IN THE INCOME TAX APPELLATE TRIBUNAL
AHMEDABAD "I" BENCH, AHMEDABAD

[Coram: Pramod Kumar AM and S S Godara JM]

ITA No.508/Ahd/2016
Assessment year: 2012-13

Dy. Commissioner of Income Tax,
Circle 2(1)(1), Ahmedabad. ***.....Appellant***

Vs.

Elitecore Technologies Private Limited ***.....Respondent***
904, Silicon Tower, Off C.G. Road, Ahmedabad – 380 006.
[PAN – AAACE6815G]

ITA No.197/Ahd/2016
Assessment year: 2012-13

Elitecore Technologies Private Limited ***.....Appellant***
904, Silicon Tower, Off C.G. Road, Ahmedabad – 380 006.
[PAN – AAACE6815G]

Vs.

Dy. Commissioner of Income Tax,
Circle 2(1)(1), Ahmedabad. ***.....Respondent***

Appearances by:

S N Soparkar, Senior Advocate, *along-with*
Bandish Soparkar and Parin Shah *for the assessee*
Byomkesh Panda *for the revenue*

Date of concluding the hearing : January 24, 2017
Date of pronouncing the order : March 31, 2017

O R D E R

Per Pramod Kumar AM:

1. These cross appeals are directed against the order dated 29th December 2015 passed by the CIT(A) in the matter of assessment under section 143(3) of the Income Tax Act, 1961, for the assessment year 2012-13. Both of these appeals are being disposed of, as a matter of convenience, by this consolidated order.

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2. In the appeal filed by the revenue, three grievances are raised- first, against the CIT(A) deleting the disallowance of Rs 65,96,434 on account of commission paid to the non-residents; second, against the CIT(A) deleting the disallowance of Rs 60,48,228 on account of provision for warranty; and, third- against the CIT(A) restricting the disallowance of foreign tax credit of Rs 3,10,799 and directing the balance unallowed foreign tax credit of Rs 52,50,507 to be allowed as deduction under section 37(1).

3. In ground no.1, in the appeal filed by the revenue, this grievance of the Assessing Officer is as follows:

> **The Ld. CIT(A) has erred in law and on facts in deleting the disallowance made by the AO on account of commission paid to non-residents amounting to Rs.65,96,434/-, without properly appreciating the facts of the case and the material brought on record.**

4. So far as this ground of appeal is concerned, the relevant material facts are like this. The assessee before us is engaged in the business of developing software products. During the course of the assessment proceedings, the Assessing Officer noticed that the assessee has paid commission of Rs 1,02,33,461 for procuring the business, out of which Rs 65,96,434 were paid to non-resident agents. It was also noticed that no tax was withheld from the payments made to non-resident commission agents. On an examination of the supporting evidences furnished by the assessee, the Assessing Officer was not satisfied with genuineness of the commission payment mainly on the ground that there was no material to justify the reasonableness of commission payment to non-resident and evidences pertaining to services rendered by the foreign commission agent having nexus with assessee's business was not available. He was also of the view that in view of the provisions of Section 9(1)(i) income of the non resident from though or from any business connection in India or any source in India is deemed to accrue or arise in India, and under section 5(2)(b) income deemed to accrue or arise in India is also taxable in India. While he did not dispute "the agent must have rendered services abroad and have solicited orders from there", he was of the view that since right to receive commission income accrued in India, the income is deemed to accrue or arise in India. He also placed reliance on the rulings given by the Authority for Advance Ruling in the cases of Rajiv Malhotra [(2006) 284 ITR 564 (AAR)] and SKF Boilers and Driers Ltd [(2012) 18 taxmann.325]. It was also pointed out that the CBDT circular no. 23, holding that commission income in the hands of the non residents is not taxable in India, stands withdrawn, and that under section 195, it was obligation of the assessee to either deduct the tax at source from foreign remittances or obtain, in case of slightest doubt, an approval of the Assessing Officer, under section 195(2), for making the remittances without any deduction of tax at source. It was thus concluded that the assessee has failed to discharge his obligations under section 195 and thus the disallowance under section 40(a)(i) comes into play. The Assessing Officer thus disallowed Rs 65,96,434 in respect of the commission paid to non resident commission agents. Aggrieved, assessee carried the matter in appeal before the CIT(A) who deleted the disallowance by observing as follows:

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6.5 I have carefully considered the facts of the case, assessment order and the submissions of the Appellant. The services provided by the non-resident agents are in relation to marketing of Appellants products and assisting the Appellant in procuring sales orders abroad. The copy of the invoices and the purchase orders submitted by the Appellant substantiate that the non-resident agents have done marketing and have assisted the Appellant in procuring sales orders. None of the agents are related to the Appellant and hence the contentions of the learned AO that the Appellant has not proved the genuineness as well as reasonableness of the commission payment is not acceptable. The contention of the AO that there are no agreements and hence genuineness of the payment cannot be ascertained is also not acceptable as there is no need to have an agreement for each and every situation. The non-resident agent has raised the bill on the Appellant for the services rendered. The Appellant has also submitted the purchase order for the sales undertaken through the services of the non-resident agents. The learned AO in the assessment order had concluded that the Appellant had not proved the identity, evidences of the services rendered and the copy of the agreements entered. On the basis of this conclusion, the learned AO made an observation that the services have not been rendered and the payments are not genuine. Against this the Appellant submitted that during the assessment proceedings it had submitted the sample copy of the invoices raised by the agents as well as purchase orders vide its submission dated 16 March 2015. A remand report was also called from the learned AO under which the learned AO has contended that in absence of the copy of the agreements, the identity of the non-resident agents have not been established and hence the genuineness of the expenditure could also not be established. The same are not acceptable as the Appellant had already submitted the documents like copy of the invoices of the agents and the purchase orders. Further I agree with the submissions of the Appellant that no tax is required to be withheld on payment of commission to non-resident agents as the same is not taxable in India. The rulings of Hon'ble Supreme court in the case of R D Aggarwal & Toshoku, Delhi High Court in the case of Eon Technology, Madras High Court in the case of Fluidtherm Technology have categorically held that commission paid to non-resident agents for securing orders outside India is not taxable in India and hence no tax is required to be withheld on the same. With regard to the ruling of AAR relied on by the learned AO, I agree with the contentions of the Appellant that the Hon'ble AAR has overlooked clause (a) of Explanation 1 to Section 9(1)(i) as the non-resident agents did not carried on any activity in India and no portion of commission was attributable to the Indian operations. The position stands settled even after the withdrawal of CBDT circular 23 and 786 as several rulings post withdrawal of the said circulars have held that the foreign commission is not chargeable to tax in India. Further Ahmedabad ITAT in the case of Ajit Impex has also held that no tax is required to be withheld on payment of foreign commission. With regard to the applicability of provisions of section 195(2), Hon'ble Supreme

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Court in the case of GE India Technology Centre Private Ltd. (327 ITR 456) has categorically held that the provisions of section 195 are not applicable if the payments are not taxable in India. As in the present case, the payment of foreign commission is not taxable in India, the provisions of Section 195 are not applicable. Hence this ground of the Appellant is allowed.

5. The Assessing Officer is aggrieved of the relief so granted by the CIT(A) and is in appeal before us.

6. We have heard the rival contentions, perused the material on record and duly considered facts of the case in the light of the applicable legal position.

7. We find that once the agreements and related invoices have been furnished by the assessee at the assessment as also at the appellate stage, and no specific defects have been pointed out in the same, it cannot be open to the revenue to contend that genuineness of commission payments is not established. The commission payments are made with regulatory approvals and through banking channels, and all the requisite documentation is furnished for perusal. In these circumstances, we are of the considered view that the CIT(A) was indeed justified in his well reasoned conclusions on this aspect of the matter. We approve the same. As regards the question as to whether the assessee had any obligations to deduct tax at source from these payments of commission to non resident agents, as learned representatives fairly agree, the issue is now covered, in favour of the assessee, by a coordinate bench decision in the case of **DCIT Vs Welspun Corporation Ltd [(2017) 77taxman.165 (Ahd)],** speaking through one of us, has observed as follows:

> *31. The scheme of taxability in India, so far as the non residents, are concerned, is like this. Section 5 (2), which deals with the taxability of income in the hands of a non-resident, provides that "**the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which— (a) is received or is deemed to be received in India in such year by or on behalf of such person; or (b) accrues or arises or is deemed to accrue or arise to him in India during such year**". There is no dispute that since no part of the operations of the recipient non-residents is carried out in India, no income accrues to these non-residents in India. The case of the revenue hinges on income which is "deemed to accrue or arise in India". Coming to the deeming provisions, which are set out in Section 9, we find that the following statutory provisions are relevant in this context:*
>
> *Section 9- Incomes deemed to accrue or arise in India*
>
> *(1) The following incomes will be deemed to accrue or arise in India:*
>
> *(i) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India,*
>
> *Explanation: For the purpose of this clause [i.e. 9(1)(i)],*

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(a) in the case of a business of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India;

*(b) (c) (d)…..**

(vii) income by way of fees for technical services payable by-

*(a) ……..**

(b) a person who is a resident, except where the fees are payable in respect of services utilised in a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India; or

*(c) ……**

*Explanation 1-……..**

Explanation 2.- For the purposes of this clause," fees for technical services" means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head" Salaries".

** Not relevant for our purposes*

32. So far as deeming fiction under section 9(1)(i) is concerned, it cannot be invoked in the present case since no part of the operations of the recipient's business, as commission agent, was carried out in India. Even though deeming fiction under section 9(1)(i) is triggered on the facts of this case, on account of commission agent's business connection in India, it has no impact on taxability in the hands of commission agent because admittedly no business operations were carried out in India, and, therefore Explanation 1 to Section 9(1)(i) comes into play.

33. There are a couple of rulings by the Authority for Advance Ruling, which support taxability of commission paid to non-residents under section 9(!)(i), but, neither these rulings are binding precedents for us nor are we persuaded by the line of reasoning adopted in these rulings. As for the AAR ruling in the case of SKF Boilers & Driers Pvt Ltd [(2012) 343 ITR 385 (AAR)], we find that this decision merely follows the earlier ruling in the case of Rajiv Malhotra [(2006) 284 ITR 564] which, in our considered view, does not take into account the impact of Explanation 1 to Section 9(1)(i) properly. That was a case in which the non-resident commission agent worked for procuring participation by other non-resident entities in a food and wine show in India, and the claim of the assessee was that since the agent has not carried out any business operations in India, the commission agent was not chargeable to tax in India, and, accordingly, the assessee had no obligation to deduct

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tax at source from such commission payments to the non-resident agent. On these facts, the Authority for Advance Ruling, inter alia, opined that "no doubt the agent renders services abroad and pursues and solicits exhibitors there in the territory allotted to him, but the right to receive the commission arises in India only when exhibitor participates in the India International Food & Wine Show (to be held in India), and makes full and final payment to the applicant in India" and that "the commission income would, therefore, be taxable under section 5(2)(b) read with section 9(1)(i) of the Act". The Authority for Advance Ruling also held that "the fact that the agent renders services abroad in the form of pursuing and soliciting participants and that the commission is remitted to him abroad are wholly irrelevant for the purpose of determining situs of his income". We do not consider this approach to be correct. When no operations of the business of commission agent is carried on in India, the Explanation 1 to Section 9(1)(i) takes the entire commission income from outside the ambit of deeming fiction under section 9(1)(i), and, in effect, outside the ambit of income 'deemed to accrue or arise in India' for the purpose of Section 5(2)(b). The point of time when commission agent's right to receive the commission fructifies is irrelevant to decide the scope of Explanation 1 to Section 9(1)(i), which is what is material in the context of the situation that we are in seisin of. The revenue's case before us hinges on the applicability of Section 9(1)(i) and, it is, therefore. important to ascertain as to what extent would the rigour of Section 9(1)(i) be relaxed by Explanation 1 to Section 9(1)(i). When we examine things from this perspective, the inevitable conclusion is that since no part of the operations of the business of the commission agent is carried out in India, no part of the income of the commission agent can be brought to tax in India. In this view of the matter, views expressed by the Hon'ble AAR, which do not fetter our independent opinion anyway in view of its limited binding force under s. 245S of the Act, do not impress us, and we decline to be guided by the same. The stand of the revenue, however, is that these rulings, being from such a high quasi-judicial forum, even if not binding, cannot simply be brushed aside either, and that these rulings at least have persuasive value. We have no quarrel with this proposition. We have, with utmost care and deepest respect, perused the above rulings rendered by the Hon'ble Authority for Advance Ruling. With greatest respect, but without slightest hesitation, we humbly come to the conclusion that we are not persuaded by these ruling

…….. Once we come to the conclusion that the income embedded in these payments did not have any tax implications in India, no fault can be found in not deducting tax at source from these payments or, for that purpose, even not approaching the Assessing Officer for order under section 195. In our considered view, the assessee, for the detailed reasons set our above, did not have tax withholding liability from these payments. As held by Hon'ble Supreme Court in the case of GE India Technology Centre Pvt Ltd Vs CIT [(2010) 327 ITR 456 (SC)], payer is bound to withhold tax from the foreign remittance only if the sum paid is assessable to tax in India. The assessee cannot, therefore, be faulted for not approaching the Assessing Officer under section 195 either. As regards the withdrawal of the CBDT circular holding that the commission payments to non resident agents are not taxable in India, nothing really turns on the circular, as de hors the aforesaid circular, we have adjudicated upon the taxability of the commission agent's income in India in terms of the provisions of the Income Tax Act as also the relevant tax treaty provisions.

8. Learned Departmental Representative nevertheless relies upon the stand of the Assessing Officer. For the detailed reasons set out above in these extracts from Welspun order (supra), his argument cannot be accepted. In any event, we see no

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reasons to take any other view of the matter than the view so taken by us above. Respectfully following the same, we uphold the relief granted by the CIT(A) and decline to interfere in the matter.

9. Ground no. 1 in revenue's appeal is thus dismissed.

10. In ground no. 2, the Assessing Officer has raised the following grievance:

> **The Ld. CIT(A) has erred in law and on facts in deleting the disallowance Rs.60,48,228/- on account of provision for warranty, without properly appreciating the facts of the case and the material brought on record.**

11. So far as this grievance of the assessee is concerned, the relevant material facts are like this. During the course of scrutiny assessment proceedings, the Assessing Officer noticed that the assessee has claimed a deduction in respect of Rs 60,48,228 debited on account of post sales client support and warranties in respect of its software products. When Assessing Officer probe the matter further, it was explained by the assessee that the provision is based on the past experience about actual warranty claims made that the assessee determines the probable ratio of licences which require replacements and efforts of the developer to rectify mistakes, to the total licences granted. As a three step process to quantify such provision (a) the assessee determines, on the basis explained above, percentage of defects likely to occur in the product sold by the assessee; (b) the assessee determines, based on the past experience and the repair cost estimate received from the vendors, average per unit likely repair costs; and (c) the assessee determines the likely number of units which are likely to have such defects, by adopting percentage (a) to the total units sold, and estimates the provision required by multiplying the number of units so likely to receive warranty service, with the average cost incurred on such service as a result of (b) above. The assessee also invited attention of the assessee to, and relied upon in this context, Hon'ble Supreme Court's judgment in the case of Rotork Controls India Pvt Ltd Vs CIT [(2009) 314 ITR 62 (SC)]. These submissions, however, did not impress the Assessing Officer. He was of the view that the assessee has not been following this method consistently inasmuch as till the assessment year 2010-11, the assessee used to make such a provision but also used to add in back in the statement of taxable income whereas now he is not doing so. As for assessee's reliance of Rotork case (supra), the Assessing Officer was of the view that it is only when a consistent and scientific method of ascertain provision for warranty is followed that the same can be allowed as deduction in computation of business income. In the present case, neither the method of quantifying the provision was scientific nor the approach of the assessee consistent. The Assessing Officer further observed that "such provision of contingent nature having no nexus with the actual expenditure of the business and hence, the same being a contingent liability, is not allowable as per law". Aggrieved, assessee carried the matter in appeal. Learned CIT(A) reversed the action of the Assessing Officer, and held, in the light of principles laid down by Hon'ble Supreme Court in the case of Rotork Control (supra) and as the provision has been computed on a fairly scientific basis, the warranty provision was indeed an admissible deduction. The Assessing Officer is aggrieved by the relief so granted by the CIT(A) and is in appeal before us.

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12. We have heard the rival contentions, perused the material on record and duly considered facts of the case as also the applicable legal position.

13. We find that Hon'ble Supreme Court, in its landmark judgment in the case of Rotork Control (supra), has inter alia observed as follows

> 12. A past event that leads to a present obligation is called as an obligating event. The obligating event is an event that creates an obligation which results in an outflow of resources. It is only those obligations arising from past events existing independently of the future conduct of the business of the enterprise that is recognized as provision. For a liability to qualify for recognition there must be not only present obligation but also the probability of an outflow of resources to settle that obligation. Where there are a number of obligations (e.g. product warranties or similar contracts) the probability that an outflow will be required in settlement, is determined by considering the said obligations as a whole. In this connection, it may be noted that in the case of a manufacture and sale of one single item the provision for warranty could constitute a contingent liability not entitled to deduction under s. 37 of the said Act. However, when there is manufacture and sale of an army of items running into thousands of units of sophisticated goods, the past event of defects being detected in some of such items leads to a present obligation which results in an enterprise having no alternative to settling that obligation. In the present case, the appellant has been manufacturing and selling valve actuators. They are in the business from asst. yr. 1983-84 onwards. Valve actuators are sophisticated goods. Over the years appellant has been manufacturing valve actuators in large numbers. The statistical data indicates that every year some of these manufactured actuators are found to be defective. The statistical data over the years also indicates that being sophisticated item no customer is prepared to buy valve actuator without a warranty. Therefore, warranty became integral part of the sale price of the valve actuator(s). In other words, warranty stood attached to the sale price of the product. These aspects are important. As stated above, obligations arising from past events have to be recognized as provisions. These past events are known as obligating events. In the present case, therefore, warranty provision needs to be recognized because the appellant is an enterprise having a present obligation as a result of past events resulting in an outflow of resources. Lastly, a reliable estimate can be made of the amount of the obligation. In short, all three conditions for recognition of a provision are satisfied in this case.
>
> 13. In this case we are concerned with product warranties. To give an example of product warranties, a company dealing in computers gives warranty for a period of 36 months from the date of supply. The said company considers following options : (a) account for warranty expense in the year in which it is incurred; (b) it makes a provision for warranty only when the customer makes a claim; and (c) it provides for warranty at 2 per cent of turnover of the company based on past experience (historical trend). The first option is unsustainable since it would tantamount to accounting for warranty

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expenses on cash basis, which is prohibited both under the Companies Act as well as by the Accounting Standards which require accrual concept to be followed. In the present case, the Department is insisting on the first option which, as stated above, is erroneous as it rules out the accrual concept. The second option is also inappropriate since it does not reflect the expected warranty costs in respect of revenue already recognized (accrued). In other words, it is not based on matching concept. Under the matching concept, if revenue is recognized the cost incurred to earn that revenue including warranty costs have to be fully provided for. When valve actuators are sold and the warranty costs are an integral part of that sale price then the appellant has to provide for such warranty costs in its account for the relevant year, otherwise the matching concept fails. In such a case the second option is also inappropriate. Under the circumstances, the third option is most appropriate because it fulfills accrual concept as well as the matching concept. For determining an appropriate historical trend, it is important that the company has a proper accounting system for capturing relationship between the nature of the sales, the warranty provisions made and the actual expenses incurred against it subsequently. Thus, the decision on the warranty provision should be based on past experience of the company. A detailed assessment of the warranty provisioning policy is required particularly if the experience suggests that warranty provisions are generally reversed if they remained unutilized at the end of the period prescribed in the warranty. Therefore, the company should scrutinize the historical trend of warranty provisions made and the actual expenses incurred against it. On this basis a sensible estimate should be made. The warranty provision for the products should be based on the estimate at year end of future warranty expenses. Such estimates need reassessment every year. As one reaches close to the end of the warranty period, the probability that the warranty expenses will be incurred is considerably reduced and that should be reflected in the estimation amount. Whether this should be done through a pro rata reversal or otherwise would require assessment of historical trend. If warranty provisions are based on experience and historical trend(s) and if the working is robust then the question of reversal in the subsequent two years, in the above example, may not arise in a significant way. In our view, on the facts and circumstances of this case, provision for warranty is rightly made by the appellant-enterprise because it has incurred a present obligation as a result of past events. There is also an outflow of resources. A reliable estimate of the obligation was also possible. Therefore, the appellant has incurred a liability, on the facts and circumstances of this case, during the relevant assessment year which was entitled to deduction under s. 37 of the 1961 Act. Therefore, all the three conditions for recognizing a liability for the purposes of provisioning stands satisfied in this case. It is important to note that there are four important aspects of provisioning. They are-provisioning which relates to present obligation, it arises out of obligating events, it involves outflow of resources and lastly it involves reliable estimation of obligation. Keeping in mind all the four aspects, we are of the view that the High Court should not to have interfered with the decision of the Tribunal in this case.

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14. In this case the High Court has principally gone by the judgment of the Supreme Court in the case of Shree Sajjan Mills Ltd. (supra). That was the case of gratuity. For the asst. yr. 1974-75 the assessee-company sought to deduct a sum of Rs. 18,37,727 towards the amount of gratuity payable to its employees and worked out actuarially. No provision was made for Rs. 18,37,727. The claim for deduction was made on the ground that the liability stood ascertained by actuarial valuation and, therefore, was deductible under s. 37 of the 1961 Act. The ITO allowed the deduction only in respect of the amounts actually paid by the assessee and the rest was disallowed on the ground of non-compliance with the provisions of s. 40A(7) of the 1961 Act. This view of the ITO was affirmed by CIT(A). The Tribunal held that for the earlier assessment year relating to 1973-74, actuarially ascertained liability for gratuity arising under Payment of Gratuity Act, 1972 was an allowable deduction. However, for the assessment year in question, the Tribunal held that the increased liability claimed by the assessee for deduction was allowable on general principles of accounting. This view was taken by the Tribunal on the basis that the actuarially determined liability was not provided for in the assesseeôs books of account. In appeal by the Department, the High Court held that the assessee was not entitled to deduction without complying with the provisions of s. 40A(7) of the 1961 Act. This view of the High Court was affirmed by this Court. It was held that s. 40A(7) which stood inserted by Finance Act, 1975 w.e.f. 1st April, 1973 has been given an overriding effect over s. 28 as well as s. 37 of the 1961 Act. Consequently, the deduction allowable on general principles was ruled out as s. 40A(1) made it clear that s. 40A had effect notwithstanding anything contained in ss. 30 to 39 of the 1961 Act. In other words, as regards deduction in respect of gratuity, the assessee was required to comply with the provisions of s. 40A(7) after Finance Act, 1975. It is interesting to note that prior to 1st April, 1973 actual payment or provision for payment was eligible for deduction either under s. 28 or under s. 37 of the 1961 Act. This has been reiterated in Shree Sajjan Mills Ltd. (supra). The position got altered only after 1st April, 1973. Before that date, provision made in the P&L a/c for the estimated present value of the contingent liability properly ascertained and discounted on an accrued basis could be deducted either under s. 28 or s. 37 of the 1961 Act. This has been explained in Shree Sajjan Mills Ltd. (supra) at p. 599. Sec. 40A(7) deals only with the case of gratuity. Even in the case of gratuity but for insertion of s. 40A(7), provision made in the P&L a/c on the basis of present value of the contingent liability properly ascertained and discounted on an accrued basis was entitled to deduction either under s. 28 or under s. 37 of the said Act. This aspect, therefore, indicates that the present value of the contingent liability like the warranty expense, if properly ascertained and discounted on accrued basis, could be an item of deduction under s. 37 of the said Act. This aspect is not noticed in the impugned judgment. We may add a caveat. As stated above, the principle of estimation of the contingent liability is not the normal rule. As stated above, it would depend on the nature of business, the nature of sales, the nature of the product manufactured and sold and the scientific method of accounting being adopted by the assessee. It will also depend upon the historical trend. It would also depend upon the number of articles produced. As stated above, if it is a case of single item being produced then the principle

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of estimation of contingent liability on pro rata basis may not apply. However, in the present case, it is not so. In the present case, we have the situation of large number of items being produced. They are sophisticated goods. They are supported by the historical trend, namely, defects being detected in some of the items. The data also indicates that the warranty cost(s) is embedded in the sale price. The data also indicates that the warranty is attached to the sale price. In the circumstances, we hold that the principle laid down by this Court in the case of Metal Box Company of India (supra) will apply. In that case this Court held that contingent liabilities discounted and valued as out-of-necessity could be taken into account as trading expenses if these were capable of being valued. It was further held that an estimated liability even under a gratuity scheme even if it was a contingent liability if properly ascertainable and if its present value stood fairly discounted, was deductible from the gross profits while preparing the P&L a/c. In view of this decision it became permissible for an assessee to provide, in his P&L a/c, for the estimated liability under a gratuity scheme by ascertaining its present value on accrued basis and claiming it as an ascertained liability to be deducted in the computation of profits and gains of the previous year either under s. 28 or under s. 37 of the 1961 Act. However, the above principle would not apply after insertion of s. 40A(7) w.e.f. 1st April, 1973. It may be stated that the principles of commercial accounting, mentioned above, formed the basis of the judgment of this Court in the case of Metal Box Company of India (supra) and those principles are affirmed by the judgment of the Supreme Court in Shree Sajjan Mills Ltd. (supra) upto 1st April, 1973. In this case we are concerned with warranty claims. In respect of warranty claims during the relevant assessment years in question there is no provision similar to s. 40A(7) of the 1961 Act. We may add that the above principle of commercial accounting in Metal Box Company of India (supra) also finds place in the judgment of this Court in the case of Madras Industrial Investment Corporation Ltd. vs. CIT (1997) 139 CTR (SC) 555 : (1997) 225 ITR 802 (SC), in which the Court has explained the meaning of the word "expenditure" in s. 37 of the 1961 Act. In other words, the principle enunciated in Metal Box Company of India (supra) which has been reiterated in Shree Sajjan Mills Ltd. (supra) (upto 1st April, 1973) which deals with making of provision on the basis of estimated present value of contingent liability holds good during the assessment years in question qua warranty claims.

[Emphasis, by underlining, supplied by us]

14. Quite clearly, therefore, as long as the assessee has made the provision for warranty claims on a scientific basis and historical data, this is admissible as deduction in computation of business income. We have noted, earlier in this order, that the warranty provision was computed as a three step process to quantify such provision (a) the assessee determines, on the basis explained above, percentage of defects likely to occur in the product sold by the assessee; (b) the assessee determines, based on the past experience and the repair cost estimate received from the vendors, average per unit likely repair costs; and (c) the assessee determines the likely number of units which are likely to have such defects, by adopting percentage (a) to the total units sold, and estimates the provision required by

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multiplying the number of units so likely to receive warranty service, with the average cost incurred on such service as a result of (b) above. This method, in our considered view, a fairly scientific basis, supported by historical data, and it meets the tests laid down by Hon'ble Supreme Court in Rotork Controls case *(supra)* above. As for learned Assessing Officer's frequent observations to the effect that such a claim is only a contingent liability, all we would consider appropriate is to invite his attention to Hon'ble Supreme Court's observation above to the effect that "**In this connection, it may be noted that in the case of a manufacture and sale of one single item the provision for warranty could constitute a contingent liability not entitled to deduction under s. 37 of the said Act. However, when there is manufacture and sale of an army of items running into thousands of units of sophisticated goods, the past event of defects being detected in some of such items leads to a present obligation which results in an enterprise having no alternative to settling that obligation."** Rather than reiterating his stand again and again, without any regard to the law laid down by highest judicial forum, on this issue, he must yield to the higher wisdom of Hon'ble Courts above. The Assessing Officer ought to have reconciled to the fact that, as is the legal position as on now, the liability in respect of provision for warranty claims is not a contingent liability but rather a reasonably estimated, to borrow the felicitous words employed by Their Lordships, "present obligation as a result of past events *(i.e. sale of products)* resulting in an outflow of resources *(in future)*". Learned CIT(A) was, therefore, quite justified in granting the impugned relief. We uphold his action and decline to interfere in the matter.

15 Ground no. 2 is thus dismissed.

16. As for ground no. 3 in the appeal filed by the Assessing Officer, we will deal with it a little later alongwith connected ground of appeal raised by the assessee.

17. Let us now turn to the appeal filed by the assessee.

18. In the first ground of appeal, the assessee has raised the following grievance:

> **1.1 On the facts and in the circumstances of the case and in law, the learned CIT(A) has erred in confirming the action of the learned AO of disallowing the employees' contribution to ESI of Rs.43,908 under section 2(24)(x) r.w.s. 36(1)(va) of the Act.**
>
> **The Appellant submits that the said amounts have been paid before the due date of filing return of income under Section 139(1) and hence allowable.**

19. Learned representatives fairly agree that this issue is covered, against the assessee, by Hon'ble Gujarat High Court's judgment in the case of CIT Vs Gujarat State Toad Transport Corporation [(2014) 366 ITR 170 (Guj)]. The conclusions arrived at by the learned CIT(A), which are in harmony with the view so expressed by Hon'ble jurisdictional High Court, donot call for any interference from us. We confirm the order of the CIT(A) on this issue.

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20. Ground no. 1 is thus dismissed.

21. In ground no. 2, the assessee has raised the following grievance:

> **2. Ground No. 2 - Disallowance of Marked to Market Loss**
>
> **2.1 On the facts and in the circumstances of the case and in law, the learned CIT(A) has erred in confirming the action of the learned AO by upholding disallowance of marked to market loss of Rs.71,29,913 arising on account of forward contracts entered into for hedging export sales of the Appellant on the ground that loss is notional and contingent in nature.**
>
> **2.2 On the facts and in the circumstances of the case and in law, the learned CIT(A) has erred in not appreciating the accounting treatment followed by the appellant which is in accordance with Accounting Standard 11.**
>
> **It is prayed that the learned AO be directed to allow loss of Rs.71,29,913 under provisions of the Act.**

22. So far as this grievance of the assessee is concerned, the relevant material facts are like this. During the course of scrutiny assessment proceedings, the Assessing Officer noticed that the assessee has shown foreign exchange difference income of Rs 1,12,55,515 under the head ó Other Income ò but when he probed the matter further, he found that this amount of Rs 1,12,55,515 has been worked out after allowing a set off of foreign exchange difference loss of Rs 71,22,045. It was explained by the assessee that all the forward contracts are with respect to exports, that these contracts are entered into on the basis of spot rates plus premium element, that, in terms of the requirements of AS-11, the exposure to such contracts is required to be evaluated on the basis of difference in the foreign exchange rates at the year ending vis-à-vis foreign exchange rates committed under the contracts, and that, it is a result of this exercise that the loss of Rs 71,22,045 has been quantified. The Assessing Officer was, however, of the view that such a treatment is incorrect since loss has not fructified till the end of the year and it is still a notional loss which is contingent upon the events in future. He also relied upon the CBDT instruction no. 3 of 2010, dated 23rd March 2010, which holds that such losses, being purely notional, are not deductible in computation of business income. Accordingly, the Assessing Officer proceeded to disallow this loss , which is termed as ómarked to market lossô in commercial parlance, amounting to Rs 71,22,045. Aggrieved, assessee carried the matter in appeal before the CIT(A) but without any success. Learned CIT(A) did take note of Hon'ble Supreme Courtôs judgment in the case of CIT Vs Woodward Governor India Pvt Ltd [(2009) 357 ITR 673 (SC)] though did not deal with it any further at all, accepted that the accounting treatment given by the assessee is in accordance with AS-11 which is binding on the assessee but declined the deduction for this loss nevertheless, as, according to the CIT(A), the views of the assessee ñare not acceptable in view of the view expressed by the CBDT vide instruction no. 3 of 2010 dated 23/03/2010ò. The assessee is aggrieved and is in further appeal before us.

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23. We have heard the rival contentions, perused the material on record and duly considered facts of the case in the light of the applicable legal position.

24. It is with some amount of anguish that we have taken note of the fact that the CIT(A) was so much overawed with the CBDT instruction no. 3 (supra) on the subject that rather than even dealing with a Supreme Court judgment cited before him, he simply followed the CBDT instructions. It is only elementary that the CBDT instructions do not bind the appellate authorities and the appellate authorities are, therefore, required to take their independent calls in accordance with the law and binding judicial precedents. That has not been done. Be that as it may, in the case of Woodward Governor *(supra),* the issue regarding deductibility of foreign exchange loss came up for consideration before Hon'ble Supreme Court. Their Lordships, dealing with this issue and holding that such a loss will be deductible in computation of business profits, observed as follows:

> *…….it is clear that profits and gains of the previous year are required to be computed in accordance with the relevant Accounting Standard. It is important to bear in mind that the basis on which stock-in-trade is valued is part of the method of accounting. It is well established, that, on general principles of commercial accounting, in the P&L account, the values of the stock-in-trade at the beginning and at the end of the accounting year should be entered at cost or market value, whichever is lower- the market value being ascertained as on the last date of the accounting year and not as on any intermediate date between the commencement and the closing of the year, failing which it would not be possible to ascertain the true and correct state of affairs. No gain or profit can arise until a balance is struck between the cost of acquisition and the proceeds of sale. The word "profit" implies a comparison between the state of business at two specific dates, usually separated by an interval of twelve months. Stock-in-trade is an asset. It is a trading asset. Therefore, the concept of profit and gains made by business during the year can only materialize when a comparison of the assets of the business at two different dates is taken into account. Sec. 145(1) enacts that for the purpose of s. 28 and s. 56 alone, income, profits and gains must be computed in accordance with the method of accounting regularly employed by the assessee. In this case, we are concerned with s. 28. Therefore, s. 145(1) is attracted to the facts of the present case. Under the mercantile system of accounting, what is due is brought into credit before it is actually received; it brings into debit an expenditure for which a legal liability has been incurred before it is actually disbursed. (See judgment of this Court in the case of United Commercial Bank vs. CIT (1999) 156 CTR (SC) 380 : (1999) 240 ITR 355 (SC). Therefore, the accounting method followed by an assessee continuously for a given period of time needs to be presumed to be correct till the AO comes to the conclusion for reasons to be given that the system does not reflect true and correct profits. As stated, there is no finding given by the AO on the correctness of the Accounting Standard followed by the assessee(s) in this batch of civil appeals.*

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17. Having come to the conclusion that valuation is a part of the accounting system and having come to the conclusion that business losses are deductible under s. 37(1) on the basis of ordinary principles of commercial accounting and having come to the conclusion that the Central Government has made Accounting Standard-11 mandatory, we are now required to examine the said Accounting Standard ("AS").

18. AS-11 deals with giving of accounting treatment for the effects of changes in foreign exchange rates. AS-11 deals with effects of exchange differences. Under para 2, reporting currency is defined to mean the currency used in presenting the financial statements. Similarly, the words "monetary items" are defined to mean money held and assets and liabilities to be received or paid in fixed amounts, e.g., cash, receivables and payables. The word "paid" is defined under s. 43(2). This has been discussed earlier. Similarly, it is important to note that foreign currency notes, balance in bank accounts denominated in a foreign currency, and receivables/payables and loans denominated in a foreign currency as well as sundry creditors are all monetary items which have to be valued at the closing rate under AS-11. Under para 5, a transaction in a foreign currency has to be recorded in the reporting currency by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction. This is known as recording of transaction on initial recognition. Para 7 of AS-11 deals with reporting of the effects of changes in exchange rates subsequent to initial recognition. Para 7(a) inter alia states that on each balance sheet date monetary items, enumerated above, denominated in a foreign currency should be reported using the closing rate. In case of revenue items falling under s. 37(1), para 9 of AS-11 which deals with recognition of exchange differences, needs to be considered. Under that para, exchange differences arising on foreign currency transactions have to be recognized as income or as expense in the period in which they arise, except as stated in para 10 and para 11 which deals with exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets, which topic falls under s. 43A of the 1961 Act. At this stage, we are concerned only with para 9 which deals with revenue items. Para 9 of AS-11 recognises exchange differences as income or expense. In cases where, e.g., the rate of dollar rises vis-a-vis the Indian rupee, there is an expense during that period. The important point to be noted is that AS-11 stipulates effect of changes in exchange rate vis-a-vis monetary items denominated in a foreign currency to be taken into account for giving accounting treatment on the balance sheet date. Therefore, an enterprise has to report the outstanding liability relating to import of raw materials using closing rate of exchange. Any difference, loss or gain, arising on conversion of the said liability at the closing rate, should be recognized in the P&L account for the reporting period.

10. As stated above, on facts in the case of M/s Woodward Governor India (P) Ltd., the Department has disallowed the deduction/debit to the P&L a/c made by the assessee in the sum of Rs. 29,49,088 being unrealized loss due to foreign exchange fluctuation. At the very outset, it may be stated that there is

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no dispute that in the previous years whenever the dollar rate stood reduced, the Department had taxed the gains which accrued to the assessee on the basis of accrual and it is only in the year in question when the dollar rate stood increased, resulting in loss that the Department has disallowed the deduction/debit. This fact is important. It indicates the double standards adopted by the Department.

11. The dispute in this batch of civil appeals centers around the year(s) in which deduction would be admissible for the increased liability under s. 37(1).

12. We quote hereinbelow s. 28(i), s. 29, s. 37(1) and s. 145 of the 1961 Act, which read as follows :

> *"Sec. 28. Profits and gains of business or profession—The following income shall be chargeable to income-tax under the head "Profits and gains of business or profession", —*
>
> *(i) the profits and gains of any business or profession which was carried on by the assessee at any time during the previous year."*
>
> *"Sec. 29. Income from profits and gains of business or profession, how computed—The income referred to in s. 28 shall be computed in accordance with the provisions contained in ss. 30 to 43D."*
>
> *"Sec. 37. General—(1) Any expenditure (not being expenditure of the nature described in ss. 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession.*
>
> *Explanation : For the removal of doubts, it is hereby declared that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure."*
>
> *"Sec. 145. Method of accounting—(1) Income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" shall, subject to the provisions of sub-s. (2), be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.*
>
> *(2) The Central Government may notify in the Official Gazette from time to time accounting standards to be followed by any class of assessees or in respect of any class of income.*
>
> *(3) Where the AO is not satisfied about the correctness or completeness of the accounts of the assessee, or where the method of*

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accounting provided in sub-s. (1) or accounting standards as notified under sub-s. (2), have not been regularly followed by the assessee, the AO may make an assessment in the manner provided in s. 144."

13. As stated above, one of the main arguments advanced by the learned Addl. Solicitor General on behalf of the Department before us was that the word "expenditure" in s. 37(1) connotes "what is paid out" and that which has gone irretrievably. In this connection, heavy reliance was placed on the judgment of this Court in the case of Indian Molasses Company (supra). Relying on the said judgment, it was sought to be argued that the increase in liability at any point of time prior to the date of payment cannot be said to have gone irretrievably as it can always come back. According to the learned counsel, in the case of increase in liability due to foreign exchange fluctuations, if there is a revaluation of the rupee vis-a-vis foreign exchange at or prior to the point of payment, then there would be no question of money having gone irretrievably and consequently, the requirement of "expenditure" is not met. Consequently, the additional liability arising on account of fluctuation in the rate of foreign exchange was merely a contingent/notional liability which does not crystallize till payment. In that case, the Supreme Court was considering the meaning of the expression "expenditure incurred" while dealing with the question as to whether there was a distinction between the actual liability in praesenti and a liability de futuro. The word "expenditure" is not defined in the 1961 Act. The word "expenditure" is, therefore, required to be understood in the context in which it is used. Sec. 37 enjoins that any expenditure not being expenditure of the nature described in ss. 30 to 36 laid out or expended wholly and exclusively for the purposes of the business should be allowed in computing the income chargeable under the head "Profits and gains of business". In ss. 30 to 36, the expressions "expenses incurred" as well as "allowances and depreciation" has also been used. For example, depreciation and allowances are dealt with in s. 32. Therefore, Parliament has used the expression "any expenditure" in s. 37 to cover both. Therefore, the expression "expenditure" as used in s. 37 may, in the circumstances of a particular case, cover an amount which is really a "loss" even though the said amount has not gone out from the pocket of the assessee.

15. For the reasons given hereinabove, we hold that, in the present case, the "loss" suffered by the assessee on account of the exchange difference as on the date of the balance sheet is an item of expenditure under s. 37(1) of the 1961 Act

25. In the present case also, the assessee is consistently following the mercantile method of accounting, the same accounting treatment for the foreign exchange losses and gains has been given by the assessee all along, the assesse is making entries in respect of such losses and gains, and the treatment is consistent with the Accounting Standards. As a matter of fact, the Assessing Officer has not even raised any issues with respect to the above. His case is confined to the loss being notional in nature and contrary to the CBDT guidelines, but then, in the same breath, he taxes the gains on foreign exchange which are computed on the same basis. If

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losses are held to be notional, even the gains must be held notional too. However, this aspect of the matter is conveniently ignored. As a matter of fact, it was somewhat similar situation in the case before Hon'ble Supreme Court and Their Lordships could not help remarking that ñ***it may be stated that there is no dispute that in the previous years whenever the dollar rate stood reduced, the Department had taxed the gains which accrued to the assessee on the basis of accrual and it is only in the year in question when the dollar rate stood increased, resulting in loss that the Department has disallowed the deduction/debit. This fact is important. It indicates the double standards adopted by the Department***.ò In the present case, the facts are even more glaring in as much as the gains on foreign exchange contracts in the same year have been taxed as ó other income+, the losses on foreign exchange contracts have not been allowed as deduction. Such an approach cannot meet any judicial scrutiny. As we say so, we must make it clear that since the assessee succeeds on merits, in the light of Hon'ble Supreme Court's direct judgment on the issue in the case of Woodward Governor (supra), such considerations of equity are rather peripheral issues. The assessee has succeeded on merits. As for the CBDT instructions, it is only elementary that any instructions issued by the CBDT cannot bind the assessee even though the assessee is entitled to, and can legitimately ask for, any benefits granted to the assessee by such instructions or circulars. Nothing, therefore, turns on the CBDT instruction even if it is actually contrary to the claim of the assessee.

26. Ground no. 2 is thus allowed.

27. In ground no. 3, the assessee has raised the following grievance

> **3.1 On the facts and circumstances of the case and in law, the learned CIT(A) has erred in confirming the action of the learned AO in not allowing entire foreign tax credit amounting to Rs.55,61,306.**
>
> **3.2 On the facts and circumstances of the case and in law, the learned CIT(A) has erred in confirming the action of the learned AO in disregarding the fact that tax credit has been claimed on the income which has been taxed in both the countries, i.e. source country and resident country.**
>
> **3.3 Alternatively, on the facts and circumstances of the case and in law, the learned CIT(A) has erred in confirming the action of the AO in not considering actual profitability of foreign income and tax thereon while computing the tax on doubly taxed income at the time of allowing the tax credit in respect of taxes paid in Indonesia, Malaysia and Rwanda**

28. In a connected ground of appeal, i.e. ground no. 3 which we must take up alongwith the above stated interrelated grievance of the assessee, the Assessing Officer has also raised the following grievance in its appeal:

> **3. The Ld. CIT(A) has erred in law and on facts in restricting the disallowance of foreign tax credit to Rs.3,10,799 and the balance unallowed credit of Rs.52,50,507 allowed u/s.37(1) of the Act, without properly appreciating the facts of the case and the material brought on record.**

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29. The relevant material facts are as follows. The assessee before us, a wholly owned subsidiary of a US based company by the name of Elitecore Technologies Inc, is a company engaged in the business of software developments and products. During the relevant previous year, the assessee earned foreign income amounting to Rs 2,72,96,723 from Indonesia, Rs 66,53,562 from Malaysia and Rs 3,51,570 from Rwanda. It was in respect of these incomes that the taxes were withheld in the respective source countries, and the taxes so withheld aggregated to Rs 55,61,306. The assesse claimed a tax credit in respect of the taxes so withheld abroad. There is no dispute that the assessee should get foreign tax credit for the taxes so paid abroad- under section 90 read with the relevant treaty provisions in cases in which the income is sourced from tax treaty partner jurisdictions, i.e. Malaysia and Indonesia in this case, and under section 91 from the jurisdictions with which India has not entered into a tax treaty. The dispute is confined to the of tax credit. While the assessee has claimed a tax credit of Rs 55,61,306, the Assessing Officer has granted the tax credit of only Rs 3,10,799. When the matter travelled in appeal, the first appellate authority, i.e. learned CIT(A) simply followed his predecessorôs order on this issue, in assesseeôs own case for the 2009-10, and confirmed the quantification of eligible tax credit at Rs 3,10,799. As for the balance amount of Rs 52,50,507 (i.e. tax withheld abroad at Rs 55,61,306 *minus* tax credit allowed of Rs 3,10,799), the CIT(A) held that it should be allowed as deduction under section 37(1)- a claim which was negatived, or rather simply brushed aside, by the Assessing Officer without any discussion at all. Aggrieved by learned CIT(A) upholding the eligible tax credit at Rs 3,10,799, the assessee is in appeal before us. In the meantime, however, the order so followed by the CIT(A) also came up for examination before us. Vide order dated 3rd January 2017 on assesseeôs appeal for the assessment year 2009-10, the stand of the CIT(A) on quantification of tax credit was reversed, claim of the assessee on quantification, to a very large extent, was upheld, and, in the process, some observations on principles governing the quantification of such tax credit were made. Learned counsel for the assessee suggests that matter deserves to be remitted to the file of the CIT(A) for fresh adjudication, on quantification aspect, in the light of the order so passed by the Tribunal, and learned Departmental Representative does not oppose this prayer. On the quantification aspect, therefore, we remit the matter the file of the CIT(A) for adjudication *de novo* in accordance with the law, in the light of the observations made by the Tribunal for the assessment year 2009-10 in assesseeôs own case, by way of a speaking order and after giving a reasonable opportunity of hearing to the parties. For the sake of completeness, we reproduce these observations as below:

> *8. So far as the first issue that we have identified for adjudication, i.e. the manner in which the quantum of income eligible which is required to be treated as taxed in both the countries ,is concerned, there is no guidance available in the treaties. All that both the treaties state is that the foreign tax credit shall not exceed the part of the income tax as computed before the deduction is given, "which is attributable as the case may be, to the income which may be taxed in that other State" but there is little guidance on how to compute such income. However, quite clearly, as the expression used is 'income', which essentially implied 'income' embedded in the gross receipt, and not the 'gross receipt' itself. This approach is reflected in the UN Model Convention Commentary as well, which, in turn, follows the approach in OECD Model Convention Commentary in this regard. UN Model*

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Convention Commentary (2011 update @ page 333) states that "Normally the basis of calculation of income tax is total net income, i.e. gross income less allowable deductions. Therefore, it is the gross income derived from the source state less any allowable deductions (specific or proportional) connected with such income which is to be exempted". It is, therefore, not really the right approach to take into account the gross receipts, as was contended by the assessee, for the purpose of computing admissible tax credit. The case before us is, however, somewhat unique in the sense that the main business is carried on in India and only some isolated transactions have taken place in Singapore and Indonesia. So far as the first two transactions are concerned, these are only for release of margin money and addition of a separate user- things which donot require any activity on the part of the assessee. In a way, therefore, these earnings are, so far as the present year is concerned, are passive earnings, and no part of the costs incurred in India can be allocated to earnings from Singapore and Indonesia. As regards earnings from maintenance contract, the assessee has allocated the costs on a proportionate basis and no defects are pointed out in the allocation so made by the assessee. However, there seems to be no logic in allocating a share, in proportion of turnover, of all the costs borne by the assessee to these earnings- as has been done by the Assessing Officer. When the income in respect of such foreign operations is not separately computed, it is to be done on a reasonable basis, and what would constitute reasonable basis will be the basis which is based on sound reasoning. The concept of averaging on the basis of overall revenues and profits of the assessee, or on the basis of some other ratio analysis, can only come into play when the income element cannot be worked out on some other reasonable basis on the facts of a particular case So far as the facts of the present case are concerned, we have also noted that the assessee has, during the course of the assessment proceedings, given the working on the computation of income- a copy of which is placed at page 79 of the paper-book filed before us.. ……..

9. We see no infirmities in this computation showing the element of income embedded in the receipts which have been taxed abroad as well. These details were duly furnished to the Assessing Officer vide letter dated 20th March 2013, a copy of which was also placed before us at pages 69 onward of the paper-book. On a perusal of these details, we find that as far as release of retention money of Rs 53,23,085, released after validation of software by IBM Singapore, is concerned, we find that it is uncontroverted claim of the assessee that entire related expenses have been incurred in the earlier years as the software supply was completed in financial year 2006-07. There cannot obviously be any incremental cost at the point of time when retention money of 15% of total contract value is released. The same is the position in respect of receipt of Rs 31,61,369 from PT Tech Mahindra is concerned, which is only for additional user of software already supplied to the customer. When an additional user is added by the customer, it does result in revenue to the seller but it does not at all add to his costs. There is thus merit in the plea that entire receipt, as in the case of release of retention money, is in the nature of income in this year. As regards receipt of Rs 5,74,060, this is in respect of annual maintenance fees but then there is a dedicated team for this purpose and the costs relatable to this particular receipt have been computed by apportioning these costs. We see no infirmity in this computation either. In our considered view, therefore, the computation of income element, as given by the assesse, is fair and reasonable and, in any event, the Assessing Officer has not pointed out any specific infirmities in the same. Given this analysis, we see no need to compute the profit element by taking into account the ratio of entire income to entire turnover of the assessee. Such a course, if at all, could have been relevant if the assessee had not furnished a reasonable

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computation of income embedded in the related receipts of the assessee. That is not the case before us. We, therefore, approve the stand of the assessee on this point. Having said that, we may add that this decision cannot be the authority for the general proposition that only marginal or incremental costs incurred in respect of foreign income should be taken into account and the overheads cannot be allocated thereto. As we have noted earlier, the allocation of proportional deductions can be justified in some situations, such as when business operations are somewhat evenly or even in a significant manner, spread over the residence and source jurisdiction, but that's not the case here. Right now, we are dealing with a situation in which a major portion of income, by release of retention money as also by addition of an additional user by the customer, is a somewhat passive income, even though in the nature of business receipt, and as such, to that extent, allocation of all the expenses incurred by the assessee, in respect of such earnings, will not be justified. As regards the income from maintenance contracts, the relates costs have already been allocated and the Assessing Officer has not pointed out any infirmity in the same. In this view of the matter, quantification of income for the purpose of computing admissible tax credit, as done by the assessee and as reproduced earlier, is accepted.

10. We have noted that the tax credit for both the jurisdictions is to be computed separately but in a similar manner, as is provided in the respective treaties. So far as the tax credit in respect of Indonesian receipts is concerned, as noted above and in view of article 23(1) of the applicable tax treaty, it cannot "exceed the part of the income tax as computed before the deduction is given, which is attributable as the case may be, to the income which may be taxed in that other State". The income tax is, therefore, required to be computed on proportionate basis. What is, therefore, to be computed next is the tax attributable to the income which is so taxed in both the tax jurisdictions. The tax has been paid, in this case, on book profits. To the best of our understanding, and particularly in the absence of any other method having been pointed out to us, only way in which be so done is by apportioning the actual tax paid under MAT provisions (i.e. Rs 54,13,417), in the same ratio as double taxed profit to the overall profits i.e. 35,86,178:4,77,79,403. The amount of tax credit in respect of this income thus comes to Rs 4,06,315, as against the actual deduction of tax aggregating to Rs 5,71,878. The tax credit claim is thus admissible to this extent. As for the tax credit in respect of Singaporean receipts, while the formulae for limitation under article 25(2) of the Indo Singapore tax treaty remains broadly the same as it is provided that the credit shall not exceed tax "which is attributable to the income which may be taxed in Singapore" but the first variable i.e. income taxed in both the countries would change. The figure of income taxed in Singapore as also India is 53,23,085. The MAT paid, relatable to this income, will be arrived at by dividing the same in the ratio 53,23,085:4,77,79,403 The amount of tax payable in respect of Singapore income, by the same formulae, works out to Rs 6,03,107 which is clearly less than Rs 5,41,029 which was deducted at source in Singapore. The tax credit of Rs 5,41,029 in respect of Singaporean receipts is thus clearly admissible. As against tax credit claim of Rs 11,12,907, the tax credit of Rs 9,47,344 is thus indeed admissible. To this extent, the claim of the assessee is upheld. The case of the assessee, in any event, was not pressed beyond this point

30. There is, however, one more aspect to the controversy regarding treatment of income taxes paid abroad by the assessee, and that is with respect to deductibility of taxes so paid abroad, except to the extent of tax credit being granted in respect of the same under section 90 or 91, under section 37(1). Aggrieved by deduction being granted by the CIT(A) in respect of the balance amount of income tax paid abroad

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(i.e. income tax withheld abroad ***minus*** the tax credit held admissible in such respect of such income tax paid abroad), the Assessing Officer is in appeal before us.

31. So far as this aspect of the matter is concerned, the stand of the assessee, at the assessment stage, has been that in case any part of the amount of income tax withheld abroad is not allowed as tax credit against the Indian tax liability, a deduction under section 37(1) be allowed in respect of the same. It was pointed that though there is a bar, under section 40(a)(ii), on deduction in respect of ótaxô on the profits and gains of the business, such a bar does not apply on the taxes paid outside India, as, in terms of definition of tax under section 2(43), ñincome-tax chargeable under the provisions of this Act, and in relation to any other assessment year income-tax and super-tax chargeable under the provisions of this Act prior to the aforesaid date and in relation to the assessment year commencing on the 1st day of April, 2006, and any subsequent assessment year includes the fringe benefit tax payable under section 115WAò. Reliance was placed on a coordinate bench decision in the case of **DCIT Vs Mastek Limited [(2013) 36 taxmann.com 384 (Ahmedabad - Trib.)]** as also some other judicial precedents which have been noted and relied upon in this coordinate bench decision. While the Assessing Officer did not deal with these arguments at all and simply brushed aside the claim of the assessee, learned CIT(A) upheld this claim and directed the Assessing Officer to allow deduction under section 37(1) in respect of amount of difference between the income tax withheld abroad and the foreign tax credit granted to the assessee in respect of the same. Aggrieved, the Assessing Officer is in appeal before us.

32. Learned counsel for the assessee had stated this matter to be a covered matter by Mastek decision *(supra),* but when he was asked to argue the matter on merits, he painstakingly took us through section 40(a)(ii) and reiterated the arguments which were taken before the authorities below. His broad contention was that in terms of the Explanation 1 to Section 40(a)(ii), it is clear that the bar on deduction under section 40(a)(ii) is confined to only such income tax paid abroad in respect of which tax credit is granted under section 90 or 91. So far as the foreign tax in respect of which no tax credit is available, according to the learned counsel, there is no bar on deduction under section 40(a)(ii). The expression ótaxô, as learned counsel contends, is a defined expression under the Income Tax Act, and its connotations are confined to only such tax as is paid under the Income Tax Act. Learned Departmental Representative, on the other hand, submitted that in terms of Section 40(a)(ii), no deduction can be allowed in respect of taxes on income, and there is no reason to assume that such a restriction is confined to taxes paid in India. As for the contention that the expression ótaxô appearing in section 40(a)(ii) is a defined expression restricting the scope of this expression to taxes paid under the Income Tax Act, learned Departmental Representative submitted that this is a hyper technical argument contrary to the scheme of the statutory provision. He, however, left the matter to us. We have heard the rival contentions, perused the material on record and duly considered facts of the case in the light of applicable legal position. If we are to uphold the contentions of the assessee and the impugned order of the CIT(A). the scheme of benefit available to the assessee in respect of taxes paid or withheld outside India, by way of an example, is as follows:

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Assuming that the assessee earned an income of Rs 100 from outside India, and the taxes withheld abroad are Rs 60 and the admissible tax credit available to the assessee under section 90 and/or 91, in respect of these taxes withheld, is Rs 40 as the effective tax rate in India in respect of the said income is 40%, the benefit available to the assessee should be as follows:

Tax credit to be adjusted against tax liability under the Income Tax Act, 1961	**Rs 40**
Deduction under section 37(1) in respect of taxes paid or withheld outside India	**Rs 20**

In effect thus, the assessee gets a tax benefit of Rs 48 (i.e. Rs 40 plus 40% of Rs 20 which is allowed as deduction) as against a related tax liability of Rs 40

33. The stand of the revenue authorities, on the other hand, is that in the above example, no amount of tax paid or withheld outside India can be allowed as deduction under section 37(1). It is undisputed position that but for the restriction placed under section 40(a)(ii) income tax paid by an assessee would be deductible expense, and, therefore, the controversy requiring our adjudication is confined to the question as to whether or not this restriction comes into play in respect of the income tax paid abroad. The case of the assessee is that taxes paid abroad are paid for the purposes of business, and as such deductible under s. 37(1) which provides that, "any expenditure (not being expenditure of the nature described in ss. 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession". It is contended that the taxes paid are inherently in the nature of expenses incurred for the purposes of business but these are not allowable as deduction because of the specific bar placed under s. 40(a)(ii). However, according to the assessee, the restriction placed under s. 40(a)(ii), in computation of income from business and profession, refers to only ótaxô but the said expression, in view of definition of the expression ótaxô under s. 2(43), covers only "income-tax chargeable under the provisions of this Act (i.e. IT Act, 1961)", and, as a corollary thereto, this limitation on deduction of tax does not extend its scope to taxes paid other than under Income Tax Act, 1961. This plea, however, stands categorically rejected by Hon'ble Bombay High Court as far back as over a quarter century in 1990, in the case of **Lubrizol India Limited Vs CIT [(1991) 187 ITR 25 (Bom)]**. The plea was rejected in the context of Section 40(a)(ii) itself, though with reference to surtax, but principle unambiguously was the same and it dealt with the same expression in the same clause of the sub section. The argument of the assessee was that for the purpose of Section 40(a)(ii), which sets out restriction in deduction of ótaxô, the definition of tax under section 2(43) must come into play, and this definition is confined to a tax levied under the Indian Income Tax Act, 1961. Hon'ble Bombay High Court had, rejecting this plea in no uncertain terms though in the context of surtax, observed as follows:

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With respect, this argument does not appeal to us. It is significant to note that the word "tax'; is used in conjunction with the words "any rate or tax", The word "any" goes both with the rate and tax. The expression is further qualified as a rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains. **If the word "tax" is to be given the meaning assigned to it by s. 2(43) of the Act, the word "any" used before it will be otiose and the further qualification as to the nature of levy will also become meaningless.** Furthermore, the word "tax" as defined in s. 2(43) of the Act is subject to "unless the context otherwise requires". **In view of the discussion above, we hold that the words "any tax" herein refers to any kind of tax levied or leviable on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains**.

[Emphasis, by underlining, supplied by us now]

34. The views so expressed by Hon'ble Bombay High Court, in Lubrizol's case *(supra),* were approved by Hon'ble Supreme Court in the case of **Smithkline & French India Ltd Vs CIT [(1996) 219 ITR 581 (SC)]**.

We are unable to see as to how these observations help the assessees herein. **Firstly, it may be mentioned, s. 10(4) of the 1922 Act or s. 40(a)(ii) of the present Act do not contain any words indicating that the profits and gains spoken of by them should be determined in accordance with the provisions of the IT Act. All they say is that it must be a rate or tax levied on the profits and gains of business or profession. The observations relied upon must be read in the said context and not literally or as the provisions in a statute.** But so far as the issue herein is concerned, even this literal reading of the said observations does not help the assessee. As we have pointed out hereinabove the surtax is essentially levied on the business profits of the company computed in accordance with the provisions of the IT Act. Merely because certain further deductions [adjustments] are provided by the Surtax Act from the said profits, it cannot be said that the surtax is not levied upon the profits determined or computed in accordance with the provisions of the IT Act. Sec. 4 of the Surtax Act read with the definition of "chargeable profits" and the First Schedule make the position abundantly clear.

7. **We may mention that all the High Courts in the country except the Gauhati High Court have taken the view which we have taken herein**. Only the Gauhati High Court has taken a contrary view in the decisions in Makum Tea Co. (India) Ltd. & Anr. vs. CIT (1989) 178 ITR 453 (Gau) and Doom Dooma Tea Co. Ltd. vs. CIT (1989) 180 ITR 126 (Gau) . The decision of the Gauhati High Court in Makum Tea Co. (India) Ltd. is under appeal before us in Civil Appeal Nos. 3976-77 of 1995. Similarly Civil Appeal No. 3246 of 1995 is preferred against the decision of the Gauhati High Court following the decision in Doom Dooma Tea Co. Ltd.. (On enquiry, the office has informed that no Special Leave Petition/Civil Appeal has been filed against the decision in Doom Dooma Tea Co. (Ltd.). **For the aforesaid reasons, we cannot agree with the view taken by the Gauhati High Court in the aforesaid decisions.**

We agree with the view taken by the High Courts of Calcutta [Molins (India) Ltd. vs. CIT (1983) 144 ITR 317 (Cal) and Brooke Bond (India) Ltd. vs. CIT (1992) 193 ITR 390 (Cal) : TC 15R.590], **Bombay** *(in)* **Lubrizol (India) Ltd. vs. CIT (1991) 187 ITR 25 (Bom) followed in several other decisions of that Court],** Karnataka [CIT

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vs. International Instruments Pvt. Ltd. (1983) 144 ITR 936 (Kar), Madras [Sundaram Industries Ltd. vs. CIT (1986) 159 ITR 646 (Mad), Andhra Pradesh [Vazir Sultan Tobacco Co. Ltd. vs. CIT (1988) 169 ITR 35 (AP)], Rajasthan [Associated Stone Industries Co. Ltd. vs. CIT (1988) 170 ITR 653 (Raj)], Gujarat [S.L.M. Maneklal Industries Ltd. vs. CIT (1988) 172 ITR 176 (Guj) followed in several cases thereafter], Allahabad [Himalayan Drug Co. Pvt. Ltd. vs. CIT (1996) 218 ITR 346 (All)] and Punjab & Haryana High Court [Highway Cycle Industries Ltd. vs. CIT (1989) 178 ITR 601 (P&H) : TC 17R.807].

35. A coordinate bench of this Tribunal, while dealing with the same question of deductibility of income tax paid abroad and in the case of **DCIT Vs Tata Sons Ltd [(1991) 9 ITR (Trib) 154 (Bom)]** and speaking through one of us, elaborately set out the broad principles governing the issue and observed as follows:

7. Let us deal with some fundamentals first. The payment of income-tax in overseas tax jurisdictions, in addition to taxability in the home jurisdiction, is an inevitable corollary of inherent conflict between the source rule and residence rule. This conflict develops when a person resident in one of the tax jurisdictions earns income which is sourced from another tax jurisdiction. As per the residence rule, irrespective of the geographical location of a place where a person earns income, the income is taxable in the tax jurisdiction in which a person is resident. The source rule, however, lays down that an income earned in a tax jurisdiction, irrespective of the residential status of the person earning the said income, is liable to be taxed in the tax jurisdiction where the income is earned. Therefore, a tax object, i.e., the income which is to be taxed, as a rule attracts taxability in the source jurisdiction, and a tax subject, i.e. the person who is to be taxed is taxed in the residence jurisdiction. These competing claims put the taxpayer to risk of being taxed more than once in respect of the same income, and a solution to avoid such double taxation is thus to be found within the four corners of tax systems. While source rule as also the residence rule continue to be integral part of most of the tax systems, a mechanism is provided in the domestic tax legislations to relieve a taxpayer of such double taxation. In 'Tax Law Design and Drafting", an International Monetary Fund publication (ISBN 90-411-9784-2), Prof. Richard Vann, at p. 756 of Volume II, deals with this issue by observing as follows :

> *"It is necessary to distinguish among four basic methods in this area. The first is for a country not to assert jurisdiction to tax foreign source income of residents (either at all or for selected types of income). This territorial approach to taxation (taxing only income sourced in the country) means that the country is not following the usual international norm of worldwide taxation of residents and so is not strictly a method for relieving double taxation as residence source double taxation will simply not arise for its residents.*
>
> *The second method is the exemption system, under which foreign source income is exempted in the country of residence. If the exemption is unconditional and the exempted income does not affect in any way the taxation of other income, then in substance the result is the same as a purely territorial system. Most exemption systems are not of this kind and so are to be distinguished from territorial systems. Most countries using an exemption system adopt exemption with progression, under which the total tax on all income of a resident is calculated, and then the average rate of tax is applied to the income that does not enjoy the exemption. Exemption systems are also increasingly subject to various conditions to ensure satisfaction of the assumption underlying the system (that the income has been taxed in the*

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source country at its ordinary rates).These conditions can consist of subject-to-tax tests (including the specification of tax rates) or selective application of exemption to foreign countries under domestic law or tax treaties. In particular, the exemption is usually not given where the source tax has been reduced or eliminated by a tax treaty. The result is that there are no countries asserting jurisdiction to tax worldwide income that give an exemption for all kinds of foreign income; where a country is referred to as an exemption country, this generally means that it provides some form of exemption to business income, dividends received from direct investments in foreign companies, and often employment income, with a credit being used in other cases.

The third system is the foreign tax credit system under which a credit against total tax on worldwide income is given for foreign taxes paid on foreign income by a resident upto the amount of domestic tax on that income. This limit is designed to ensure that foreign taxes do not reduce the tax on the domestic income of residents and is calculated by applying the average rate of tax on the worldwide income before the credit to the foreign-source income. In its simplest form, this limit is applied to foreign income in its entirety, without distinguishing the type of income and the country where it is sourced.

The fourth system is to give a deduction for foreign income-taxes in the calculation of taxable income. While this system is used in some countries, often as a fall back from a foreign tax credit where the credit may not be of use to the taxpayer, it is not widely accepted as a method for use on its own and, more specifically is not used in tax treaties.

It can be argued that relief of double taxation in either credit or exemption form involves a number of complexities that are best avoided by developing or transition countries. Pure territorial taxation, however, simply invites tax avoidance through the moving of income offshore, and once qualifications on the pure territorial principle are admitted, such as limiting it to certain kinds of income, it is hard to see that any great simplicity is achieved as problems of characterization of income arise, as well as incentives to convert income from one form to another. Similar difficulties arise when a conditional exemption system is used. For this reason, a simple foreign tax credit system is probably suitable for most such countries—it asserts the worldwide jurisdiction to tax income of residents and does not require significant refinements of calculation. It leaves open the greatest scope for elaboration of the system by domestic law and tax treaties in the future without having to repeal or modify any exemption (often a difficult process politically because of entrenched interests). Given that tax treaties are premised on an item-by-item foreign tax credit limit, rather than on a worldwide limit aggregating all foreign income of the taxpayer, the item-by-item limit is probably easiest to use in domestic law.

Whichever double tax relief system is adopted, some method of apportioning deductions between domestic and foreign income will be necessary. Where deductions allocated to foreign income exceed that income, the loss should not be available for use against domestic income."

8. There are thus four methods in which relief can be granted to a taxpayer in the residence country in respect of income-tax paid abroad. It is also important to bear in mind the fact that these four methods are mutually exclusive methods in the sense

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that each one of these methods, on standalone basis, is meant to grant requisite relief from double taxation of an income. Application of more than one of these methods, in a particular situation can thus only result in granting relief greater than the double taxation itself. To sum up even at the cost of an element of repetition, these methods are as follows :

> *• In the first method, residence country follows pure territorial method of taxation and brings to tax only such incomes as are sourced in the residence jurisdiction itself. There is then no conflict between the source rule and the residence rule in as much as the residence rule is not strictly followed. Globally, however, there are not many takers for this system, and quite reasonably so, because, as Prof. Vann rightly puts it, it simply invites shifting of income offshore to evade taxes completely.*
>
> *• The second method is to grant tax exemption to the income taxed abroad. The exemption method is usually conditional in the sense it provides progressive relief, on average rate basis, and is contingent upon the related income not being exempted from tax, or subjected to tax at a less than ordinary tax rate, under a tax treaty arrangement. Effectively thus it is not a simpliciter exemption of income taxed abroad, but an exemption of income subject to several riders. In that sense, it is distinct from the pure territorial method of taxation.*
>
> *• In the third method, tax credit is given, in computation of tax liability of the taxpayer in respect of his worldwide income, in respect of taxes paid abroad. However, the credit so given, in respect of taxes paid abroad, does not exceed the domestic tax liability in respect of the income earned abroad. In principle, thus, even income-tax paid abroad is seen as appropriation of income towards State's share in income of a taxpayer and the credit is granted, in computation of domestic taxes, in respect thereof.*
>
> *• In the fourth method, deduction is allowed in respect of the income-taxes paid abroad. It is thus seen as a charge of income, rather than appropriation of income and is seen as an expense incurred in earning the income abroad. That is in sharp contrast with all other methods where income-tax paid abroad is seen as an application of income towards Sovereign's share in income earned by a taxpayer.*

9. Let us now deal with the legal provisions in the Indian IT Act, 1961, dealing with double taxation relief, and examine the manner in which the Indian IT Act provides relief from taxation of an income in more than one tax jurisdiction. These provisions are set out in Chapter IX of the Act, and are reproduced below for ready reference :

> *"CHAPTER IX : DOUBLE TAXATION RELIEF*
>
> *90. Agreement with foreign countries or specified territories.—(1) The Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India,—*
>
> *(a) for the granting of relief in respect of—*
>
> *(i) income on which taxes have been paid both income-tax under this Act and income-tax in that country or specified territory, as the case may be, or*

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(ii) income-tax chargeable under this Act and under the corresponding law in force in that country or specified territory, as the case may be, to promote mutual economic relations, trade and investment, or

(b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country or specified territory, as the case may be, or

(c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country or specified territory, as the case may be, or investigation of cases of such evasion or avoidance, or

(d) for recovery of income-tax under this Act and under the corresponding law in force in that country or specified territory, as the case may be,

and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.

(2) Where the Central Government has entered into an agreement with the Government of any country outside India or specified territory outside India, as the case may be, under sub-s. (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.

(3) Any term used but not defined in this Act or in the agreement referred to in sub-s. (1) shall, unless the context otherwise requires, and is not inconsistent with the provisions of this Act or the agreement, have the same meaning as assigned to it in the notification issued by the Central Government in the Official Gazette in this behalf.

Explanation 1 : For the removal of doubts, it is hereby declared that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company.

Explanation 2 : For the purposes of this section, 'specified territory' means any area outside India which may be notified as such by the Central Government.

**90A. Adoption by Central Government of agreement between specified associations for double taxation relief.—(1) Any specified association in India may enter into an agreement with any specified association in the specified territory outside India and the Central Government may, by notification in the Official Gazette, make such provisions as may be necessary for adopting and implementing such agreement—*

(a) for the granting of relief in respect of—

(i) income on which taxes have been paid both income-tax under this Act and income-tax in any specified territory outside India; or

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(ii) income-tax chargeable under this Act and under the corresponding law in force in that specified territory outside India to promote mutual economic relations, trade and investment, or

(b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that specified territory outside India, or

(c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that specified territory outside India, or investigation of cases of such evasion or avoidance, or

(d) for recovery of income-tax under this Act and under the corresponding law in force in that specified territory outside India.

(2) Where a specified association in India has entered into an agreement with a specified association of any specified territory outside India under sub-s. (1) and such agreement has been notified under that sub-section, for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.

(3) Any term used but not defined in this Act or in the agreement referred to in sub-s. (1) shall, unless the context otherwise requires, and is not inconsistent with the provisions of this Act or the agreement, have the same meaning as assigned to it in the notification issued by the Central Government in the Official Gazette in this behalf.

Explanation 1 : For the removal of doubts, it is hereby declared that the charge of tax in respect of a company incorporated in the specified territory outside India at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such company.

Explanation 2 : For the purposes of this section, the expressions—

(a) 'specified association' means any institution, association or body, whether incorporated or not, functioning under any law for the time being in force in India or the laws of the specified territory outside India and which may be notified as such by the Central Government for the purposes of this section;

(b) 'specified territory' means any area outside India which may be notified as such by the Central Government for the purposes of this section.

**This section was not in force in the relevant assessment year as it was also introduced w.e.f. 1st April, 2006 vide Finance Act, 2006, but it is reproduced nevertheless for the sake of completeness. Similarly, there are certain other variations in the statutory provisions as prevailing in the asst. yr. 2000-01 vis-a-vis the statutory provisions as on now, but these variations are not relevant in the context of issue under consideration in this appeal.*

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91. Countries with which no agreement exists.—(1) If any person who is resident in India in any previous year proves that, in respect of his income which accrued or arose during that previous year outside India (and which is not deemed to accrue or arise in India), he has paid in any country with which there is no agreement under s. 90 for the relief or avoidance of double taxation, income-tax, by deduction or otherwise, under the law in force in that country, he shall be entitled to the deduction from the Indian income-tax payable by him of a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax of the said country, whichever is the lower, or at the Indian rate of tax if both the rates are equal.

(2) If any person who is resident in India in any previous year proves that in respect of his income which accrued or arose to him during that previous year in Pakistan he has paid in that country, by deduction or otherwise, tax payable to the Government under any law for the time being in force in that country relating to taxation of agricultural income, he shall be entitled to a deduction from the Indian income-tax payable by him—

(a) of the amount of the tax paid in Pakistan under any law aforesaid on such income which is liable to tax under this Act also; or

(b) of a sum calculated on that income at the Indian rate of tax;

whichever is less.

(3) If any non-resident person is assessed on his share in the income of a registered firm assessed as resident in India in any previous year and such share includes any income accruing or arising outside India during that previous year (and which is not deemed to accrue or arise in India) in a country with which there is no agreement under s. 90 for the relief or avoidance of double taxation and he proves that he has paid income-tax by deduction or otherwise under the law in force in that country in respect of the income so included he shall be entitled to a deduction from the Indian income-tax payable by him of a sum calculated on such doubly taxed income so included at the Indian rate of tax or the rate of tax of the said country, whichever is the lower, or at the Indian rate of tax if both the rates are equal.

Explanation : In this section,—

(i) the expression 'Indian income-tax' means income-tax charged in accordance with the provisions of this Act;

(ii) the expression 'Indian rate of tax' means the rate determined by dividing the amount of Indian income-tax after deduction of any relief due under the provisions of this Act but before deduction of any relief due under this chapter, by the total income;

(iii) the expression 'rate of tax of the said country' means income-tax and super-tax actually paid in the said country in accordance with the corresponding laws in force in the said country after deduction of all relief due, but before deduction of any relief due in the said country in respect of double taxation, divided by the whole amount of the income as assessed in the said country;

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(iv) the expression 'income-tax' in relation to any country includes any excess profits tax or business profits tax charged on the profits by the Government of any part of that country or a local authority in that country."

10. The scheme of relief from double taxation of an income, as evident from a plain reading of the above provisions, is like this. Under s. 91 of the Act, when a person resident in India earns any income outside India, which is not deemed to accrue or arise in India, and he suffers income-tax thereon in such source country, that person is entitled to deduction from his domestic income-tax liability to the extent of domestic tax liability in respect of such foreign income or taxes actually paid abroad in respect of such income—whichever is less. In other words thus, if at all a taxpayer is also taxed in India in respect of the income taxed abroad, it is only to the extent the tax rate abroad falls short of Indian tax rate. Each foreign sourced income is thus treated as a separate basket of income, and foreign tax relief in respect of that basket of income is restricted to the Indian income-tax actually levied on the same. This action also provides relief in the context of agricultural income-tax in Pakistan and also in the context of taxation of a non-resident's share of income from a resident Indian partnership firm, which includes income earned outside India, except income deemed to accrue or arise in India, which has suffered tax in such source jurisdiction. Sec. 90 and s. 90A provide that when India has entered into a DTAA with a foreign country, or a specified association outside India, the provisions of such agreements will override the provisions of the Indian IT Act—except to the extent the provisions of the Indian IT Act are beneficial to the assessee. Under the tax credit scheme envisaged in the schemes of tax treaties, once again each income sourced in the treaty partner country is practically treated as a separate basket of income and the double taxation relief, in respect of taxes paid in that treaty partner country, is restricted to the taxes actually levied in the home country in respect of the said income. It thus follows that the least relief available in respect of income-tax paid abroad is if at all an assessee is also taxed in India in respect of the income-taxed abroad, it is only to the extent the tax rate abroad falls short of Indian tax rate. There is no dispute that the assessee has claimed double taxation relief under the scheme of the Act—as set out in s. 90 and s. 91 of the Act.

11. The assessee, however, was not satisfied with the relief so granted by the AO. He also claimed deduction, in computation of income from 'profits and gains from business and profession', in respect of taxes paid abroad. It is the case of the assessee that the taxes so paid abroad constituted expenditure laid out or expended wholly and exclusively for the purposes of the business or profession, and, therefore, deductible under s. 37(1) of the Act. It is this deduction which is now subject-matter of core dispute before us. Interestingly, while the assessee has claimed deduction of overseas income-taxes under s. 37(1), the assessee has also claimed tax credits, in respect of taxes so paid abroad, under s. 90 or under s. 91—as applicable. The same amount has been treated as a charge on income, by claiming the same as deduction as expenditure incurred to earn an income, as also an application of income, by claiming the same as appropriation of income being tax levied on profits and claiming income-tax credit in respect thereof. There is no meeting ground between these two diametrically opposed approaches, and, in our humble understanding, there cannot be any justification for making these contradictory claims. This would also result in a double unintended benefit to the assessee. To illustrate, the assessee has paid US Federal income-tax @ 35 per cent amounting to Rs. 35,01,71,283. On the one hand, the assessee has claimed deduction in respect of these taxes which gives assessee a tax advantage of Rs. 13,48,15,940, being

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38.5 per cent of this amount, and the assessee has also claimed tax credit of Rs. 35,01,71,283 in respect of US Federal income-tax, in computation of Indian income-tax liability. Thus, for a payment of US Federal income-tax amounting to Rs. 35.01 crores, the assessee has claimed tax relief of Rs. 48.49 crores in India. To cap it all, the income which is so subjected to US Federal tax has not been taxed in India at all, due to deduction under s. 80HHE being available in respect of the same, and effectively thus the US Federal taxes paid by the assessee are sought to be offset, on 1.38 times weighted basis, against taxes on assessee's domestic incomes taxable in India. While holding that the assessee is entitled to deduction under s. 80HHE, the CIT(A) has declined the claim of tax credit in respect of taxes paid in USA as there is no Indian tax liability in respect of the said income taxed in USA. That has at least restricted some intended double benefit to the assessee, but even in a situation in which tax relief is confined to a situation in which the same has been actually taxed in India, the relief will be available against tax liability in respect of other incomes to the extent of applicable tax rate on taxes actually paid abroad. The net effect is that even when there is admittedly no double taxation of an income, the assessee is able to reduce his Indian income-tax liability, in respect of other incomes, by being allowed deduction in respect of taxes paid abroad. Such a claim being accepted will lead to quite an incongruous result by any standard.

12. It is in the backdrop of the above claim for deduction that one has to take a look at s. 40(a)(ii) and s. 2(43) which are reproduced below for ready reference :

> *"Sec. 40(a)(ii)—Notwithstanding anything to the contrary in ss. 30 to 38, the following amounts shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession",—*
>
> *(ii) any sum paid on account of any rate of tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains.*
>
> ***Explanation 1 : For the removal of doubts, it is hereby declared that for the purposes of this sub-clause, any sum paid on account of any rate of tax levied includes and shall be deemed always to have included any sum eligible for relief of tax under s. 90 or, as the case may be, deduction from the Indian income-tax payable under s. 91.*
>
> ***Explanation 2 : For the removal of doubts, it is hereby declared that for the purposes of this sub-clause, any sum paid on account of any rate of tax levied includes any sum eligible for relief of tax under s. 90A.*
>
> ***Inserted w.e.f. 1st April, 2006, vide Finance Act, 2006*
>
> *Sec. 2(43)—In this Act, unless the context otherwise requires—*
>
> *"tax" in relation to the assessment year commencing on the 1st day of April, 1965, and any subsequent assessment year means income-tax chargeable under the provisions of this Act, and in relation to any other assessment year income-tax and super-tax chargeable under the provisions of this Act prior to the aforesaid date;"*

13. Let us now address ourselves to the web of legal arguments in support of this claim of deduction, in respect of taxes paid abroad, made by the assessee. The case

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of the assessee is that taxes paid abroad are paid for the purposes of business, and as such deductible under s. 37(1) which provides that, "any expenditure (not being expenditure of the nature described in ss. 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession". It is contended that the taxes paid are inherently in the nature of expenses incurred for the purposes of business but these are not allowable as deduction because of the specific bar placed under s. 40(a)(ii). However, according to the assessee, the restriction placed under s. 40(a)(ii), in computation of income from business and profession, refers to only 'tax' but the said expression, in view of definition of the expression 'tax' under s. 2(43), covers only "income-tax chargeable under the provisions of this Act (i.e. IT Act, 1961)", and, as a corollary thereto, this limitation on deduction of tax does not extend its scope to taxes paid other than under IT Act, 1961.

14. The above claim of deduction has been approved by the Co-ordinate Benches, for the first time in the asst. yr. 1976-77, and which has also been followed by another Co-ordinate Bench, vide order dt. 23rd Oct., 1984—a copy of which was also filed before us. This decision has been followed by the Co-ordinate Benches since then. It has been noted in this order that "there is no finding that local taxes (abroad) were assessed on a proportion of the profits i.e. consultancy fees received". When CIT sought a reference under s. 256(1), for esteemed views of Hon'ble Bombay High Court and against this order on the question of deductibility of local taxes paid abroad, the Tribunal declined the reference and, inter alia, observed that "the question is one of the facts", that "the tax deducted is a local tax and not a tax on profits" and that "foreign tax is not covered by the provisions of s. 40(a)(ii)". Hon'ble High Court also declined CIT's prayer for reference under s. 256(2) and the order of the Tribunal thus received finality. This decision has been consistently followed over the decades. However, in the lead decision cited before us, there is a categorical observation to the effect that "the tax deducted is a local tax and not a tax on profits", whereas in the present case it is an undisputed position that the tax levied abroad, being income-tax, is a tax on profits of the assessee—whether on presumptive basis or on the basis of actual profits earned by the assessee. Obviously, therefore, a decision in the context of 'local tax' not in the nature of tax on profits will have no application on these facts. It is also important to take note of amendment in law by inserting Expln. 1 to s. 40(a)(ii) which provides that, "for the removal of doubts, it is hereby declared that for the purposes of this sub-clause, any sum paid on account of any rate or tax levied includes and shall be deemed always to have included any sum eligible for relief of tax under s. 90 or, as the case may be, deduction from the Indian income-tax payable under s. 91". It cannot, therefore, be said that a foreign tax, in respect of which relief is eligible under s. 90 or s. 91, is not covered by the scope of expression 'tax' in s. 40(a)(ii).

15. In any event, the scope of expression 'tax' has to be considered in the context of s. 40(a)(ii), and in harmony with the scheme of things as envisaged in the IT Act. A lot of emphasis has been placed on definition of 'tax' in s. 2(43), but, like any other definition clause in the Act, all definitions are subject to the rider that only 'unless the context otherwise requires' these definitions hold the field. It thus follows that these definitions cannot be viewed on standalone basis in isolation with the context in which the expressions so defined are set out. The underlying principle of this approach is that the statutory definitions cannot be applied everywhere, de hors the context in which these expressions are employed, on 'one size fits all' basis, exalting

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these definitions into a prison house of obduracy, regardless of the varying circumstances in which, and myriad developments around which, these definitions are used. Hon'ble Supreme Court, in the case of K.P. Varghese vs. ITO & Anr. (1981) 24 CTR (SC) 358 : (1981) 131 ITR 597 (SC), has held that the task of interpretation is not a mechanical task and, quoted with approval, Justice Hand's observation that "it is one of the surest indexes of a mature and developed jurisprudence not to make a fortress out of the dictionary but to remember that statutes always have some purpose or object to accomplish, whose sympathetic and imaginative discovery is the surest guide to their meaning". Their Lordships further observed that, "we must not adopt a strictly literal interpretation of ... but we must construe its language having regard to the object and purpose which the legislature had in view in enacting that provision and in the context of the setting in which it occurs" and that "we cannot ignore the context and the collection of the provisions in which ....., appears, because, as pointed out by Judge Learned Hand in the most felicitous language : interpret '. . .the meaning of a sentence may be more than that of the separate words, as a melody is more than the notes, and no degree of particularity can ever obviate recourse to the setting in which all appear, and which all collectively create . ..'" One of the things which is clearly discernible from the above observations of their Lordships is that while interpreting the statutes, one has to essentially bear in mind the context and underlying scheme of the legislation in which the words are set out. Keeping these discussions in mind, let us see the context in which expression 'tax' is used in s. 40(a)(ii) which provides that "any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains" cannot be allowed as a deduction in computation of income from business or profession. The underlying principle in this provision is that a tax which is levied on the income of the assessee is an appropriation of income, representing State's share in the income of the assessee, and not a charge on income. In the case of Lubrizol India Ltd. vs. CIT (1991) 93 CTR (Bom) 237 : (1991) 187 ITR 25 (Bom), Hon'ble Bombay High Court has observed that, "As held in a number of decisions income-tax is a Crown's or Central Government's share in the profits of a company". In other words thus, income-tax represents State's share in income of a subject. The principle of income-tax being an appropriation of income rather than a charge on income is also in harmony with the views expressed by Hon'ble Bombay High Court, in the case of S. Inder Singh Gill vs. CIT (1963) 47 ITR 284 (Bom) wherein their Lordships took note of this Tribunal's findings to the effect that "We (the Tribunal) are not aware of any commercial practice or principle which lays down that tax paid by one on one's income is a proper deduction in determining one's income for the purpose of taxation", and approved the same by observing that "no good reason has been shown to us to differ from the conclusion to which the Tribunal has reached". It is thus clear that in the esteemed views of Hon'ble jurisdictional High Court, taxes paid abroad do not constitute admissible deduction under s. 37(1). Incidentally, these observations were in the context of overseas income-tax paid by the assessee, i.e. in Uganda in that case. Learned counsel's reliance on definition of tax under s. 2(43), in the context of disallowance under s. 40(a)(ii), is thus of no help to the assessee. In Lubrizol's case (supra), Hon'ble Bombay High Court took note of the wording of s. 40(a)(ii) and disagreed with the assessee's contention that the expression 'tax' is restricted to 'income-tax' as defined under s. 2(43). While doing so, their Lordships, inter alia, observed as follows :

> *"It is significant to note that the word 'tax' is used in conjunction with the words 'any rate or tax'. The word 'any' goes both with the rate and tax. The expression is further qualified as a rate of tax levied on the profits or gains of*

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any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains. If the word 'tax' is to be given the meaning assigned to it by s. 2(43), the word 'any' used before it will be otiose and the further qualification as to the nature of levy will also become meaningless. Furthermore, the word 'tax' as defined in s. 2(43) of the Act is subject to "unless the context otherwise requires". In view of the discussion above we hold that the word 'any' tax herein refers to any kind of tax levied or leviable on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains."

16. Hon'ble Bombay High Court's judgment in Lubrizol India Ltd. (supra) which holds that the meaning of expression 'tax' cannot be restricted to the definition of 'tax' was delivered on 11th July, 1990, and, to that extent, Tribunal's decision dt. 23rd Oct., 1984, in assessee's own case for the asst. yr. 1976-77 and which has been followed in all other assessment years, is no longer good law. None of the subsequent decisions of the Tribunal, which merely followed the said order, had an occasion to deal with the law so laid down by their Lordships. It needs hardly be stated that mere rejection of reference by the Hon'ble High Court does not amount to approval of the views of the Tribunal. As against this rejection of reference, which is sought to be construed as implied approval of Tribunal's analysis, there is a direct decision by the Hon'ble High Court holding that definition of tax under s. 2(43) is not relevant for the purpose of s. 40(a)(ii). With respect, instead of following the Co-ordinate Bench in such circumstances, we have to yield to the higher wisdom of the Hon'ble Courts above.

17. The situation before us is also quite unique in the sense that in none of the decisions cited before us, the assessee has claimed double taxation relief under s. 90 or s. 91, and, in addition to such a relief having been claimed, the assessee has also claimed deduction in computation of business income in respect of the taxes so paid. This is clearly double 'double taxation relief' to the assessee whereas in fact there is no double taxation at all to the extent assessee's income from exports of software was held to be eligible for deduction under s. 80HHE in India. What does it lead to ? It leads to, for example, a situation that the taxes paid in US are being sought to be offset against assessee's tax liability in respect of domestic incomes, and in addition to the same, the taxes paid in USA are also being sought to be deducted from assessee's taxable income in India. The net result of this claim is that, as we have seen in para 11 above, that the assessee is claiming a weighted deduction of 1.38 times the tax paid in USA from income-tax liability in respect of other incomes. Even in a situation in which tax relief is confined to a situation in which the same has been actually taxed in India, the relief will be available against tax liability in respect of other incomes to the extent of 38.5 per cent of taxes paid abroad. The scheme of the Act does not visualize this kind of an undue relief to the assessee which provides much greater relief than the hardship caused to the assessee. The hardship is of double taxation of an income in more than one tax jurisdiction, and the relief must not go beyond mitigating this hardship; it cannot be turned into an undue advantage, or source of income, to the assessee. Sec. 91 restricts the double taxation relief only to such amount as may have been paid by the assessee in excess of his income-tax obligations in India. Similarly, in terms of the provisions of tax treaties which are entered into under s. 90, tax credits, in respect of taxes paid abroad, are restricted to assessee's domestic tax liability in respect of the subject income as was held by this Tribunal in the case of Jt. CIT vs. Digital Equipments India Ltd. (2005) 93 TTJ (Mumbai) 478 : (2005) 94 ITD 340 (Mumbai). If we are to hold that the assessee is entitled to deduction of tax paid abroad, in

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addition to admissibility of tax relief under s. 90 or s. 91, it will result in a situation that on one hand double taxation of an income will be eliminated by ensuring that the assessee's total income-tax liability does not exceed income-tax liability in India or income-tax liability abroad—whichever is greater, and, on the other hand, the assessee's domestic tax liability will also be reduced by tax liability in respect of income decreased due to deduction of taxes. Such a benefit to the assessee is not only contrary to the scheme of the Act and contrary to the fundamental principles of international taxation, it also ends up making double taxation relief a mechanism to reduce domestic tax liability in India—something which is most incongruous. In our considered view, an interpretation which leads to such glaring absurdities cannot be adopted.

18. Learned counsel has also submitted that in the event of our declining the deduction, we should at least direct that tax credit in terms of the provisions of s. 90 be granted in respect of the entire amount. Learned counsel submits that this approach is justified in as much as we must take into account right to tax, rather than the actual levy of tax. In our considered view, however, the right to tax is relevant only for the purpose of allocation of taxing rights, as was held by this Tribunal in the case of Asstt. Director of IT vs. Green Emirate Shipping & Travels (2006) 99 TTJ (Mumbai) 988 : (2006) 100 ITD 203 (Mumbai), and not for the purposes of granting tax credits. Being granted tax credits in excess of the actual domestic tax liability would result in a situation that even when assessee has no tax liability in India, he is to be allowed credit in respect of entire taxes paid in US, and thus perhaps even entitling him to refund in India in respect of taxes paid in USA. That is clearly contrary to the scheme of tax credit under the applicable tax treaty. In any event, this issue is, however, covered against the assessee by Tribunal's decision in the case of Digital Equipment (supra), wherein the Co-ordinate Bench, speaking through one of us, has observed as follows :

> *"4. We consider it useful to reproduce the text of art. 25(2)(a) of the Indo-US DTAA which is as follows :*
>
> *'Where a resident of India derives income which, in accordance with the provisions of this Convention, may be taxed in the United States, India shall allow a deduction from the income of that resident an amount equal to income-tax paid in the Unites States, whether directly or by way of deduction. Such deduction shall however not exceed that part of income-tax (as compute before the deduction is given) which is attributable to the income which is taxed in the United States.'*
>
> *A plain reading of the above provision makes it clear that the deduction on account of income-tax paid in the US, from income-tax payable in India, cannot exceed Indian income-tax liability in respect of such an income. This restriction on the deduction is unambiguous and beyond any controversy, as evident particularly from the last sentence in art. 25(2)(a) which is italicized as above the supply the emphasis on the same. As a matter of fact, we are unable to appreciate any basis whatsoever for the CIT(A)'s conclusion that the taxes paid in the US, in the instant case, are to be credited to the assessee's account and are to be refunded to the appellant, in case he has no income-tax liability in respect of that income in India. As for the CIT(A)'s observation, referring to payment of income-tax in the United States on an income and returning a loss in respect of that income in India, to the effect that "this is an absurd situation and was not visualized by the treaty", it cannot*

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but stem from his inability to take note of the fact that certain incomes (e.g., royalties, fees for technical or included services, interest, dividends etc.), are taxed on gross basis in the source country but are only be taxed on net basis, as is the inherent scheme of income-tax legislation normally, in the country of which the assessee is resident. In such situations, it is quite possible that while an assessee pays tax in the source country which is on gross basis, he actually ends up incurring loss when all the admissible deductions, in respect of that earning, are taken into account. There is nothing absurd about it. The underlying philosophy of the source rule on gross basis, which prescribes taxation of certain incomes on gross basis in the source country, is that irrespective of actual overall profits and losses in earning those incomes, the assessee must pay a certain amount of tax, at a negotiated lower rate though, in the country in which the income in question is earned. It is also noteworthy that the heading of art. 25 is "Elimination of double taxation" but then there has to be double taxation of an income in the first place before the question of elimination of that double taxation can arise. In the case before us the assessee company has paid taxes, in respect of that earning, only in one country, i.e., the United States, and claimed losses, on taking into account the admissible deductions therefrom, in the other country i.e., India. This is surely not, by any stretch of logic, a case of double taxation of an income. Article 25 does not, therefore, come into play at all. Turning to the CIT(A)'s observation that "the treaty nowhere stipulates that the credit for the taxes paid in the USA has to be given on proportionate basis", all we need to say is that the Indo-US DTAA, as indeed other DTAAs as well, does stipulate that the foreign tax credit cannot exceed the income-tax leviable in respect of that income in the country of which the assessee is resident. It is because of this limitation that the AO declined the refund in respect of taxes paid by the assessee in the United States. In view of this limitation on the foreign tax credit, the innovative theory of crediting the entire tax paid in the US to the assessee and grant of refund to him in case there is no tax liability in India in respect of that income, as enunciated and adopted by the CIT(A), is wholly unsustainable in law. Where is the question of refund of taxes paid abroad when FTD (i.e., foreign tax credit), in view of specific provisions to that effect in the DTAAs, cannot even exceed the Indian income-tax liability ? It is not the tax payment abroad which is the material figure for the purpose of computing Indian income-tax liability, but it is the admissible foreign tax credit in respect of the same which affects such an Indian income-tax liability. The FTD in respect of income-tax paid in the US cannot exceed the Indian income-tax liability in respect of the income on which income-tax is paid in US."

19. In view of the aforesaid judicial precedent, and being in considered agreement with the same, we reject this alternate claim of the assessee.

20. Learned counsel has also contended that in any event, we must allow deduction in respect of State income-taxes paid in USA and Canada as relief is not admissible in respect of the same in respective tax treaties. We have been taken through India USA tax treaty to point out that tax credits are admissible only in respect of income-tax levied by the Federal Government and not by the State Governments. It is contended that since no relief is admissible in respect of State taxes under s. 90 or s. 91, these taxes will continue to be tax deductible, and to that extent, decisions of the Co-ordinate Benches will hold good. We are unable to see legally sustainable merits in this submission either. Apart from the fact that such a claim of deduction is clearly contrary to the law laid down by Hon'ble jurisdictional High Court in Lubrizol's case

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(supra), there is another independent reason to reject this claim as well. The reason is this. It is only elementary that tax treaties override the provisions of the IT Act, 1961, only to the extent the provisions of the tax treaties are beneficial to the assessee. In other words, a person cannot be worse off vis-a-vis the provisions of the IT Act, even when a tax treaty applies in his case. Sec. 90(2) States that even in relation to the assessee to whom a tax treaty applies "the provisions of this Act shall apply to the extent they are more beneficial to that assessee". Undoubtedly, title of s. 91 as also reference to the countries with which India has entered into agreement, suggests that it is applicable only in the cases where India has not entered into a DTAA with respective jurisdiction, but the scheme of the s. 91, read along with s. 90, does not reflect any such limitation, and s. 91 is thus required to be treated as general in application. The scheme of the IT Act is to be considered in entirety in a holistic manner and each of the section cannot be considered on standalone basis. It is important to bear in mind the fact that so far as s. 91 is concerned, it does not discriminate between taxes levied by the Federal Governments and taxes levied by the State Government. The income-tax levied by different States in USA usually ranges from 3 per cent to 11 per cent, and the aggregate income-tax paid by the assessee in USA will range from 38 per cent to 46 per cent. Therefore, on the facts of the present case and bearing in mind the fact that the Federal income-tax in USA at the relevant point of time was lesser in rate at 35 per cent vis-a-vis 38.5 per cent income-tax rate applicable in India, the admissible double taxation relief under s. 91 will be higher than relief under the tax treaty. It will be so for the reason that State income-tax will also be added to income-tax abroad, and the aggregate of taxes so paid will be eligible for tax relief—of course subject to tax rate on which such income is actually taxed in India. The tax relief under s. 91 thus works out to at least 38 per cent, as against tax credit of only 35 per cent admissible under the tax treaty. In such a situation, the assessee will be entitled to relief under s. 91 in respect of Federal as well as State taxes, and that relief being more beneficial to the assessee vis-à-vis tax credit under the applicable tax treaty, the provisions of s. 91 will apply to State income-taxes as well. The State income-tax is also, therefore, covered by Expln. 1 to s. 40(a)(ii), and deduction cannot be allowed in respect of the same. Finally, in view of Hon'ble Bombay High Court's judgment in Gill's case (supra), income-tax abroad cannot be allowed as a deduction in computation of income and this judgment does not discriminate between Federal and State taxes either. Interestingly, State income-taxes paid in USA, subject to certain limitations, are deductible in computation of income for the purposes of computing Federal tax liability in USA, but that factor cannot influence deductibility of these taxes, particularly in the light of the provisions of Expln. 1 to s. 40(a)(ii) and in the light of Hon'ble Bombay High Court's judgment in Gill's case (supra), in computation of business income under Indian IT Act. For all these reasons, we are unable to uphold the plea of the assessee seeking deduction of at least State income-tax paid in USA.

21. In view of the above discussions and for the detailed reasons set out above, we uphold the grievance of the AO. The CIT(A) was indeed not justified in deleting the disallowance of Rs. 67,89,30,514 in respect of income-tax paid abroad. We vacate the relief granted by the CIT(A) and restore this disallowance.

36. Oblivious of the judicial precedents discussed above, another bench of this Tribunal, in the case of Mastek Ltd *(supra),* however, touched a different chord. This bench was of the view that deduction in respect of taxes paid abroad can be allowed as a deduction under section 37(1). In coming to this conclusion, bench did not take note of the Lubrizol decision (supra) by Hon'ble Bombay High Court, which stands specifically approved by Hon'ble Supreme Court in the case of Smimthkline and

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French India *(supra),* or even of the coordinate bench decision in the case of Tata Sons *(supra).* The coordinate bench did refer to the High Court decisions in the cases of Tata Sons Ltd and South East Asia Shipping, but these decisions were rejecting the reference applications under section 256(2) thus lending finality to the decisions of the Tribunal which, in any case, were rendered ineffective in the light of subsequent decision of Hon'ble Bombay High Court in Lubrizol's case. The coordinate bench decision in the case of Tata Sons *(supra),* as we have seen earlier in this order, specifically held so. Even if there were contrary views of the Tribunal at that point of time, and even if the coordinate bench had any reservations on correctness of Tata Sons decision *(supra)* by another coordinate bench, the matter could have been at best referred to a Special Bench. However, neither any of the parties brought these decisions to the knowledge of the bench, nor did the bench know about these decisions. It was thus, in ignorance about these significant developments, the coordinate bench, in Mastek's case *(supra),* has observed as follows:

> *39. Due consideration of the provisions of sec.37 and sec.40(a)(ii) of the Act as well, it emerges that u/s 37, all taxes and rates are allowable irrespective of the place where they are lived i.e., whether on Indian soil or offshore, whereas u/s 40(a)(ii) of the Act, income-tax which is a tax leviable on the profits and gains chargeable under the Act is deductible. On the other hand, all other taxes levied in foreign countries whether on profits or gains or otherwise are deductible under the provisions of sec. 37 of the Act and payment of such taxes does not amount to application of income.*
>
> *40. Let us now have a glimpse at the judicial views on a similar issue.*
>
> *(i) South East Asia Shipping Co. ITA No.123 of 1976 - Mumbai Tribunal:*
>
> *The issue, in brief, was that the tax authorities of the respective country had collected income-tax at source, according to them, a part of such earnings accrued and arose in their countries which were liable to income-tax under its taxing laws. Such foreign tax claimed as a deduction by the assessee was turned down by the AO. This was reversed by the AAC with a reasoning that the 'payment of foreign income-tax formed part of the expenditure like other usual business expenses incurred in the course of business and as such, the assessee was entitled to claim deduction of the same u/s 37 of the Act for being incurred wholly and exclusively for the purpose of business.'*
>
> *On a further appeal, the Tribunal had, after due consideration of the provisions of both the sections - 37 which allows a business expenditure and 40(a)(ii) which contained prohibition -as under:*
>
> > *'40(a)(ii) - any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains'*
>
> *The Tribunal observed that the term 'tax' is defined in relation to the AY commencing on the 1st day of April, 1965 and in subsequent assessment years as meaning tax chargeable under the provisions of the Act and that this amendment was effected by the Finance Act 1965. taking cognizance of it, the Hon'ble Tribunal had held that 'any sum paid on account of any rate or income tax and super-tax chargeable under the provisions of the Income-tax Act' is expressly disallowed by this clause (ii) of sec. 40(a).*
>
> *Accordingly, the Hon'ble Tribunal observed with regard to the allowability of foreign*

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taxes u/s 37 of the Act as under:

> *"So we have to see whether such expenditure is allowable under section 37 of the Act. In our view, rates and taxes which are payable irrespective of any profits being earned are admissible allowances under section 37 and section 40(a)(ii) does not apply to them. The tax levied by different countries is not a tax on profits but a necessary condition precedent to the earning of profits. So the AAC was absolutely justified in allowing the appeal of the assessee and we see no reason to differ from the finding."*

Reference application of the Revenue was rejected by the Tribunal which has been ratified by the Hon'ble Bombay High Court in ITA NO.123 OF 1976.

(ii) In the case of Tata Sons Ltd. [ITA NO.89 OF 1989], the Hon'ble Mumbai Bench of Tribunal had held on a similar issue that:-

> *"It is an established principle that when a matter is settled by higher courts in a case of a particular assessee, at least in that case litigation cannot be allowed to perpetuate for an indefinite period. In the instant case, the issue is not only settled in favour of the assessee in its own case by the Tribunal in ITA Nos. 5708/Mum/82 and 5790/Mum/83 dated 23.10.82, but even after rejection of Revenue's Application under section 256(1) in RA Nos.305 AND 306/Bom/85 dated 14.1.86, its application under section 256(2) on the issue has been rejected by the High court by its order dated 29/3/93 in ITA No.89 of 1989. thus, the issue has reached finality in the assessee's own case and it cannot be dragged into further litigation."*

41. Taking into account all these facts and circumstances of the issue and in consonance with the findings of the Hon'ble Benches of Mumbai Tribunal (supra), we are of the firm view that the learned CIT (A) was justified in his stand which requires no interference of this Bench at this juncture. It is ordered accordingly.

37. The views so taken by the coordinate bench, however, are not only diametrically opposed to an earlier decision of another coordinate bench in the case of **Tata Sons** *(supra),* as reproduced earlier, and of Hon'ble Bombay High Court's decision in the case of **Lubrizol India** *(supra)* but also clearly contrary to certain observations a later judgment of Hon'ble Bombay High Court in the case of **Reliance Infrastructure Ltd vs CIT [TS 676 HC 2016 (BOM)]** wherein Their Lordships have, *inter alia*, observed as follows:

> *We have considered the rival submissions. So far as the question relating to the Tribunal not following its order in the case of the applicant itself for A.Y. 1979-80, we find that there is a justification for the same. This is so as the decision of this Court in Inder Singh Gill (supra) was noted by the Tribunal on an identical issue while passing the order for the subject assessment year. Thus, the Tribunal had not erred in not following its order for A.Y. 1979-80. In fact, the decisions of this Court in South East Asia Shipping Co.(supra) and Tata Sons Ltd. (supra), which are being relied upon in preference to Inder Singh Gill (supra) cannot be accepted as both the orders being relied upon by the applicant was rendered not at the final hearing but on applications under Section 256(2) of the Act and at the stage of admission under Section 260A of the Act. This unlike the judgment rendered in a Reference by this Court in Inder Singh Gill (supra). Moreover, the decision in South East Asia Shipping Co. (supra) is not available in its entirety. Therefore, it would not be safe to rely upon it as all facts*

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> *and on what consideration of law, it was rendered is not known. Similarly, the decision of this Court in Tata Sons (supra) being Income Tax Appeal No.209 of 2001 produced before us, dismissed the appeal of the Revenue by order dated 2nd April, 2004 by merely following its order dated 23rd March, 1993 rejecting the Revenue's application for Reference under Section 256(2) of the Act. Thus, it also cannot be relied upon to decide the controversy. Moreover, the order of this Court in Tata Sons Ltd. (supra) as produced before us for Assessment Year 1985-86 had not noticed the decision of this Court in Inder Singh Gill (supra) on a Reference. Therefore, it is rendered per incuriam.*
>
> **[Emphasis, by underlining, supplied by us]**

38. To the best of our knowledge there is no, and having done our necessary research on judicial precedent on these issues we do not find any, decision of any of Hon'ble High Courts which is contrary to the view so taken by Hon'ble Bombay High Court in Reliance Infrastructure's case *(supra).* Clearly, therefore, the coordinate bench, in Mastek Ltd's case *(supra),* was swayed by judicial precedents which, as held by Hon'ble Bombay High Court in the aforesaid case, are not really binding judicial precedents on the issue. There are direct decisions of Hon'ble Bombay High Court itself, in the case of Inder Singh *(supra)* and Lubrizol *(supra),* which, for the detailed reasons set out above by Hon'ble Bombay High Court, must be preferred over these decisions declining to admit reference applications under section 256(2), as it then existed.

39. Having said that, we may also point out that earlier decision of Hon'ble Bombay High Court in **Lubrizol's case** *(supra)* and the fact that it stands specifically approved by Hon'ble Supreme Court in the case of **Smithkline and French India** *(supra)* was not brought to the notice of Hon'ble Bombay High Court either. It was in this backdrop that Their Lordships further made the following observations in the case of **Reliance Infrastructure** *(supra):*

> ***It therefore, follows that the tax which has been paid abroad would not be covered with in the meaning of Section 40(a) (ii) of the Act in view of the definition of the word 'tax' in Section 2(43) of the Act. To be covered by Section 40(a)(ii) of the Act, it has to be payable under the Act.*** *We are conscious of the fact that Section 2 of the Act, while defining the various terms used in the Act, qualifies it by preceding the definition with the word "In this Act, unless the context otherwise requires" the meaning of the word 'tax' as found in Section 2 (43) of the Act would apply wherever it occurs in the Act. It is not even urged by the Revenue that the context of Section 40(a)(ii) of the Act would require it to mean tax paid anywhere in the world and not only tax payable/ paid under the Act.*
>
> **[Emphasis, by underlining, supplied by us]**

40. Ironically, there is no meeting ground between the observations so made by Hon'ble Bombay High Court and its earlier observations, in **Lubrizol's case** *(supra),* to the effect that "**If the word 'tax' is to be given the meaning assigned to it by s. 2(43), the word 'any' used before it will be otiose and the further qualification as to the nature of levy will also become meaningless**", which stand specifically approved by Hon'ble Supreme Court in the case of **Smithkline French India's case** *(supra)* nor, for that purpose, with Hon'ble Supreme Court's observations, in

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Smithkline French India's case *(supra),* to the effect that "**Firstly, it may be mentioned, s. 10(4) of the 1922 Act or <u>s. 40(a)(ii) of the present Act do not contain any words indicating that the profits and gains spoken of by them should be determined in accordance with the provisions of the IT Act</u>. <u>All they say is that it must be a rate or tax levied on the profits and gains of business or profession</u>. The observations relied upon must be read in the said context and not literally or as the provisions in a statute**…… Such a conflict, as it would appear to us, requires us to bow before the higher wisdom of Hon'ble Supreme Court and to that extent, remain completely uninfluenced by any observations, from any other judicial forum below Hon'ble Supreme Court, which come in conflict with the views so expressed by the Hon'ble Supreme Court. In any event, the views so expressed by the Hon'ble non-jurisdictional High Court are without the benefit of considering the impact of Hon'ble Supreme Court's decision in **Smithkline and French** *(supra)*.

41. Learned counsel for the assessee submits that the decision of Hon'ble Bombay High Court in the case of **Reliance Infrastructure** *(supra)* is directly on the issue of foreign tax credit while **Lubrizol's decision** *(supra)* and **Smithkline and French India** decision *(supra)* are in the context of surtax. These decisions, according to the learned counsel, have nothing to do with the question of deductibility of taxes paid abroad. The only direct decision on the issue is from Hon'ble Bombay High Court in the case of **Reliance Infrastructure** *(supra)* and that is in favour of the assessee. It is his argument that since there is no decision by the jurisdictional High Court to the contrary of what has been stated by Hon'ble Bombay High Court, **Reliance Infrastructure** *(supra)* decision is a binding precedent for us and we must follow the same. Any other approach, he very politely tells us, would be violate fundamental principles of judicial discipline and cannot, therefore, meet approval of Hon'ble Courts above. He reminds us that the Tribunal decision in the case of **Tata Sons** *(supra)* is authored by one of us and suggests, in very decorous manner- which is his hallmark anyway, that we should not become so attached to our labour of love that the cause of justice is sacrificed. We are thus urged to follow the **Mastek decision** *(supra)* **Reliance Infrastructure** decision *(supra)* in letter and in spirit. Learned counsel has then pointed out that the Explanations to Section 40(a)(ii) refer only such taxes paid outside India in respect of which relief under section 90 and 91 are available, and it cannot be open to extend the scope of what is covered by Explanations to Section 40(a)(ii).

42. Learned counsel's remarks are indeed thought provoking. We have to take a conscious call on the points made by him. As we do so, we must make it clear, though at the cost of stating the obvious, that whatever we say is, and shall always remain, what Hon'ble Courts above hold on this issue. In a way, therefore, we are writing on the sand fully aware that whatever we write, no matter how painstakingly we write, on this sand, will be washed away by a wave of judicial thought from Hon'ble Courts above. We are also alive to the fact that considering how significant this issue is it is only a matter of time that Hon'ble Courts above may have to take a call on it. Its ironically in this comfort of a very limited and short lived impact of our decision on this issue, we are taking this close call. Coming to the core issue, the

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argument before us is that for the purpose of section 40(a)(ii), the definition of ótaxô must be the same as is assigned to ótaxôunder section 2(43) of the Act. It is for this reason that tax paid outside India, not being tax levied under the Indian Income Tax Act, is said to be intact from the bar placed under section 40(a)(ii) of the Act. Section 40(a)(ii), it may be recalled, provides that ñ**any sum paid on account of any rate of tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains**ò shall not be allowed as a deduction, *inter alia,* under section 37(1) of the Act. The entire controversy before us is confined to the connotations of expression ñtaxò appearing in the aforesaid statutory provision. The question thus is as to what are the connotations of the expression ótaxôand the alternative approaches canvassed are that (a) the connotations of expression ótaxôappearing in the above provisions are controlled by definition under section 2(43) of the Act; (b) the connotations of the expression ótaxôappearing in the above provision extend to any tax, whether under the Income Tax Act, 1961 or not, as long as the tax is levied on the profits and gains of business, or assessed at a proportion of, or otherwise on the basis of, any such profits and gains. This controversy is evident from the following extracts from the various decisions, including the decision cited by the learned counsel of the assessee, as also from orders impugned in appeal before us:

(i) Mastek Ltd's decision by the coordinate bench, relied upon by the learned counsel:

*39. **Due consideration of the provisions of sec.37 and sec.40(a)(ii) of the Act as well, it emerges that u/s 37, all taxes and rates are allowable irrespective of the place where they are lived** i.e., whether on Indian soil or offshore, whereas **u/s 40(a)(ii) of the Act, income-tax which is a tax leviable on the profits and gains chargeable under the Act is deductible**. On the other hand, all other taxes levied in foreign countries whether on profits or gains or otherwise are deductible under the provisions of sec. 37 of the Act and payment of such taxes does not amount to application of income.*

40. Let us now have a glimpse at the judicial views on a similar issue.

(i) South East Asia Shipping Co. ITA No.123 of 1976 - Mumbai Tribunal:

The issue, in brief, was that the tax authorities of the respective country had collected income-tax at source, according to them, a part of such earnings accrued and arose in their countries which were liable to income-tax under its taxing laws. Such foreign tax claimed as a deduction by the assessee was turned down by the AO. This was reversed by the AAC with a reasoning that the 'payment of foreign income-tax formed part of the expenditure like other usual business expenses incurred in the course of business and as such, the assessee was entitled to claim deduction of the same u/s 37 of the Act for being incurred wholly and exclusively for the purpose of business.'

On a further appeal, the Tribunal had, after due consideration of the provisions of both the sections - 37 which allows a business expenditure and 40(a)(ii) which contained prohibition -as under:

> *'40(a)(ii) - any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains'*

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*The Tribunal observed that the **term 'tax' is defined in relation to the AY commencing on the 1st day of April, 1965 and in subsequent assessment years as meaning tax chargeable under the provisions of the Act** and that this amendment was effected by the Finance Act 1965. taking cognizance of it, the Hon'ble Tribunal had held that 'any sum paid on account of any rate or income tax and super-tax chargeable under the provisions of the Income-tax Act' is expressly disallowed by this clause (ii) of sec. 40(a).*

Accordingly, the Hon'ble Tribunal observed with regard to the allowability of foreign taxes u/s 37 of the Act as under:

> *"So we have to see whether such expenditure is allowable under section 37 of the Act. In our view, rates and taxes which are payable irrespective of any profits being earned are admissible allowances under section 37 and section 40(a)(ii) does not apply to them. The tax levied by different countries is not a tax on profits but a necessary condition precedent to the earning of profits. So the AAC was absolutely justified in allowing the appeal of the assessee and we see no reason to differ from the finding."*

Reference application of the Revenue was rejected by the Tribunal which has been ratified by the Hon'ble Bombay High Court in ITA NO.123 OF 1976.

……...

(ii) Reliance Infrastructure *(supra)* by Hon'ble Bombay High Court

We would have answered the question posed for our consideration by following the decision of this Court in Inder Singh Gill (supra). *However, we notice that the decision of this Court in Inder Singh Gill (supra) was rendered under the Indian Income Tax Act, 1922 and not under the Act. We further note that just as Section 40(a)(ii) of the Act does not allow deduction on tax paid on profit and/or gain of business. The Indian Income Tax Act, 1922 Act also contains a similar provision in Section 10(4) thereof.* ***However, the Indian Income Tax Act, 1922 contains no definition of "tax" as provided in Section 2(43) of the Act****. Consequently, the tax paid on income / profits and gains of business / profession anywhere in the world would not be allowed as deduction for determining the profits / gains of the business under Section 10(4) of the Indian Tax Act, 1922.* ***Therefore, on the state of the statutory provisions as found in the Indian Income Tax Act, 1922 the decision of this Court in Inder Singh Gill (supra) would be unexceptionable.***

However, the ratio of the aforesaid decision in Inder Singh Gill (supra) cannot be applied to the present facts in view of the fact that the Act defines "tax" as income tax chargeable under the provisions of this Act. *Thus, by definition, the tax which is payable under the Act alone on the profits and gains of business are not allowed to be deducted notwithstanding Sections 30 to 38 of the Act. It therefore, follows that the tax which has been paid abroad would not be covered with in the meaning of Section 40(a) (ii) of the Act* ***in view of the definition of the word 'tax' in Section 2(43) of the Act. To be covered by Section 40(a)(ii) of the Act, it has to be payable under the Act.*** *We are conscious of the fact that Section 2 of the Act, while defining the various terms used in the Act, qualifies it by preceding the definition with the word "In this Act, unless the context otherwise requires" the* ***meaning of the word 'tax' as found in Section 2 (43) of the Act would apply wherever it occurs in the Act.*** *It is not even urged by the Revenue that the context*

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of Section 40(a)(ii) of the Act would require it to mean tax paid anywhere in the world and not only tax payable/ paid under the Act.

(iii) Arguments of the assessee as noted in the assessment order and the CIT(A)'s order impugned in appeal before us

It is submitted that the taxes paid in foreign jurisdictions constituted expenditure laid out or expended wholly and exclusively for the purposes of the business or profession, and, therefore, deductible under section 37(1) of the Act. The deduction for withholding tax was an inevitable & if we do not agree for the same then we would not be able to carry out such business deal as well.

Further, the above expenditure is not covered under Section 40(a)(ii) hence it is duly allowed as an expenditure under section 37(1) of the Act. Section 40(a)(ii) provides that "any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains",;

"Tax" has been defined U/s.2(43) as "fax" in relation to the assessment year commencing on the 1st day of April, 1965, and any subsequent assessment year means income-tax chargeable under the provisions of this Act, and in relation to any other assessment year income-tax and super-tax chargeable under the provisions of this Act prior to the aforesaid date [and in relation to the assessment year commencing on the 1st day of April, 2006, and any subsequent assessment year includes the fringe benefit tax payable under section 115WA.

It is submitted that "tax" only includes taxes levied under Indian Income Tax Act, 1961 and foreign tax is out of the definition of 'tax" hence foreign tax paid will not be disallowed by virtue of Sec.40 (a)(ii).

Reliance is placed on following decided cases where it has been held that taxes paid in foreign country is an allowable expenditure U/s.37(1)

- *CIT vs. Tata Sons Ltd (ITA No. 89 of 1989) - Bombay high court rejected reference in 1993 for this matter hence its approved stand of high court that foreign tax credit is an allowable expenditure.*

- *CIT vs. South East Asia Shipping Co (ITA No.123 of 1976) - Bombay high court rejected reference of this matter as well.*

- *DCIT Vs. Mastek Limited (Ahmedabad Tribunal) - Jurisdictional tribunal decision delivered on 16m may 2012 which relied on above decision of Bombay High Court.*

The above contention of ETPL has been accepted by the learned Commissioner of Income-tax (Appeals) in ETPL's case for AY 2009-10. Copy of the said order is attached as Annexure 1A

[Emphasis, by underlining, supplied by us now]

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43. In the light of the above observations in judicial precedents relied upon by the learned counsel for the assessee, and in the light of extracts from the impugned orders, the core issue, in our considered view, is whether or not the meaning of expression ótaxô appearing in section 40(a)(ii) must remain confined to a tax levied under the Indian Income Tax Act, 1961. As a matter of fact, Hon'ble Bombay High Court, in the case of Reliance Infrastructure (supra), Their Lordships have gone to the extent of saying that but for definition of tax under section 2(43) ñ **We** *(Their Lordships)* **would have answered the question posed for our consideration by following the decision of this Court in Inder Singh Gill** *(supra)"* which was rendered in the context of the Income Tax Act, 1922, and added that **"the ratio of the aforesaid decision in Inder Singh Gill (supra) cannot be applied to the present facts in view of the fact that the Act (Income Tax Act, 1961) defines "tax" as income tax chargeable under the provisions of this Act"**. In our humble and sincere understanding, given these facts, it is not really possible for us to ignore the question as to what is the impact of Section 2(43) on connotations of expression ótaxô appearing in section 40(a)(ii), and when we address this question, we cannot be oblivious of the following guidance from Hon'ble Courts above:

(i) Hon'ble Bombay High Court in Lubrizol's case *(supra)*

With respect, this argument *[i.e. the definition of 'tax' under section 2(433) must hold the field]* **does not appeal to us.** It is significant to note that the word "tax'; is used in conjunction with the words "any rate or tax", The word "any" goes both with the rate and tax. The expression is further qualified as a rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains. **If the word "tax" is to be given the meaning assigned to it by s. 2(43) of the Act, the word "any" used before it will be otiose and the further qualification as to the nature of levy will also become meaningless.** Furthermore, the word "tax" as defined in s. 2(43) of the Act is subject to "unless the context otherwise requires". **In view of the discussion above, we hold that the words "any tax" herein refers to any kind of tax levied or leviable on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains**.

[Emphasis, by underlining, supplied by us now]

(ii) Hon'ble Supreme Court in Smithkline and French's case (supra) specifically approving the Lubrizol judgment

é é é ..**Firstly, it may be mentioned, s. 10(4) of the 1922 Act or s. 40(a)(ii) of the present Act do not contain any words indicating that the profits and gains spoken of by them should be determined in accordance with the provisions of the IT Act. All they say is that it must be a rate or tax levied on the profits and gains of business or profession. The observations relied upon must be read in the said context and not literally or as the provisions in a statute.** But so far as the issue herein is concerned, even this literal reading of the said observations does not help the assessee. As we have pointed out hereinabove the surtax is essentially levied on the business profits of the company computed in accordance with the provisions of the IT Act. Merely because certain further deductions [adjustments] are provided by the Surtax Act from the said profits, it cannot be said that the surtax is not levied upon the profits determined or computed in accordance with the provisions

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of the IT Act. Sec. 4 of the Surtax Act read with the definition of "chargeable profits" and the First Schedule make the position abundantly clear.
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We agree with the view taken by the High Courts of Calcutta [Molins (India) Ltd. vs. CIT (1983) 144 ITR 317 (Cal) and Brooke Bond (India) Ltd. vs. CIT (1992) 193 ITR 390 (Cal) : TC 15R.590], **Bombay** *(in)* **Lubrizol (India) Ltd. vs. CIT (1991) 187 ITR 25 (Bom) followed in several other decisions of that Court],** Karnataka [CIT vs. International Instruments Pvt. Ltd. (1983) 144 ITR 936 (Kar), Madras [Sundaram Industries Ltd. vs. CIT (1986) 159 ITR 646 (Mad), Andhra Pradesh [Vazir Sultan Tobacco Co. Ltd. vs. CIT (1988) 169 ITR 35 (AP)], Rajasthan [Associated Stone Industries Co. Ltd. vs. CIT (1988) 170 ITR 653 (Raj)], Gujarat [S.L.M. Maneklal Industries Ltd. vs. CIT (1988) 172 ITR 176 (Guj) followed in several cases thereafter], Allahabad [Himalayan Drug Co. Pvt. Ltd. vs. CIT (1996) 218 ITR 346 (All)] and Punjab & Haryana High Court [Highway Cycle Industries Ltd. vs. CIT (1989) 178 ITR 601 (P&H) : TC 17R.807].

44. We are therefore of the considered view that the plea of the assessee does not merit legal acceptance. No doubt it is a close call but within our limitation of knowledge and wisdom, we sincerely believe that the plea of the assessee must be rejected. To put a question of ourselves, can it be open to us to hold that the meaning of expression ótaxô under section 40(a)(ii) will be fettered by the definition of tax under section 2(43), so far as the question of credit for taxes abroad is concerned, even though Honôble Supreme Court notes, in the case of **Smithkline French** *(supra),* that **"s. 40(a)(ii) of the present Act do not contain any words indicating that the profits and gains spoken of by them should be determined in accordance with the provisions of the IT Act. All they say is that it must be a rate or tax levied on the profits and gains of business or profession".** We, therefore, do not think we have the liberty of taking the view that learned counsel is urging us to take.

45. In any case, Honôble Bombay High Courtôs judgment in the case of Reliance Infrastructure (supra) proceeds on peculiar facts and a sort of concession by the revenue inasmuch as it was not the case of the revenue that context in which the expression ótaxô is used in section 40(a)(ii) requires a meaning different from the meaning assigned by Section 2(43). This is evident from the observations made by Their Lordships to the effect that ñ**We are conscious of the fact that Section 2 of the Act, while defining the various terms used in the Act, qualifies it by preceding the definition with the word "In this Act, unless the context otherwise requires" the meaning of the word 'tax' as found in Section 2 (43) of the Act would apply wherever it occurs in the Act. It is not even urged by the Revenue that the context of Section 40(a)(ii) of the Act would require it to mean tax paid anywhere in the world and not only tax payable/ paid under the Act**ò. That was not the situation before us. The very thrust of stand of the revenue was that the connotations of expression ótaxô in section 40(a)(ii) must be taken in its contextual meaning which extends to any tax ascertainable with reference to the profits of the assessee as evident from the wordings of section which refer to ñ**any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains**ò, and that its connotations cannot be treated as restricted to tax under the Income Tax Act.

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This argument, in the context of deduction in respect of tax outside Income Tax Act, 1961, has already met the approval of Hon'ble Supreme Court. The law laid down by Hon'ble Supreme Court binds all of us under Article 141 of the Constitution of India. Once we are aware about a particular position that Hon'ble Supreme Court has taken, it is not open to us to reach a conclusion which is, or can be perceived as, in defiance to the position taken by Hon'ble Supreme Court. Maybe, if the views expressed were by our jurisdictional High Court, or by any of Hon'ble High Courts after taking into account the views expressed by Hon'ble Supreme Court on that issue, things may have been little different, but that is not the case here.

46. In view of these discussions, the correctness of our reliance on **Tata Sons decision** *(supra)* is no more than academic. As for the fact that **Tata Sons decision** *(supra)* is by one of us, merely because it is authored by one of us, we cannot ignore it either. It is as much of a binding judicial precedent as much any other decision of the Tribunal decision which is not *per incuriam.*

47. In our considered view, Mastek Ltd decision *(supra)* by the coordinate bench is a *per incuriam* decision for the reason that it was rendered without taking into account an earlier decision by a bench of equal strength on the same issue in the case of Tata Sons *(supra),* as learned representatives appearing before the said bench did not bring this judicial precedent to their notice. In the case of **Punjab Land Development and Reclamation Corpn. Ltd. vs. Presiding Officer, Labour Court (1990) 3 SCC 682; (1990) 77 FJR 17 (SC)** Hon'ble Supreme Court explained the expression 'per incuriam' thus (at p. 36 of 77 FJR) : "**The Latin expression '*per incuriam*' means through inadvertence. A decision can be said generally to be given per incuriam when the Supreme Court has acted in ignorance of a previous decision of its own or when a High Court has acted in ignorance of a decision of the Supreme Court.'** *A fortiori,* a decision of the Tribunal unmindful of its earlier decision(s) on the same issue is also a *per incuriam* decision. Of course, if the subsequent decision had considered the earlier decision and yet differed from the conclusion, the situation would have been materially different. The only reason we have preferred Tata Sons decision *(supra)* over **Mastek decision** *(supra),* both of which are decisions from benches of equal strength, is that the latter was delivered in ignorance of earlier decisions in the cases of **Tata Sons** *(supra)* and **Lubrizol India** *(supra).*

48. A *per incuriam* decision, as noted by several binding judicial precedents, including, for example, in the case of **CIT Vs B R Constructions [(1979) 222 ITR 202 AP Full Court],** ceases to be a binding judicial precedent. As observed by the Full Bench of Hon'ble AP High Court in this case, "**It may be noticed that precedent ceases to be a binding precedent— (i) if it is reversed or overruled by a higher Court, (ii) when it is affirmed or reversed on a different ground, (iii) when it is inconsistent with the earlier decisions of the same rank, (iv) when it is sub silentio, and (v) when it is rendered per incuriam"**. Nothing, therefore, turns on Mastek decision by the coordinate bench. Learned counsel has then invited our attention to the fact that the said decision in Mastek's case (supra) is now pending for consideration before Hon'ble jurisdictional High Court, as Their Lordships have, vide order dated 14th March 2013 in TA No. 826 of 2012, have

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admitted the appeal, *inter alia*, on the question ñ**whether the Appellate Tribunal has substantially erred in deleting the disallowance under section 40(a)(ii) in respect of Rs 42,57,297 paid as Belgium Tax claimed as deduction under section 37(1) of the Act**ò In our considered view, nothing turns on this argument either, since the pendency of matter before Hon'ble jurisdictional High Court acts as a bar only on the constitution of a special bench of this Tribunal, as was held in the case of **General Motors India Pvt Ltd Vs ACIT [TS-640 -ITAT-2016-Ahd-TP],** and not otherwise. In any event, once a judicial precedent is held to be *per incuriam* the pendency of appeal against such a *per incuriam* judicial precedent cannot convert it into a binding precedent.

49. Coming to the scope of Explanations to Section 40(a)(ii), on which learned counsel for the assessee has relied upon so much, we may only add that if the main provision, as is the claim of the learned counsel, does not cover the taxes paid abroad, there cannot be any occasion to include, under Explanations to Section 40(a)(ii), taxes in respect of which relief under section 90 and 91 is not admissible. These Explanations donot extend the scope of the Section 40(a)(ii) but rather explain the scope of the said section. If something is covered by the Explanation, it cannot be said that it is not covered by the main provision. If taxes in respect of which tax credit under section 90 or 91 are covered by the proviso, these are covered by the scope of Section 40(a)(ii) as well. And if these taxes are covered by Section 40(a)(ii), the theory that meaning of ótaxôunder section 40(a)(ii) must remain confined to the taxes levied under Income Tax Act, 1961 comes to a naught since the taxes in respect of which credits are available under section 90 or 91 cannot be, under any circumstances, imposed under the Indian Income Tax Act. The argument of the learned counsel, if we have understood it correctly, is devoid of, in our considered view, legally sustainable merits.

50. In view of the above discussions, we are of the considered view that no deduction under section 37(1) can be allowed in respect of any income tax withheld abroad as the same will be, for the detailed reasons set out above, hit by the disabling provisions under section 40(a)(ii) of the Act. The relief granted by the CIT(A), by directing the grant of deduction of Rs.52,50,507 in respect of income tax withheld abroad in respect of which no foreign tax credit is admissible, under section 37(1) of the Act must, therefore, stand vacated. We direct so. We further direct that, as a result of our directions earlier in this order, in the event of assessee being allowed only partial tax credit in respect of taxes withheld abroad, the assessee cannot be allowed any deduction, in respect of the balance of the taxes so withheld abroad, under section 37(1) of the Act.

51. As we conclude our adjudication on this issue, we must say that we are not very happy with the position that we are placed in, which was wholly avoidable only if all the judicial precedents really relevant to the issues were duly mentioned before the respective judicial forums. Nothing prevented the revenue authorities from inviting attention of the coordinate bench to earlier decision by another coordinate bench, on the same issue, in favour of the revenue- particularly when it was in public domain and reported by tax journals and websites. Undoubtedly, it was even then

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open for the bench to agree with this or disagree with this decision, and there were options available to them in case the coordinate bench was to disagree, but a conscious call anyway could have been taken. The same is the position with respect to Lubrizol decision which was dealing with the same expression appearing in the same statutory provision, and was approved by Hon'ble Supreme Court. It was also a well reported decision and it could have been easily located and brought to the notice of Their Lordships. It was for the respective judicial forum to take a conscious call on whether this decision will hold good for the connotations of expression 'tax' in the context of section 40(a)(ii), in the context of surtax only, or will also extend to the connotations of 'tax' for the purpose of foreign tax in the context of section 40(a)(ii), but someone should at least have pointed out all the relevant, including Lubrizol and Tata Sons, decisions. Perhaps we cannot hold learned counsel for the assessee responsible for this situation, as it will perhaps be too utopian to expect such an unrealistic degree of fairness in the conduct of the assessees. It is not for them, as they would certainly argue, to find out every conceivable argument in support of the revenue authorities and to demonstrate that such arguments are unsustainable in law. It may also not always be possible for the departmental representatives, who are primarily tax administrators, to adequately conduct such a detailed research, in limited time available to them- sometimes in less than a working day and that too without much of a research assistance and without adequate support machinery. As a specialized forum, the expectations about our awareness and expertise levels may be high but there are certain practical constraints. Any efforts to conduct our own extended independent research, in each case, may not be practical or even welcome either as it may be perceived to be infringing our neutrality; ideally, such a research support has to be institutionalized in mechanism, consistent in approach and transparent in action. It is, therefore, high time that something is done about this situation and the level of representation before the Tribunal, and the benefit of research assistance available to us, is improved.

52. It will perhaps be appropriate for the income tax department to consider, particularly when such a huge talent pool of young lawyers and chartered accountants is available and with the benefit of such highly talented young lawyers and chartered accountants now adding to the available pool of tax professionals every year, outsourcing, in controlled conditions- to begin with, the representation of cases before the benches of this Tribunal and to consider the modifications in the role of Departmental Representatives to administering and monitoring the representation before the Tribunals rather than invariably arguing the appeals on their own. It is much better to use the present talent pool of younger lawyers and chartered accountants, in a cost effective manner and let the tax administrators be used, apart from other very crucial roles in tax administration, in getting the best out of people assigned to argue the cases before the Tribunal. A cost benefit analysis of various approaches would perhaps be in order. It is also an idea worth exploring that while research and ground work is outsourced to young law and accountancy professionals, final call on the line of argument and actual arguments before the bench, though with or without active assistance of independent professionals retained by the revenue authorities, remains with the Departmental Representatives. Of course, assistance by the independent tax researchers directly to us could help as well. While as a specialist body dealing with only one branch of law, we may not have any excuse for not being up to date on the developments about our area of

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expertise, we have to be realistic in our approach particularly in the light of many of our constraints. Being informed of the latest judicial precedents cannot be left to chance alone. There has to be a formal mechanism to ensure that all the relevant judicial precedents are duly placed before, and considered, by the Tribunal. There is no point in living in denial. The truth is that reforms are needed about the manner in which interests of revenue are represented before the judicial authorities. What we have suggested above are only some of the ideas, which immediately come to our mind, but then there can indeed be several other options, perhaps much better and much more thoughtful options, to salvage the situation. A conscious call in required to be taken about the ways and means in which the situation is improved. In a responsive and accountable governmental system that we have today, interests of the exchequer need to be guarded in a more professional and careful manner than ever before. We leave it at that for the time being.

53. Ground no. 3 in the revenue's appeal, as also ground no. 3 in the assessee's appeal, is thus allowed for statistical purposes in the terms indicated above.

54. To summarize appeal wise, so far as revenue's appeal is concerned, ground nos. 1 and 2 in revenue's appeal are dismissed, and ground no. 3 in revenue's appeal is allowed for statistical purposes, in the terms indicated above. So far as assessee's appeal is concerned, ground no. 1 is dismissed, ground no. 2 is allowed and ground no. 3 is allowed for statistical purposes, in the terms indicated above.

55. In the result, both the cross appeals are partly allowed in the terms indicated above. Pronounced in the open court today on the 31st day of March, 2017.

Sd/xx ***Sd/xx***
S S Godara **Pramod Kumar**
(Judicial Member) (Accountant Member)
Ahmedabad, the 31st day of March, 2017

Copies to: *(1)* *The appellant* *(2)* *The respondent*
(3) *Commissioner* *(4)* *CIT(A)*
(5) *Departmental Representative* *(6)* *Guard File*

By order

Assistant Registrar
Income Tax Appellate Tribunal
Ahmedabad benches, Ahmedabad

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