 2004-05 & 2005-06

M/s Zylog Systems Ltd
No.155, Thiruvalluvar Salai
Kumaran Nagar
Chennai – 600 119
[PAN - AAACZ1086G]

vs

The ACIT
Company Circle III(3)
Chennai

(Appellant)

(Respondent)

I.T.A Nos. 283, 284 & 285/Mds/2009
Assessment years : 2001-02, 2004-05 & 2005-06

The ACIT
Company Circle III(3)
Chennai

vs

M/s Zylog Systems Ltd
No.155, Thiruvalluvar Salai
Kumaran Nagar
Chennai – 600 119

(Appellant)

(Respondent)

Assessee by : Shri V.D. Gopal
Department by : Shri K.E.B Rengarajan, Jr. Standing
Counsel

ORDER

PER HARI OM MARATHA, JUDICIAL MEMBER:

All the captioned appeals are being disposed of by a common
order for the sake of convenience and brevity.

Assessment year 2001-02

2. For this assessment year, both assessee and Revenue are in appeal. In Revenue's appeal, being I.T.A.No. 283/Mds/09, only one issue relating to product development expenses incurred in foreign currency amounting to ₹ 8,64,51,871/-, is involved. The Id. CIT(A) has taken a view that expenditure for development of products cannot be reduced from export turnover as against the view taken by the Assessing Officer otherwise. The Revenue is aggrieved and has raked up this issue before us.

3. At the time of hearing, it was found for a fact that this issue stands covered in favour of the assessee by the decision of ITAT, Chennai, Special Bench, in assessee's own case for assessment year 2003-04 in I.T.A.No.1138/Mds/2007, in which one of us [JM] was a party. This Special Bench decision is dated 2.11.2010. The assessee had incurred expenses in foreign currency for the year ending 31.3.2001 at ₹ 13,10,20,724/-. As per the Assessing Officer, in view of the definition of 'export turnover' as given in clause (iii) of Explanation 2 of section 10-B, 'export turnover' does not include freight, telecommunication charges or insurance attributable to the delivery of articles or things or computer software outside India, as expenses, if any, incurred in foreign exchange in providing technical services including computer software, outside India. Therefore, he excluded

technical services expenses incurred outside India from the export turnover and accordingly, disallowed a sum of ₹ 4,83,46,037/-. Apart from the above, the assessee has incurred a sum of ₹ 1,64,51,871 equivalent in foreign currency to develop the products which have been capitalized for their enduring benefits and have been amortized over five years. The contention of the assessee is that this expenditure was not incurred for the purpose of rendering technical services outside India rather the product development expenditure is for the development of computer software products which is different from the expenditure incurred for rendering technical services. It was stated that this part of the amortized expenditure has not been reduced from the export turnover in assessment year 2003-04, hence, this expenditure should not be reduced from the export turnover. The Id. CIT(A) has deleted this addition by following the Tribunal orders by the time the decision of Special Bench has also come, which confirms the finding of the Id. CIT(A) that development of product is different from rendering of technical services and therefore, it is not required to be excluded from the export turnover. Consequently, by respectfully following the Special Bench decision(supra) we cannot allow the grounds raised by the Revenue.

4. In the result, the Revenue's appeal in I.T.A.No.283/Mds/2009 for assessment year 2001-02 stands dismissed.

5. In assessee's appeal, I.T.A.No. 2297/Mds/2008, for assessment year 2001-02, the first issue relates to reopening of assessment u/s 147 r.w.s 148. The Id. CIT(A) has discussed this issue in para 4 and 4.2 of his order and has given his finding in para 5.4 of his order. We are in agreement with the Id. CIT(A) as the Assessing Officer has formed the opinion that income to that extent has escaped assessment. Para 5.4 of the Id. CIT(A)'s order is extracted as under:

"I have considered the issue carefully and I am inclined to follow my predecessor on this issue. Further the appellant admits that the entire expenses incurred in foreign currency are purely for rendering technical services without which the company could not have generated the revenue. If it is so the definition of the "Export turnover" as provided in the Act requires exclusion of these items from export turnover. Hence, I confirm the action of the Assessing Officer in excluding a sum of ₹ 4,43,19,916/- from export turnover following the order of the CIT(A)-III in A.Y 2003-04 on the same issue in the case of the appellant itself. The appellant fails on this ground."

Therefore, Ground No.II of this appeal stands dismissed.

6. The next issue raised vide Ground No.IV relates to confirming the action of the Assessing Officer in excluding ₹ 4,43,19,916/- as not forming part of export turnover who has excluded this amount on the reasoning that the amount represented expenses incurred in foreign exchange in providing technical services outside India. The facts of this issue have already been narrated above.

7. After hearing both sides on this issue, we find that in view of the Special Bench decision (supra) in assessee's own case, wherein it has been held that such amount cannot be excluded from export turnover, this addition cannot survive. Consequently, by following the Special Bench decision (supra) we order to delete the impugned addition.

8. The next issue of this appeal taken vide ground No.V, relates to foreign travel expenses. It was stated before us that despite the fact that the assessee had evidence in this regard, yet could not produce before the Assessing Officer, so it was pleaded that this issue may be remanded back to the Assessing Officer so that evidence can be produced and justice can be done to the assessee. Despite the Id.DR's objection, we find it a fit case for remanding the issue to the file of the Assessing Officer to do substantial justice in the case. Accordingly, we restore this issue to the file of the Assessing Officer with a direction that he shall decide this issue afresh after giving opportunity of hearing to the assessee.

9. The other grounds raised are general in nature and therefore, require no specific adjudication.

10. In the result, the appeal of the assessee is partly allowed and partly allowed for statistical purposes.

Assessment year 2002-03

11. For this assessment year, there is no Revenue's appeal. In the assessee's appeal, in I.T.A.No. 2298/Mds/2008, the first issue is regarding reopening of the assessment u/s 147 r.w.s 148 of the Act. We cannot allow this ground in view of the reasoning that the Assessing Officer has formed his opinion on the basis of objective material available with him and therefore, the assessment was validly reopened, after recording valid reasons as per the law.

12. The second issue raised vide Ground No. IV relates to exclusion of ₹ 32,34,01,504/-, being expenses incurred in foreign currency on onsite development which were excluded from export turnover. In this regard, the perusal of the Id. CIT(A)'s order which has been appealed against, it is found that the Id. CIT(A) has already given direction to the Assessing Officer to verify this fact and allow the claim if it is in the line of the ground raised before him. It was stated by the Id.AR at the time of hearing that the Assessing Officer has verified and allowed the relief. Therefore, no grievance survives in this regard. Consequently, we dismiss this ground of appeal as cause of action does not survive any longer.

13. The next issue relates to expenditure on foreign travel amounting to ₹ 44,26,416/- raised vide ground No.6. The Id. CIT(A) has discussed the issue in para 4 at page 9 of his order. We

reproduce para 4 for understanding the facts and the finding of the Id.

CIT(A):

“4. Other expenses: The appellant company has incurred a sum of ₹ 44,26,416/- as travel expenses under the head other expenses in foreign currency. The appellant has not produced any evidence before me in support of the claim. Hence the action of the Assessing Officer in excluding the amount from the export turnover is correct and same is confirmed .”

14. A perusal of above finding clearly evidences that the Assessing Officer has correctly denied this claim of expenditure because no evidence was produced before in this regard. Secondly, any claim of expenditure being not supported by any evidence, cannot be allowed by us also. No evidence has been produced before us as well. We, therefore, dismiss this ground.

15. In the result, the appeal of the assessee for assessment year 2002-03 stands dismissed.

Assessment year 2004-05

16. For this assessment year, cross appeals have been filed. In the Revenue's appeal being I.T.A.No. 284/Mds/2009, the first issue is regarding disallowance of exchange fluctuation loss, which has been taken against the finding of the Id. CIT(A) by following the decision of ITAT, Chennai, in the case of M/s India Intellisys Technology Pvt. Ltd. in I.T.A.No.835/Mds/2007, order dated 14.9.2007. The Id.DR's argument is that the decision of Hon'ble Madras High Court in the case

of Indian Overseas bank is applicable which is against the claim of the assessee whereby the exchange fluctuation loss cannot be allowed. The argument of the Id.AR is that the ratio in the case of Indian Overseas Bank is not applicable as it involves a notional loss by a bank trading in foreign currency. To the contrary, he has relied on the decision of Hon'ble Supreme Court rendered in the case of Sutelj Cotton Mills Ltd vs CIT, 116 ITR 1, which is in favour of the assessee. In addition to the above, the Id.AR has relied on the other decisions of this Bench as well as that of the Mumbai Bench rendered in the case of Renaissance Jewellery, 289 ITR AT 65. It has been submitted that the assessee has claimed loss in trading receipts and this method of accounting has been consistently followed.

17. We have found the arguments of the Id.AR in order and consequently, by following the Hon'ble Supreme Court's decision as well as the other decisions of the Tribunal relied on before us, we confirm the finding of the Id. CIT(A) on this issue and dismiss Ground No.2 of this appeal raised by the Revenue.

18. The next issue raised vide ground No.3 of this appeal of the Revenue relates to expenditure incurred in foreign exchange on onsite development of computer software . This issue stands covered in favour of the assessee by the Special Bench decision referred to

above. Hence, we decide this issue in favour of the assessee and dismiss the ground raised by the Revenue.

19. Ground No.4.1 and 4.2 of this appeal read as under:

“4.1 The Id. CIT(A) erred in directing the Assessing Officer to allow the expenses claimed by the assessee with regard to taking over of contracts with clients alongwith their business as claimed by the assessee (at 1/5th)

4.2 The Id. CIT(A) failed to note that the expenditure incurred by the assessee is for the purpose of warding off competition and hence the same is to be disallowed as capital in nature.”

20. The facts of this issue are that the assessee company had taken over the business of three companies comprising Human Resources, Clientee and other related benefits for a lumpsum consideration of ₹ 8,47,18,999/- [US \$ 17,31,985] and the assessee has proposed to amortize the said amount for a period of five years. During this year, an amount of ₹ 1,69,43,800/- was charged to Profit & Loss Account . As per the Assessing Officer, the provisions of section 35DD are applicable to a case where an assessee, being an Indian Company, incurs any expenditure on or after 1.4.1999 wholly and exclusively for the purpose of amalgamation or demerger of an undertaking, the assessee shall be allowed deduction of an amount equal to 1/5th of such expenditure for each of the five successive previous years, beginning the previous year in which the amalgamation or demerger

takes place in case the demerger or amalgamation is in pursuance to a scheme of arrangement u/s 391 to 394 of the Companies Act, 1956 and approved by the Central Government. According to the Assessing Officer, in this case, the taking over of the business of the companies was not in pursuance of any amalgamation or demerger arrangement. He denied this claim of deduction to the assessee. But in appeal, the Id. CIT(A) agreed with the assessee on the premise that the assessee had acquired ongoing business contracts of those companies with their clients for software development alongwith the technical resources including employees, etc. to execute the contract. According to him, no capital asset has been acquired by the assessee-company, therefore, this expenditure is for expansion of the units with an assurance that these three companies would not enter into business in the same line with those clients. So, the Id. CIT(A) has held this expenditure as revenue in nature. According to him, section 35DD will not apply.

21. After hearing both sides, we find that the facts of this issue are incomplete and further investigation of facts regarding application of 35DD or otherwise is required. The Tribunal being the final fact finding body, it becomes imperative that the issue should be churned afresh to cull out the exact facts of an issue. Hence, we restore this issue to the file of the Assessing Officer. The decisions relied on by

both the parties on the issue shall be taken into consideration by the Assessing Officer. The Assessing Officer shall decide the issue anew after giving opportunity of hearing to the assessee. The grounds raised by the Revenue are allowed for statistical purposes.

22. In the result, the appeal of the Revenue for assessment year 2004-05 is partly allowed for statistical purposes.

23. In assessee's appeal in I.T.A.No.2299/Mds/2008, the following grounds have been raised:

- I. The order of the learned CIT 'Appeals' to the extent it is against the appellant is contrary to law, facts of the case and the materials available on record.
- II. In the facts and circumstances of the case the learned CIT 'A' should have been pleased to allow the appeal in full directing the assessing officer to accept the income returned.
- III.
 - a) The learned CIT 'A' erred in confirming the action of the assessing officer in excluding ₹ 2,15,18,654/- as not forming part of export turnover, who had excluded the above amount erroneously thinking that the amount represented expenses incurred in foreign exchange in providing technical services out side India.
 - b) The learned CIT 'A' should have been pleased to hold particularly in view of the various ITAT decisions, that expenses incurred in foreign exchange were incurred for earning profits and gains on the onsite development of computer software including services for development of software outside India at the client's place, within the meaning of explanation 3 to 8ec.10B(8) of the Income Tax Act 1961.

c) Assuming without conceding that the sum of ₹2,15,18,654/- deserves to be excluded from the export turnover, the CIT 'A' should have also directed the assessing officer to exclude the above sum from total turnover, especially when the appellant is an 100% export oriented unit.

IV a) The learned CIT 'A' erred in stating that the appellant had not pressed ground relating to S115 JB computation made by the assessing officer.

b) The learned CIT 'A' should have directed the book profits declared by the appellant should be accepted by Assessing Officer.

V. For the above grounds and such other grounds as may be submitted before or at the time of the hearing of the appeal, the appellant prays that the Hon'ble ITAT may be pleased to allow the appeal directing the lower authorities to accept the income returned."

24. Ground No.III relates to exclusion of expenditure in foreign currency on onsite development at client's place from export turnover. This issue stands covered by the Special Bench decision in assessee's own cited supra, hence, this ground is decided in favour of the assessee.

25. The other grounds in this appeal do not arise from the appellate order. Therefore, there is no need to decide them on merits.

26. In the result, the appeal of the assessee for assessment year 2004-05 is partly allowed.

Assessment year 2005-06

27. For this assessment year cross appeals have been filed. In the appeal I.T.A.No.285/Mds/2009, by the Revenue, only one issue regarding amortization expenses, has been raised. With the reasoning given in assessment year 2004-05, for an identical issue, we set aside this issue to the file of the Assessing Officer with similar direction.

28. In the result, the appeal filed by the Revenue is allowed for statistical purposes.

29. In the assessee's appeal,[I.T.A.No. 2300/Mds/2008], following grounds have been raised:

- I. The order of the learned CIT 'Appeals' to the extent it is against the appellant is contrary to law, facts of the case and the materials available on record.
- II. In the facts and circumstances of the case the learned CIT 'A' should have been pleased to allow the appeal in full directing the assessing officer to accept the income returned.
- III. a) The learned CIT 'A' erred in confirming the action of the assessing officer in excluding ₹ 8,46,55,916/- as not forming part of export turnover, who had excluded the above amount erroneously thinking that the amount represented expenses incurred in foreign exchange in providing technical services out side India.

b) The learned CIT 'A' should have been pleased to hold particularly in view of the various ITAT decisions, that expenses incurred in foreign exchange were incurred for earning profits and gains on the onsite

development of computer software including services for development of software outside India at the client's place, within the meaning of explanation 3 to Sec.10B(8) of the Income Tax Act, 1961.

c) Assuming without conceding that the sum of ₹8,46,55,916/- deserves to be excluded from the export turnover, the CIT 'A' should have also directed the assessing officer to exclude the above sum from the total turnover, especially when the appellant is an 100% export oriented unit.

IV. For the above grounds and such other grounds as may be submitted before or at the time of the hearing of the appeal, the appellant prays that the Hon'ble ITAT may be pleased to allow the appeal directing the lower authorities to accept the income returned. “

30. The first effective grounds III(a) and (b) relate to expenditure incurred in foreign currency on onsite development at the client's place. This issue stands covered by the Special Bench decision, hence, these grounds stand allowed in the same way as has been allowed in earlier years.

31. Ground No.III(c) raises the second effective issue which is an alternate plea as taken in earlier years. This also stands thus decided alongwith ground III(a) & (b).

32. In the result, the assessee's appeal for assessment year 2005-06 stands allowed.

33. To summarize the result-

A.Y 2001-02	2297/Mds/2008	-	Partly allowed and partly allowed for statistical purposes.
	283/Mds/2009	-	Dismissed
A.Y 2002-03	2298/Mds/2008	-	Dismissed
A.Y 2004-05	2299/Mds/2008	-	Partly Allowed
	284/Mds/2009	-	Partly allowed for statistical purposes
A.Y 2005-06	2300/Mds/2008	-	Allowed
	285/Mds/2009	-	Allowed for statistical purposes

Order pronounced in the open court on 28.2.2011.

Sd/-
(DR. O.K. NARAYANAN)
VICE-PRESIDENT

Sd/-
(HARI OM MARATHA)
JUDICIAL MEMBER

Dated: 28.2.2011
RD

Copy to: Appellant/Respondent/CIT(A)/CIT/DR