IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH "B", NEW DELHI
BEFORE SHRI R. K. PANDA, ACCOUNTANT MEMBER
AND
SHRI SUDHANSHU SRIVASTAVA, JUDICIAL MEMBER

ITA Nos.6561 & 6562/Del/2016
Assessment Years : 2012-13 & 2013-14

Ernst & Young Ltd., India Branch Office, Office No.7, 1st Floor, Atma Ram Mansion, Scindia House, KG Marg, Connaught Place, New Delhi.	**Vs.**	ACIT (International Taxation), Circle-1(2)(2), New Delhi.
PAN : AABCE9897M		
(Appellant)		**(Respondent)**

Appellant by	:	Shri Abhimanyu Jhamba, Adv.
Respondent by	:	Shri G. K. Dhall, CIT-DR
Date of hearing	:	10-05-2018
Date of pronouncement	:	31-05-2018

O R D E R

PER R. K. PANDA, AM :

The above two appeals filed by the assessee are directed against the separate orders passed u/s 144C(13) r.w.s. 143(3) of the I.T. Act, 1961 by the Assessing Officer [ACIT, Circle- 1(2)(2), International Taxation, New Delhi] for assessment years 2012-13 and 2013-14 respectively. For the sake of convenience, these were heard together and are being disposed of by this common order.

ITA No.6561/Del/2016 (A.Y. 2012-13) :

2. Facts of the case, in brief, are that the assessee filed its return of income on 29.11.2012 declaring income of Rs.4,72,45,714/-. Ernst and Young Limited 'the Company' or the 'Head Office', incorporated in United Kingdom, established its India Branch office in New Delhi with the permission of the Reserve Bank of India in April 2008 vide order no.FE.CO.FID/10.83.137/2007-08 to provide professional services to its parent and other member firms of Ernst & Young Global. The Branch provides Professional services which may be in the nature of technical assistance / advice in relation to expatriate tax and business tax compliance services including technical review and approval of income tax returns and other related work products, advice and technical assistance with respect to the production of income tax returns and other related work products; knowledge transfer on engagement specific matters to the Global Shared Services (GSS) personal working in the back office operations where US and UK returns are processed. The Branch is also engaged in providing professional services in the nature of on the job training and consultancy services to other EY network firms.

3. During the course of assessment proceedings, the Assessing Officer observed that the assessee has filed the computation of income vide submission dated 05.01.2016. On perusal of the same, the Assessing Officer noted that the

assessee has claimed a deduction of Rs.24,86,617/- u/s 44C of the I.T. Act. He, therefore, asked the assessee to explain the justification of the same by raising the following queries :-

> *"2. After going through the financial statements filed with submission dated 29.08.2013, it is observed that no expenses which could be termed as 'Head Office Expenses' have been reported in the said audited financial statements as separate line item. However, vide submission dated 10.02.2016, through a management certificate it has been stated that an amount of GBP118834 equivalent to Rs.1,18,83,400/- has been incurred by the Head Office for the Indian Branch in United Kingdom. It could be fairly concluded that no expenditure in the nature of 'Head Office Expenses' was recorded in the books of Indian Branch.*
> *3. Further, the computation of income as furnished by you along with submission dated 05.01.2016, it is observed that you have claimed a deduction u/s 44C of the Act amounting to Rs.24,86,617/-. However, vide submission dated 10.02.2016 if has been submitted that the assessee is eligible to claim the same as deductible expenses within the permissible limit and purview of section 44C of the Act been though the same is not debited in the books of BO or are reimbursed by the Ho in view of the same, the assessee has claimed a deduction of Rs.24,86,617/- during the AY 2012-13 being 5% of the adjusted total income as prescribed under section 44C of the Act.*
> *4. It has been noted that the assessee is a 'cost plus entity' wherein it receives a markup on all the costs incurred by it from the Head Office. Going by the revenue earning concept/model, you are required to show cause as to why the markup on the 'Head office expenses' which have been incurred by the head office, be not taxed as income in the hands of Indian BO.*
> *5. Without prejudice to all the questions asked previously, please show cause as to why deduction/allowance claimed u/s 44C of the Act may not be disallowed, since said 'Head office expenses' have not been booked in the profit & loss account of Indian BO, in the absence of its recording in the audited financial statement of Indian BO."*

4. In response to the same, the assessee replied that the assessee is a BO of the foreign company and accordingly there are certain general & administrative expenses incurred by the head office ('HO') outside India which are attributable to some extent of the operations of the BO. Even though these expenses are not recharged/ debited in the profit & loss account of the BO, the same have been

claimed as deductible in accordance with and within the limits prescribed under section 44C of the Act. The provisions of section 44C were brought to the notice of Assessing Officer. It was submitted that during the year the HO had incurred a total general administrative expenditure of GBP 118,834 (which is approximately INR 11,883,400 as on current rate of exchange) outside India with respect to administrative matters of the Indian BO. However, the assessee has limited its claim for deduction of such expenses only to the extent of cap limit prescribed u/s 44C, i.e. 5% of the adjusted total income which comes to Rs.24,86,617/-. Copy of certificate issued by the HO in this regard was enclosed as Annexure 2. It was reiterated that section 44C is applicable only on the expenses in the nature of 'general & administrative expenditure' incurred outside India. Other expenses which are incurred in India and attributable wholly for the purpose of business in India, are fully allowable as deduction under normal provisions of the Act (i.e. section 37(1) of the Act). The decision of the Kolkata Bench of the Tribunal in the case of Rupenjuli Tea Co. Ltd. vs. CIT reported in 186 ITR 301 was brought to the notice of the Assessing Officer.

5. As regards the query of the Assessing Officer regarding why the markup of the 'Head Office Expenses' which have been incurred by the head office, be not taxed as income in the hands of the India BO, it was submitted that the assessee is compensated at arm's length price as per the Indian transfer pricing

regulations. Accordingly, the income side of the assessee is computed based on a certain percentage of markup applied on the costs incurred by the BO in India which is in accordance with the transfer pricing benchmarking study and has been accepted by the transfer pricing officer since last several years. Accordingly, the mark-up is applied only on expenditure incurred by the assessee in India and not on the allowance claimed by the assessee while computing the taxable income. It was argued that deduction under section 44C is in the nature of allowance (with a cap on allowable limit), the same cannot be considered as a cost incurred by the BO and therefore, cannot and should not be subjected to the mark-up as applied on other expenses recharged by the BO to the HO. It was submitted that the assessee's income has been computed on similar basis since last several years and there has been no disallowance by the assessing office or transfer pricing officer with respect to the claim for Head Office expenses under section 44C. Moreover, the assessee has also entered into Advance Pricing Agreement with the CBDT wherein also the same basis has been accepted. Thus, the non-debiting of the HO expenses in the Books of the Branch, since the same are not incurred by the Branch, is of no consequence to the computation of the taxable. It was further submitted that since the HO incurs general & administrative expenses in relation to administrative matters of the BO outside India, the assessee is eligible to claim the allowance for the same

within the permissible limit and purview of section 44C of the Act even though the same is not debited in the books of the BO or reimbursed to the HO.

6. However, the Assessing Officer was not satisfied with the explanation given by the assessee. Rejecting the explanation given by the assessee, the Assessing Officer made addition of Rs.21,39,012/- being undisclosed markup on the cost incurred by the HO in UK and made addition of Rs.24,86,617/- on account of disallowance of deduction u/s 44C of the I.T. Act. The assessee approached the DRP but without any success. The Assessing Officer thereafter in the order passed u/s 144C(3) r.w.s. 143(3) determined the total income of the assessee at Rs.5,18,71,340/- by making the above two additions.

7. Aggrieved with such order of the ld. CIT(A), the assessee is in appeal before the Tribunal by raising the following grounds of appeal :-

> *"Based on the facts and circumstances of the case, Ernst & Young Limited - India Branch Office (hereinafter referred to as 'the Appellant') respectfully craves to prefer an appeal against the assessment order issued by the Assistant Commissioner of Income-tax, Circle 1(2)(2), International Taxation, New Delhi (hereinafter referred to as 'Assessing Officer') under section 143(3) read with section 144C(13) of the Income-tax Act, 1961 ('Act') on the following grounds:*
> *1. Based on the facts and circumstances of the case, the Hon'ble Dispute Resolution Panel -I, New Delhi ('Hon'ble DRP') and the learned Assessing Officer ('Ld. AO') have erred in law and in facts in computing the total income of the appellant for the year at Rs 5,18,71,340/- as against returned income of Rs. 4,72,45,714/-.*
> *2. Based on the facts and circumstances of the case, the Hon'ble DRP has erred on facts and in law in failing to appreciate that the General & Administrative expenses incurred outside India by the Head Office of the Appellant and not charged to the Branch are not in the nature of 'reimbursement of expenses' and cannot be to be considered as a part of 'cost base' while applying mark-up of 18% on costs incurred in India, and consequently in making an addition of Rs. 2,139,012/- to the returned income.*

3. Based on the facts and circumstances of the case, the Hon'ble DRP has also erred on facts and in law in denying the allowance claimed under section 44C of the Act amounting to Rs.2,486,617/- on the incorrect averment of the Ld. AO that 100% deduction for the expense has been allowed while adding the same to the cost base for computing mark-up, and while doing so, the Hon'ble DRP has failed to appreciate the fact that the general & administrative expenses are incurred outside India by the head office of the Appellant and are not charged or debited by the BO in India.

4. Based on the facts and circumstances of the case, the Hon'ble DRP has erred on the facts in failing to appreciate that the appellant had duly submitted Form No. 3CEB before the Ld. AO on the basis of which the subject return of income was referred to the transfer pricing officer ('TPO') and the order of the TPO under section 92CA(3) of the Act was received on 29 December 2015.

5. Based on the facts and circumstances of the case, the Ld. AO has erred in law and in not granting refund of Rs. 1,273,586/- determined as refundable as per the assessed income tax computation form dated 22 November 2016 issued by the Ld. AO.

6. Based on the facts and circumstances of the case, the Ld. AO has erred in law in initiating penalty proceedings under section 271(1)(c) of the Act without appreciating the fact that the Appellant has not concealed any income or disclosed any incorrect particulars during the proceedings.

The above grounds are mutually exclusive and without prejudice to each other.

The appellant craves leave to add, amend, vary, omit or substitute any of the aforesaid grounds of appeal at any time before or at the time of hearing of the appeal. Any consequential relief, to which the Appellant may be entitled under the law in pursuance of the aforesaid grounds of appeal, or otherwise, may be thus granted."

8. The ld. counsel for the assessee referring to the provisions of section 44C submitted that as per the said provision, in the case of an assessee being a non-resident, an amount equal to 5% of the adjusted total income is allowable as expenditure in nature of Head Office (HO) Expenses. Referring to para 5 of the assessment order, he submitted that the Head Office had incurred an amount of Rs.1,18,83,400/- towards general administrative expenditure outside India with respect to the administrative matters of the Indian Branch Office. However, the assessee has limited its claim for deduction of such expenses only to the extent of the gap limit prescribed in section 44C i.e. 5% of the adjusted total income

which comes to Rs.24,86,617/-. Referring to the copy of the order of the DRP, he drew the attention of the Bench to page 4 of the order where the DRP has observed as under:-

> *"The DRP observes that the submissions of the taxpayer do not have merit since the AO has not doubted the genuineness of the expenses or the factum of these having been incurred by the Head Office for the BO. The deduction under section 44C is a specific allowance available to non-resident assessees for executive and general administration expenditure incurred by the head office outside India but attributable to the India BO subject to the S. 44C ceiling limit @ 5% of the adjusted total. The AO has thus correctly disallowed deduction u/s 44C since he has already allowed 100% deduction for the expense when adding it to the cost base for computing mark-up and his action is approved. The taxpayer cannot claim a double deduction when the sum has been allowed @ 100% in its P&L."*

9. He submitted that although the assessee has not debited the amount to the Profit & Loss Account, however, the same has been claimed as expenditure in the return of income and the expenditure is within the permissible limit as per the provisions of section 44C of the I.T. Act. Referring to the decision of the Delhi Bench of the Tribunal in the case of Education Australia Limited vs. DDIT vide ITA No.5124/Del/2010 order dated 18.05.2012 for assessment year 2007-08, he drew the attention of the Bench to the following observation at 8 of the order :-

> *"8. We have considered the facts of the case and submissions made before us. The finding of the AO is that expenditure incurred by the head office will have to be allocated to the Indian offices. There has been no allocation made by the assessee. The income is being offered for tax on cost plus basis, therefore, the general and administrative expenditure incurred by the head office for running India offices has to be considered for working out the cost base. The fact of the matter is that the Indian offices have not incurred any expenditure. If any income accrues on account of expenditure incurred by the head office, it will be the income of the head office and not Indian offices. At the same time, if any expenditure is attributed to Indian offices*

deduction of the expenditure will have to be allowed. Thus seen from any angle the revenue does not have any case in this matter."

10. So far as non-claim of expenditure in the Profit & Loss Account is concerned, he submitted that entries in the books of account are not decisive. Referring to the decision of the Mumbai Bench of the Tribunal in the case of British Bank of Middle East vs. JCIT reported in 4 SOT 122, he drew the attention of the Bench to the following observation :-

"As far as the question of expenditure not being debited in the books of account of India operations is concerned, this is not really relevant in the light of law laid down by the Hon'ble Supreme Court in the case of Kedarnath Jute Mills Co. Ltd. [1971] 82 ITR 363. As long as the expenditure is really incurred and is otherwise deductible, the deduction cannot be declined on the ground that it has not been debited in the books of account. We have also noted that as noted in the Assessing Officer's order itself, the requisite details were duly furnished by the assessee. Keeping all these factors in mind, as also entirely of the case, we deem it fit and proper to delete the impugned disallowance of Rs.86,75,496/-. The assessee gets relief accordingly."

11. Referring to the decision of the Hon'ble Supreme Court in the case of CIT vs. Excel Industries Ltd. reported in 13 SSC 459, he drew the attention of the Bench to the following observations :-

"Income tax cannot be levied on hypothetical income. It is a levy on income. The Income Tax Act takes into account two points of time at which the liability to tax is attracted viz. the accrual of the income or its receipt; but the substance of the matter is the income. If income does not result at all, there cannot be a tax even though in bookkeeping, an entry is made about a "hypothetical income", which does not materialize. Where income has, in fact, been received and is subsequently given up in such circumstances that it remains the income of the recipient, even though given up, the tax may be payable. Where, however, the income can be said not to have resulted at all, there is obviously neither accrual nor receipt of income, even though an entry to that effect might, in certain circumstances, have been made in the books of account.

Income accrues when it become due but it must also be accompanied by a corresponding liability of the other party to pay the amount. Only then can it be said

that for the purposes of taxability that the income is not hypothetical and it has really accrued to the assessee."

12. He accordingly submitted that the addition made by the Assessing Officer being not justified should be deleted.

13. The ld. DR on the other hand heavily relied on the order of the Assessing Officer/TPO/DRP. He submitted that since the expenditure has not been claimed by the assessee in the Profit & Loss Account on account of Head Office Expenditure, therefore, nothing has to be allowed. Further, the Assessing Officer/TPO/DRP has rightly made addition on account of undisclosed mark up on the costs incurred by the HO. He accordingly submitted that since the order of the Assessing Officer is in accordance with law, therefore, the same should be upheld.

14. We have considered the rival arguments made by both the sides and perused the material available on record. We find the assessee in the instant case has claimed an amount of Rs.24,87,617/- u/s 44C of the I.T. Act on account of Head Office Expenditure. We find the Assessing Officer noting that the assessee has not claimed such expenditure in the Profit & Loss Account of the Indian branch office, disallowed the same. The Assessing Officer further made addition of Rs.21,39,012/- being the undisclosed markup on the cost incurred by the Head Office in UK. It is the submission of the ld. counsel for

the assessee that the assessee claimed the deduction u/s 44C which is in accordance with law and non-claim of the same in the Profit & Loss Account is not relevant. Further, it is also his submission that no income has accrued to the assessee on account of Head Office and income, if any, that accrues to the Head Office has to be accounted for by the Head Office only. Therefore, the Assessing Officer was not justified in making the addition on account of undisclosed markup on the cost incurred by the Head Officer in UK.

15. We find some force in the above arguments advanced by the ld. counsel for the assessee.

16. So far as addition of Rs.21,39,012/- made by the Assessing Officer on account of undisclosed markup on the cost incurred by the Head Office in UK is concerned, we are of the opinion that the income, if any that accrues on account of expenditure incurred by the Head Office, it will be the income of the Head Office and not the Indian Branch Office in view of the decision of the Delhi Bench of the Tribunal in the case of Education Australia Limited (supra), the finding of which has already been reproduced at para 9 of this order.

17. So far as disallowance of Rs.24,86,617/- claimed by the assessee on account of section 44C is concerned, we are of the opinion that the Assessing Officer is not justified in making the addition. No doubt, the assessee has not debited the said expenditure in the Profit & Loss Account. However, it is an

admitted fact that the assessee has claimed the expenditure in the computation statement. The Mumbai Bench of the Tribunal in the case of British Bank of Middle East (supra) under similar circumstances has held that non-debiting of the expenditure in the books of account of India operations is not relevant for allowability of the same in the light of the law laid down by the Hon'ble Supreme Court in the case of Kedarnath Jute Mills Co. Ltd. (supra). It has been held that as long as the expenditure is really incurred and is otherwise deductible, the deduction cannot be declined on the ground that it has not been debited in the books of account. Since in the instant case there is no dispute to the fact that the head office has incurred the expenditure for the Branch office, the genuineness of which has not been doubted and since the assessee has claimed the deduction u/s 44C of the I.T. Act in the computation statement, therefore, in view of the decision of the Mumbai Bench of the Tribunal cited (supra), we hold that the Assessing Officer is not justified in disallowing the claim merely for not debiting the same in the Profit & Loss Account. In this view of the matter, we set-aside the order of the Assessing Officer/DRP/TPO and direct the Assessing Officer to allow the claim of expenditure u/s 44C and delete the addition on account of undisclosed mark up on the costs incurred by the HO in UK. The grounds raised by the assessee are accordingly allowed.

ITA No.6562/Del/2016 (A.Y. 2013-14) :

18. Grounds of appeal raised by the assessee are as under :-

"Based on the facts and circumstances of the case, Ernst & Young Limited - India Branch Office (hereinafter referred to as 'the Appellant') respectfully craves to prefer an appeal against the assessment order issued by the Assistant Commissioner of Income-tax, Circle 1(2)(2), International Taxation, New Delhi (hereinafter referred to as 'Assessing Officer') under section 143(3) read with section 144C(13) of the Income-tax Act, 1961 ('Act') on the following grounds:

1. Based on the facts and circumstances of the case, the Hon'ble Dispute Resolution Panel -I, New Delhi ('Hon'ble DRP') and the learned Assessing Officer ('Ld. AO') have erred in law and in facts in computing the total income of the appellant for the year at Rs 53,486,438/- as against returned income of Rs. 48,296,518/-.

2. Based on the facts and circumstances of the case, the Hon'ble DRP has erred on facts and in law in failing to appreciate that the General & Administrative expenses incurred outside India by the Head Office of the Appellant and not charged to the Branch are not in the nature of 'reimbursement of expenses' and cannot be to be considered as a part of 'cost base' while applying mark-up of 18% on costs incurred in India, and consequently in making an addition of Rs. 2,647,998/- to the returned income.

3. Based on the facts and circumstances of the case, the Hon'ble DRP has also erred on facts and in law in denying the allowance claimed under section 44C of the Act amounting to Rs.2,541,922/- on the incorrect averment of the Ld. AO that 100% deduction for the expense has been allowed while adding the same to the cost base for computing mark-up, and while doing so, the Hon'ble DRP has failed to appreciate the fact that the general & administrative expenses are incurred outside India by the head office of the Appellant and are not charged or debited by the BO in India.

4. Based on the facts and circumstances of the case, the Hon'ble DRP has erred on the facts in failing to appreciate that the appellant had duly submitted Form No. 3CEB on 26 November 2016 and also submitted the same before the Ld. AO during the course of hearing vide submission dated 18 August 2015.

5. Based on the facts and circumstances of the case, the Ld. AO has erred in law in initiating penalty proceedings under section 271(1)(c) of the Act without appreciating the fact that the Appellant has not concealed any income or disclosed any incorrect particulars during the proceedings.

The above grounds are mutually exclusive and without prejudice to each other.

The appellant craves leave to add, amend, vary, omit or substitute any of the aforesaid grounds of appeal at any time before or at the time of hearing of the appeal. Any consequential relief, to which the Appellant may be entitled under the law in pursuance of the aforesaid grounds of appeal, or otherwise, may be thus granted."

19. After hearing both the sides, we find the grounds raised by the assessee are identical to the grounds raised in ITA No.6561/Del/2016 for assessment year 2012-13. We have already decided the issue and the grounds raised by the assessee have been allowed. Following similar reasoning, the grounds raised by the assessee are allowed.

20. In the result, both the appeals filed by the assessee are allowed.

Order pronounced in the open Court on this 31st day of May, 2018.

Sd/-	**Sd/-**
(SUDHANSHU SRIVASTAVA)	(R. K. PANDA)
JUDICIAL MEMBER	ACCOUNTANT MEMBER

Dated: 31-05-2018.
Sujeet

Copy of order to: -

1) The Appellant
2) The Respondent
3) The CIT
4) The DRP-1
5) The DR, I.T.A.T., New Delhi

By Order

//True Copy//

Assistant Registrar
ITAT, New Delhi