INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH "D": NEW DELHI

BEFORE SHRI AMIT SHUKLA, JUDICIAL MEMBER
AND
SHRI L.P. SAHU, ACCOUNTANT MEMBER

ITA Nos. 2845/Del/2013
Asstt. Year: 2006-07

DCIT, Central Circle – 20, Room No. 333, ARA Centre, Jhandewalan Extn. New Delhi.	vs.	Xerox India Ltd., 5 & 6th Floor, Block One Vatika Business Park Sector 49, Sohna Road Gurgaon, Haryana-122018 PAN AAACM8634R
(Appellant)		**(Respondent)**

ITA Nos. 2895, 2896/Del/2013
Asstt. Years 2006-07,1998-99

Xerox India Ltd., 5 & 6th Floor, Block One Vatika Business Park Sector 49, Sohna Road Gurgaon, Haryana-122018 PAN AAACM8634R	Vs.	DCIT, Central Circle – 20, New Delhi.
(Appellant)		**(Respondent)**

Department by:	Shri Amit Jain, Sr.DR
Assessee by :	Shri Ajay Wadhwa, Advocate Ms. Bharti Sharma, CA
Date of Hearing	08/08/2018
Date of pronouncement	05/11/2018

O R D E R

PER AMIT SHUKLA, J.M.

The aforesaid cross appeals have been filed by the assessee as well as revenue against separate impugned order of even date 28.2.2013 passed by Ld. CIT(Appeals) XXXI, New Delhi for the quantum of assessment passed u/s 143(3) for the Asst. Year 1998-99 and u/s 143(3) for the Asstt. Year 2006-07.

ITA No. 2896/Del/2013

A.Y. 1998-99

2. We will first take up the assessee's appeal for the Asstt. Year 1998-99, wherein the assessee has raised following issues in various grounds of appeal: -

1) Disallowance of Rs. 53,27,950/-, deduction of bonus claimed u/s 43B.
2) Disallowance of Rs. 36,92,020/-, deduction of sales tax claimed u/s 43B.
3) Disallowance of Rs. 3,25,00,000/- towards foreign travelling expenses.
4) Disallowance of Rs. 70,97,500/- towards contest expenses.

3. This is the second round of appeal in pursuance of Tribunal order dated 19.9.2008, wherein certain issues were restored back to of the AO for fresh adjudication.

4. In so far as disallowance u/s 43B is concerned of Rs. 53,27,950/-, in the original assessment proceedings assessee had claimed deduction of Rs. 53,27,950/- u/s 43B in respect of bonus for Asstt. Year 1997-98, paid during the year under consideration. The claim was made by the assessee as an additional claim which was rejected by the AO on the ground that same was not made in the return of income and Ld. CIT(A) had not adjudicated this issue. The

Tribunal has remanded back the matter to the AO to consider the grounds on merits after hearing the assessee. However, the AO in the set aside proceedings has rejected the claim of bonus again for the same reason that claim was not made in the return of income and there is no legal provision to allow such incomplete disregard to the rejection of the Tribunal. Ld. CIT(A), remanded the matter to the AO to verify the claim of bonus on merits and in the remand proceedings the assessee filed the details of bonus deducted against Asstt. Year 1997-98 which was duly examined by the AO in the remand proceedings. However, the Ld. CIT(A) has disallowed claim of bonus for altogether different reasons now that the bonus paid is a performance related incentive payable as per certain HR policy which is not covered u/s 43B. According to him the bonus paid by the assessee was deductible in the year in which liability for the same arose.

5. Before us Ld. Counsel for the assessee, Mr. Ajay Wadhwa after narrating the entire facts and background of the case, submitted that in the earlier year also this issue had come up where the assessee has itself has disallowed the bonus amounting to Rs. 35,93,232/- u/s 43B in its computation and in the scrutiny assessment proceedings AO has disallowed the bonus of Rs. 1,06,51,114/- which included the disallowance made by the assessee also. Ld. CIT(A) had sustained the disallowance amounting to Rs. 86,10,251/-, so additional disallowance of bonus after reducing the disallowance made by the assessee worked out to Rs. 50,17,019/-. In this year assessee has paid bonus of Rs. 53,27,950/-. Since the earlier disallowance offered by the assessee due to non-payment in the A.Y.1997-98 has been claimed by the assessee in this year as the same was paid in the A.Y. 1998-99, therefore, there cannot be any dispute that the payment of bonus of Rs.53,27,950/- has been made during the year. Here the disallowance has been made by the Ld. CIT(A) on the ground that it is

incentive bonus. He submitted that the bonus is covered u/s 43B(c) which covered u/s 36(1)(ii). From the plain reading of the same, it is clear that nowhere section 36(1)(ii) envisages that performance related bonus are to be excluded. He also referred to various decision wherein it has been held that such kind of bonus is allowable u/s 36(1)(ii) read with section 43B the list of such judgments relied upon by him are as under :-

i. Hon'ble Bombay High Court in the case of Sesa Goa Ltd. (2009) 316 ITR 399;

ii. Hon'ble Kerala High Court in the case of CIT v. P. Alikunju (1987) 166 ITR 611;

iii. Hon'ble Madras High Court in the case of CIT vs. D. Mohamed Ismail (1997) 227 ITR 211 (Madras);

iv. Hon'ble Kerala High Court in the case of CIT vs. Travancore Titanium Products Ltd. (1993) 203 ITR 714 (Kerala).

6. On the other hand, Ld. DR strongly relied upon the order of the Ld. CIT(A).

7. After considering the rival submissions and on perusal of the relevant finding from the impugned order, we find that in the first round the subject matter of disallowance was, whether the assessee can make such a claim during the course of assessment proceedings or not and the matter was set aside by the Tribunal to the AO to examine the claim of the assessee on merits. AO has again disallowed the claim of payment of bonus u/s 43B precisely on the same ground that it was not claimed by the assessee in the return of income, which was in complete disregard to the direction of the Tribunal. There is no dispute that such a payment of bonus amounting to Rs. 53,27,950/- has been made during the year and the same has been claimed u/s

43B. Before the Ld. CIT(A) in the remand proceedings the AO has stated that assessee has not furnished any vouchers, bills, details of mode of payment, details of employees to whom such bonus was paid which was in the nature of "customers satisfaction management survey bonus". But before the CIT(A) the assessee has complete details of payment including details of vouchers dates of payment in regard to the amount of bonus which was filed before the AO which runs into hundreds of documents. All these facts have been noted by the Ld. CIT(A) in para 3.2.8. However, he Ld. CIT(A) without disputing the nature of details filed, held that the bonus paid by the assessee is not bonus payable under the 'Bonus Act 1965' and since it is a performance related incentive payable as per HR policy, therefore, same is not covered u/s 43B. Such a reasoning given by the Ld. CIT(A) is incorrect, because section 43B(c) only mentions that, "any sum referred to any clause (ii) of sub section (1) of section 36". The said provision of Section 36(1) (ii) reads as under: -

> *"36(1) The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28-*
>
> *.........*
>
> *(ii) any sum paid to an employee as bonus or commission for services rendered, where such sum would not have been payable to him as profits or dividend if it had not been paid as bonus or commission."*

8. Ergo, there is no condition that the sum paid as a bonus to the employee for services rendered cannot be performance related. The only limitation is that such sum was not payable to him as a profit or dividend, that is, payment of bonus should not be in the nature of profit or dividend of the company. If assessee has been paying bonus

from last several years which is given to the employee in the form of customer satisfaction bonus or linked to any performance based, then also such a bonus is allowable as deduction u/s 36(1)(ii). This precise issue has been dealt with the Bombay High Court in the case of **Sesa Goa Ltd.(supra)**. Nowhere it has been the case of the department that these were linked with the profit of the business. But it was a matter of certain customary practice adopted by the company to give performance-based bonus to the employees. Thus, the reason for making a disallowance of the Ld. CIT(A) cannot be sustained and same is directed to the deleted. In the result ground No. 3 to 3.2 is allowed.

9. In so far as disallowance of sales tax payment is concerned, the same has not been pressed as raised in ground No. 4 to 4.2, therefore, the same is dismissed as not pressed.

10. Coming to the issue of disallowance of foreign travelling expenses the Tribunal has set aside this issue to the file of the AO after disallowing and holding as under: -

> *"14.3 We have considered the facts of the case and rival submissions. We have also considered the submissions of the Ld. Counsel that provision made in this year was reversed in the next year and only the actual expenditure was claimed, which is a practice followed by the assessee consistently over a period of time. However, we find that the Tribunal had restored the matter to the file of AO in the order for A.Y. 1997-98. Since, a view has been taken in the matter already by a coordinate Bench, it would be in order that the same is followed. Therefore, we restore the matter to the file of the AO for fresh adjudication in the light of the facts available on record."*

11. AO has made the disallowance of Rs. 3.25 crores for the reasons of non-furnishing of complete details relating to foreign and inland travel expenses. Before the Ld. CIT(A) assessee filed additional evidences stating that the AO has asked to furnish each and every detail and since the matter was more than 14-year-old, therefore, it is not possible for the company to locate records relating to travel undertaken by its employees. Apart from that, management of the company has also changed hands and even officers looking after this matter has been changed on at least three to four occasions. Thus, after lot of efforts each and every voucher relating to travel and contest expenses have been located and was filed before the Ld. CIT(A). These evidences were sent to the AO to submit his remand report. However, the AO held that despite various opportunities to the assessee these details were not furnished therefore additional evidences may not admitted. In response, the assessee has given a detailed reply which has been incorporated by the Ld. CIT(A) from pages 12 to 17. However, the Ld. CIT(A) too has not admitted the additional evidence and rejected the assessee's entire submissions.

12. Before us Ld. Counsel for the assessee submitted that the assessee incurred expenditure of Rs. 11,44,47,444/- on foreign and in-land travels. The expenditure included provision of Rs. 12.08 lakh in respect of in-land travels and Rs. 2,67,63,000/- relating to foreign travels. As per the assessee company, it had evolved "Grand Slam" scheme as an incentive to the employees. The scheme was floated to motivate the employees to achieve their sale targets and the employees who fulfilled the targets were permitted to take their spouses with them therefore, the expenditure was incurred for the purpose of business. Regarding provision, the assessee was following the practice of making provision in respect of travelling expenses calculated on the basis of advances given to the employees. The provision was made in

respect of journeys which had already been performed but their bills and supporting evidence for travel were received in the subsequent assessment year. The provision is thus an expenditure which was entered in the Profit and Loss account for the year. This provision made was reversed in toto to the last rupee in the subsequent assessment year. Hence on reversal of the provision, the profit of the company was increased to the extent of the reversed amount. The net effect of this transaction is that the expense booked in the last year is taken as income in the subsequent year. The expenditure claim is therefore, allowable in the year in which the provision is made and the same provision becomes the income in the subsequent assessment year when it is reversed. Hence, between FY 1997-98 and FY 1998-99, the expense was reversed and taken as income. In this manner, there is tax neutrality. To reiterate, he submitted that the provision disallowed by the Id. Assessing Officer has been reversed and treated as income on 31.12.1998. Evidence in support has been enclosed in the paper book showing that a sum of Rs.2,67,63,000/- towards foreign travel provision was reversed by crediting GL Code G4120601vide voucher No. J-124403 dt.31/12/1998. Similarly, provision towards inland travel was also reversed by a sum of Rs. 12,02,000/- by crediting GL Code G4060401vide voucher No. J-40927 dt.25/04/1998. After having reversed the provision in the subsequent year, the assessee accounted for foreign travel expenses for which the bills had been received and were finally approved by the management. In respect of A.Y. 1998-99, Ld. Counsel pointed out that the provision for foreign travel expenses made on 31.12.1997 which was Rs. 2,67,63,000/- and Rs. 12,02,000/- for inland travel made on 31.03.1998. Further this provision was reversed on 25.04.1998 for inland travel and on 31.12.1998 for foreign travel; and during the F.Y. 1998-99, expenses of Rs. 2,07,08,476/- for foreign travel and Rs.

12,30,609/- for inland travel were incurred and booked and claimed against the said provisions of Rs. 2,67,63,000/- for foreign travel and Rs. 12,02,000/- for inland travel. As a matter of accounting practice, this policy has been followed by the assessee company from the beginning, claim of which stood allowed in previous years also. Therefore, he submitted that the issue is purely legal in nature and relates to the assessee's method of consistency i.e. making a provision for travelling expenses which is reversed in subsequent assessment year which is completely tax neutral.

13. Ld. Counsel further submitted that this system was thoroughly examined by the Tribunal in Asstt. Year 1995-96 and 1996-97, wherein this issue has been decided in favour of the assessee in revenue's appeal. In this year also, the Tribunal has followed the ratio of decision of Asstt. Year 1997-98 and directed the AO to follow the principle of consistency.

14. On the other hand, Ld. DR strongly relied upon the order of the Ld. CIT(A) and submitted that despite various opportunities the details of such expenses could not be furnished.

15. We have heard the rival submissions and also perused the relevant finding given in the impugned order. From the records it is seen that assessee is following a practice of making provision in respect of travelling expenses of the employees which was calculated on the basis of advances given to the employees and such a provision was made in respect of the journeys which have already been performed, but their bills and supporting evidences for the travel was received in the subsequent year. The provision of such expenditure was entered in the profit and loss account which has been reversed in the subsequent assessment year and accordingly, the profit of the assessee had increased to the extent reversed amount. The net effect

of this transaction is that, the provision for expenses booked in the last year is taken as income in the subsequent year. The expenditure has been claimed on the basis of provision made and if such provision is found to be excess then same is reversed in the subsequent year and offered as income. Hence, it is a kind of tax neutral. Apart from that, we find that assessee has enclosed all the details alongwith vouchers regarding foreign travel expenses which was reversed, which amounted to Rs. 2,67,63,000/- and also provision towards inland travel reversed was Rs. 12,02,000/-. Such a system of reversal of provision has been accepted by the Tribunal in the earlier year, therefore, there is no reason as to why such accounting practice and consistency should be not followed when it is tax neutral.

16. In so far as the allegation of the AO and Ld. CIT(A) that additional evidence filed cannot be admitted, we are unable to subscribe to such a finding, because this matter pertains to the financial year 1997-98 and the set aside proceedings had started in the year 2009; and since there were more than 100's of entries and bills, therefore it was contended that the entire details which is almost 14 years old could not be located. Once after due diligence and effort assessee could furnish entire documentary evidence and details then it was the incumbent upon the AO and Ld. CIT(A) to examine the same in the interest of justice especially when more than one and a half decade has been passed. If the assessee is filing the lead evidence before the appellate authorities and is able to demonstrate as to why such evidence could not filed earlier, then such matter having bearing on the issue not only need to be considered but also has to be adjudicated in the interest of justice. Therefore, the ground taken by the AO and Ld. CIT(A) to reject the additional evidences is not correct. On the perusal of the details which have been furnished before the Ld. CIT(A), it is seen that assessee has filed all the necessary documents

and details and the basis for making the provision for foreign travel and otherwise also the claim is based on provision made and as and when bills were submitted by the employees to the assessee company then only such a claim was made and hence it has to be allowed. Thus, in the facts and circumstances of the case we are unable to uphold or sustain any addition and hence the same is directed to be deleted.

17. In so far as Disallowance of Rs. 70,97,500/- toward contest expenses is concerned, admittedly this is identical to the issue of provision of travelling expenses. The brief facts are that the assessee had incurred total expenses of Rs. 2,00,60,379/- on account of contest sale during the year. These expenses were incurred by the company to conduct contests for promotion of sales under various schemes. However, at the year end, as per the accounting policy of the company, certain expenses which were incurred for the year but bills of which were not received, were provided for in the Expense Account. In the following year, that amount was reversed thus making the transaction tax neutral. The AO has disallowed the claim on account of not furnishing the ledger account original bills of expenditure and commercial expediency. Ld. CIT(A) too has rejected the same kind of additional evidences filed before the Ld. CIT(A) on the same ground. Here also the fact remains the same that assessee has been as a matter of fact and as accounting practice has been making provision in respect of contest expenses and reversing the same after the bills are received. Since the facts and issues involved are exactly the same as discussed in respect of provision of travelling expenses, therefore our finding given therein will apply *mutatis mutandis* for this issue also accordingly this addition too is directed to be deleted.

18. Lastly, with regard to levy of interest u/s 220(2), as raised in ground No. 7, we direct the AO to levy the interest only from the date of fresh notice of demand created by the AO in the set aside proceedings. The relevant particulars and cross payment in this regard reads as under: -

Sl. No.	Particulars	Relevant Date	Amount of Demand	Comments
1	Assessment u/s 143(3) was made	29-Dec-00	9,01,00,655/-	Original demand
2	Demand was partially met from Refund for AY1994-95	20-Feb-01	5,60,84,046/-	Demand paid in 50 days from date of assessment Order.
3	Order u/s 154/143(3) was made	26-Jul-01	8,80,07,964/-	Original demand rectified u/s 154
4	Appeal effect of CIT(A) Order (disallowance of tour & travel expenses and contest expenses was deleted)	25-Feb-02	1,00,93,312/-	This was the demand remaining after appeal effect of CIT(A) Ordeer. Tax refund of Rs.4,59,90,728/- (i.e. 2 minus 4) was computed and returned in cash
5	Appeal effect to ITAT Order given u/s 251/143(3) - (disallowance of tour & travel expenses and contest expenses was restored)	30-Nov-09	4,30,78,776/-	Demand restored for grounds allowed in our favour by CIT-A but restored by ITAT which includes (i) tax demand of Rs. 13407168/-, (ii) Interest u/s 2 3 4 B of Rs.7353688/- and (iii) Interest u/s 220(2) of

6	*Demand raised in Order u/s 251/143(3) dt.30-Nov-09 was paid on various dates from various year's refunds*	*27-Sep-2011* *20-Feb-2012* *20-Oct-*	*2,21,61,926/-* *1,84,17,694/-* *20,15,414/-*	*Demand of Rs. 4,30,78,77/- was paid to the extent of Rs.4,25,95,034/-*

From the above it is seen that the demand which has been finally sustained is much more than the demand which was sustained by the Tribunal in the first round which should have been much lower as substantial relief was granted. Therefore, there cannot be any issue of levy of interest u/s 220(2) from the original date of first assessment order. Accordingly, the AO is directed to compute the interest u/s 220(2) from the date of demand notice issued by him after the expiry of 30 days of 30th November, 2011; and after giving effect to this order considering the additions which have been deleted in the earlier paragraphs.

19. Accordingly appeal of the assessee is partly allowed.

<u>IT A No. 2895/Del/2013 (A.Y. 2006-07)</u>

20. In this appeal the assessee has raised following grounds:-

1. *"The order of Ld. CIT (A)-XXXI, New Delhi dated 28.02.2013 is bad in law and on facts.*
2. *That the CIT(A) has erred on facts and in law in not allowing deduction of royalty payment amounting to Rs.3,95,258j- as a revenue expenditure by erroneously alleging 20% of the royalty expenses incurred by the appellant attributable to use of trademark, and therefore capital in nature without appreciating the submissions filed and case laws relied on by the appellant.*

2.1 That the CIT(A) has erred in law and in facts in overlooking the fact that the royalty on sales paid by the appellant is towards (i) grant of license, (ii) furnishing of improvements, (Hi) provision of technical assistance; and not towards use of trademark.

2.2 The Ld CIT(A) has erred in law and on facts in not appreciating the fact that there is no royalty attributable to trademark at all. Hence the disallowance made is on a mistaken belief which is not sustainable in law.

2.3 The Ld. CIT(A) has erred in facts, in believing that assessee has himself claimed that royalty to the extent of 20% may be attributed towards use of trade mark.

3. *That the Ld. CIT(A) has erred in law and on facts in holding that assessee was paying royalty as a pre-specified percentage of domestic and export turnover of goods manufactured by it and there was a transfer in technology by the parent Co to assessee Co.*

4. *That the Ld. CIT(A) has erred in law by not appreciating that on similar facts and circumstances, jurisdictional Tribunal and High Court have upheld such royalty expenditure as revenue expense.*

5. *That the CIT(A) has erred on facts and in law in charging interest under section 234B and 220(2) of the Act.*

6. *The appellant craves leave to alter, amend or add any other ground of appeal either before or during the course of hearing."*

21. In assessment year 2006-07 cross appeal has been filed by the assessee as well as by the assessee also which is **<u>ITA No. 2845/Del/2013.</u>**

22. We will first take up the revenue's appeal wherein revenue has raised following grounds: -

"1. The order of the Ld. CIT (A) is not correct in law and facts.

2. On the facts and circumstances of the case as well as in law the Ld. CIT (A) has erred in deleting the addition of Rs.27,55,467/- made by AO on account of retrenchment of certain personnel/severances as the assessee was under no obligation to make any payment.

3. *On the facts and circumstances of the case as well as in law the Ld. CIT (A) has erred in not appreciating that there was no admissibility of expenses to employees working under contractors either u/s 37 of IT Act, 1961 or under any other provision of the Act.*
4. *On the facts and circumstances of the case as well as in law the Ld. CIT (A) has erred in giving direction to treat the 80% of total expenditure on account of royalty as revenue expenditure despite had enduring benefit as long as business continued.*
5. *On the facts and circumstances of the case as well as in law the Ld. CIT(A) has erred in giving direction to allow depreciation on 20% of the royalty expenditure despite no asset was created even after payment of royalty.*
6. *On the facts and circumstances of the case as well as in law the Ld. C1T (A) has erred in giving direction to allow depreciation on the assets discarded despite the assessee failed to identify such assets.*
7. *The appellant craves leave to add, amend any / all of the grounds of appeal before or during the course of the hearing of the appeal".*

23. In so far as the ground No. 2 and 3 of revenue's appeal is concerned, i.e., disallowance of compensation of employees, AO has disallowed the expenditure on the ground that assessee company was under no contractual obligation to make the payment of retrenchment to the employees who were not in an employment at the time of payment as they were the employees of the contractors and assessee company has no contract with its employees in respect of this payment. Lastly, such expenditure cannot be allowed u/s 37. Ld. CIT(A) has deleted the disallowance after considering the additional evidence in the form of bills/invoices raised by the contractors and assessee seeking payment of retrenchment compensation for the employees and such additional evidence was also confronted to the AO

from which AO has also submitted the remand report. The AO's contention in the remand report has been that there was no necessity that the assessee company was under legal obligation to make such payment, therefore, there is no necessity to peruse the bills / vouchers. The assessee has filed submissions before the Ld. CIT(A) the sums and substance of which reads as under: -

i) The assessee had taken a number of persons on contractual basis from the contractors. Their salaries and social security dues were paid by the contractor who in turn used to raise monthly bills on the company for placing the service of manpower with the assessee.

(ii) During the impugned assessment year, services of some such workers were discontinued. The contractors brought to the notice of the assessee that they have to incur cost towards full and final settlement of such employees along with severance cost such as retrenchment compensation, leave encashment, gratuity etc.

(iii) According to the assessee, the payment had to be 'made to safeguard the interest of the company and to avoid any dispute with the employees.

(iv) The assessee sought an advice from a senior Advocate of Hon'ble Supreme Court of India who opined as under: -

"Considering the totality of facts and circumstances, it is not advisable to have "Off Roll" employees through OSP arrangement as is presently there it is also relevant to notice that these "Off Roll" .employees are at the premises of XMC for the full day and work shoulder to shoulder along with regular employees of XMC The working hours, leave, off day, Email ID, lunch arrangement etc. are same and similar for Off Roll persons as well as regular employees of XMC These "Off Roll" employees virtually get Instructions and are in the supervision and control of the

executives of XMC In such circumstances, If the issue is tested before the Court, there is good possibility of the finding being that they are In fact the employ XMC.

The terminology of "Off Roll" employee is wholly unwanted and unjustified. There is no concept of Off Roll employees In employment laws applicable in the country. In law these persons are contract labour and covered by the CL Act".

(v) Hence, according to the assessee, the factum of manpower provided 'by the contract stood established; services were rendered by the said manpower; the services were terminated by the assessee; the workers raised invoices on the contractor clamming retrenchment compensation; the contractor in turn claimed the retrenchment compensation from the assessee by raising invoices; the assessee accepted the invoices raised by the contractor and paid the retrenchment compensation and, therefore, the payment was wholly and exclusively for the purpose of business.

(vi) The assessee further submitted that there is a direct nexus between the compensation paid to the contractor with the business of the "assessee since "the workers were wholly and exclusively working for the assessee.

(vii) The assessee also submitted that there is no necessity of making payment pursuant to written agreement as the invoice /bill duly accepted constitutes a legal valid agreement and the payment made thereto ought to be allowed.

24. Ld. CIT(A) had deleted the said disallowance on the ground that assessee has made such payment as a prudent businessman in order to avoid legal controversies related to services rendered wholly and exclusively by the manpower supplied by the contractor. Consequently the payment was made to specify the business interest and avoid

litigation and consequential claims and lastly the expenditure was incurred in normal course of assessee's business.

25. After hearing both the parties on perusal of the relevant finding given in the impugned order we find that in so far as transaction of payment in the form of retrenchment compensation made by the assessee company to off roll employees to the contractors is concerned is not in dispute. The only reason for making the disallowance by the AO was that there was no legal obligation to make the payment for retrenchment of the employees who otherwise were supplied by the contractors. Assessee has undertaken number of persons on contractual basis and all the salaries and social security dues were paid by the contractors, who in turn used to raise monetary bills from the company for placing the service of man power with the assessee. During the impugned assessment year services of same were discontinued and contractors brought to the notice that they have to incur cost towards full and final settlement of such employees alongwith severance cost such as retrenchment compensation, leave encashment, gratuity etc. The assessee has sought an opinion from Senior Advocate of Supreme Court who advised them that these persons are contract labour and are covered under the CL act. Based on such advice and to avoid any kind of litigation and to safeguard the interest of the company, assessee has compensated the cost to the contractors, because the workers were wholly and exclusively for the assessee company. When any amount is paid for the claim of compensation damages for any of the worker working wholly and exclusively for the assessee which has been either wrongly terminated or they have been retrenched, then if the employer is of the view that due to commercial expediency and as a prudent businessman he should make the payment then revenue cannot take a view that such

a payment or claim by the assessee is not allowable. Thus, the addition deleted by the Ld. CIT(A) is upheld.

26. In so far as disallowance of royalty expenditure is concerned, AO has treated the payment of royalty of the assessee company to its overseas parent company, Xerox Limited, a capital expenditure following the judgment of Hon'ble Supreme Court in the case of Southern Switchgear Ltd. vs. CIT and another 232 ITR 359. Various reasons given by the AO for making the disallowance are as under: -

i. That the assessee made the payment of royalty towards use of Trade mark and therefore, Ld. AO disallowed the expenditure.

ii. As per Ld. AO, the assessee company was solely dependent on parent company for any technical inputs, manufacturing technology and supplies from parent company.

iii. When there is a sale of products in any category, the parent company had a claim of its share in profits by way of royalty which was embedded in sales.

iv. Decision of Hon'ble Supreme Court in the case of Southern Switchgear Ltd (supra) not in favour of the assessee.

v. No asset was created after payment of royalty therefore no depreciation is allowable.

vi. No TDS was deducted u/s 40(a) (ia).

27. Ld. CIT(A) has sustained part of the disallowance amounting to Rs. 5,27,010/- after allowing depreciation @ 25% against which assessee is also in cross appeal. The relevant observation and finding of the Ld. CIT(A) read as under: -

> *"3.3.3 I find that the appellant is making payment to its parent company certain amount as percentage of sales and exports. The*

rate depended on nature of product sold and also on the fact as to whether it is domestic sale or export sale, The AO has not objected to the quantum of royalty, rate at which royalty is computed or royalty was really payable in the- given circumstances. He has treated the royalty amount as capital, expenditure quoting the ratio of the decision in the case of Southern Switchgear Ltd. vs. CIT and Another (1998) 232 ITR 359 (SC), From the detailed submissions made during the proceedings before the AO, it: is noted that the appellant had claimed that royalty paid to the extent of 2% (amounting to Rs. 5,27,010/- after allowing depreciation @ 25% thereon) could be attributable to, the use of trade mark. Rs.5,27,101/-out of Rs. 26,35,051/- amounts to about 20% of the royalty paid. It is, not clear how the calculation has been done. The rates of royalty paid were 2%, 5% and 8% of the sales. It is noted that the trade mark "Xerox" is the most valuable aspect of the contribution of. the parent company to the Indian company. Hence' I hold that' 20% of the total royalty amount paid would be attributable to the use of trade mark. The AO is directed to allow depreciation on the said amount @25%. The balance is allowed as revenue expenditure."

28. After hearing both the parties and on perusal of the relevant material referred to before us, it is seen that assessee has incurred and paid sum of Rs. 26,35,051/-towards payment of 'royalty' to its overseas parent company for which assessee deducted TDS of Rs. 5,50,989/- and have made net payment of Rs. 20,84,062/-. This payment has been made under Principal Royalty Agreement entered into on 27.10.1983 between Xerox Modicorp Limited (earlier name of the assessee) and Xerox Limited (parent company). This Principal Royalty Agreement was renewed and extended from time to time. Clause 4 of the supplement technical agreement provides for payment

of royalty for (i) provision for technical assistance; (ii) grant of license; and (iii) furnishing of improvements. The relevant clause 4 of the agreement reads as under: -

> *"In consideration of the provision of Technical Assistance pursuant to Article 5 and Grant of Licence under Article 2 and the furnishing of improvements pursuant to Article 3, XMC shall pay to XL for the term of the Agreement referred to in Article 17.3 hereof an annual royalty as follows:*
>
> *(a) on sales within India:-*
>
> > *(i) at the rate of two percent (2%) on the Licensed Products, Parts and Consumables listed in the Schedul-1 hereto,*
> >
> > *(ii) at the rate of five percent (5%) on the Licensed Products, Parts and Consumables which are listed in the Schedule-II hereto,*
>
> *(b) on export sale of all Licensed Products, Parts and Consumables to destinations outside India, at the rate of eight percent (8%),*
>
> *The said royalty shall be calculated quarterly (subject to taxes) on the net ex-factory selling price (as defined below) of the Licenced Products, Parts and Consumables manufactured by XMC exclusive of excise duties, landed cost of imported components irrespective of the source of procurements including ocean freight, insurance and customs duty if any thereon and cost of standard bought out components (as defined below) if any in such XMC manufactured Licensed Products, Parts and consumables.*
>
> *The price shall be published single unit sale price of XMC manufactured Licensed Products, Parts and Consumables to commercial customers in India in cases of export sales where no such published single unit sale price is available, the price shall be the FOB invoiced value,*

Standard bought-out components shall mean uch components as are available in India and which are not specifically made for XMC manufactured Licensed Products, Parts and consumable."

Thus, determination of amount of royalty was linked with the sale of licensed products and was directly linked with the amount of turnover.

29. Before us, Ld. Counsel relied upon catena of judgment wherein similar payment of royalty based on domestic /export sales has been treated as revenue expenditure. The main judgments relied upon by the Ld. Counsel were:

a) Hon'ble Delhi High Court in the case of **Climate Systems India Ltd. v CIT [2009] 319 ITR 113 (Delhi)** wherein this precise issue has been decided in favour of the assessee by holding that payment of royalty that depended on domestic as well as export sales is treated as revenue expenditure. Relevant paras of the said judgement are reproduced as under:

"On a reading of the technical collaboration agreement entered into between the assessee and the foreign company, it was clear that for transfer of technology, the assessee agreed to pay a lump sum amount. That payment was, admittedly, treated as capital expenditure by the assessee and had been shown as such. However, insofar as payment of royalty was concerned, that depended on the domestic as well as export sales. Quantum of the said sales would determine the extent of royalty to be paid and it would decrease or increase every year depending upon the decrease or increase in the sales. Significantly, that payment was not because of 'transfer' of technology, but for providing 'technical service: In such circumstances, the payment of roval/x which was a continuous process, should have been treated as revenue

expenditure. As a result, the orders of the authorities below were to be set aside.”

b. Hon'ble Delhi High Court in the case of **CIT v. Sharda Motor Industrial Ltd.** wherein it was held that:-

"7. Learned counsel for the Revenue submits that the Tribunal has not considered the effect of the judgment of the Supreme Court in Southern Switch Gear Ltd. v. CIT [199B} 232 ITR 359, inasmuch as in that case the payment or royalty was treated as capital expenditure. However, what is glossed over is that under the terms of the agreement in that case/ the assessee company therein had agreed to pay the foreign company lump sum of royalty and it was in these circumstances the same was treated as capital expenditure and the Tribunal had disallowed 25 per cent thereof. In the present case/ as pointed out above/royalty is to be paid on the quantity of the goods produced, calculating per piece of the said goods produced. Therefore/ the Tribunal rightly held that the aforesaid judgment is not applicable to the facts of the present case.”

c. Hon'ble Delhi Court in the case of CIT v. G4S Securities System (India) P. Ltd. [2011] 338 ITR 46 (Delhi), wherein it was held that: -

"Held that the ownership rights of the trade mark and know-how throughout vested with 'G' and on the expiration or termination of the agreement, the assessee was to return all know-how obtained by it under the agreement. The payment of royalty was also to be on year to year basis on the net sales of the assessee and at no point of time/ the assessee was entitled to become the exclusive owner of the technical know-how and the trade mark. Hence the expenditure incurred by the assessee as royalty was revenue expenditure and was therefore deductible under section 37(1).

d. Hon'ble Delhi ITAT in the case of [2014] 32 ITR (T) 31 (Delhi - Trib.) has followed the judgement of Climate Systems India Ltd. (supra) and held as under:

"12. We have heard the rival submissions of both parties and have gone through the material available on record. We find that as per various clauses of the licence agreement the assessee was to pay at the time of entering into the agreement certain amounts to cover equipment and training and further it was required to pay a regular annual royalty on all domestic sales which was to be calculated on the basis of turnover. The learned Commissioner of Income-tax (Appeals) therefore has rightly held the payment to be of revenue nature and has rightly allowed the relief. The hon'ble Deihi High Court in the case law of Climate Systems India Ltd. (supra) under similar facts and circumstances has held as under:

''Held, allowing the appeal, that under the agreement payments were to be made by the assessee in two parts: a lump sum fee for transfer of technology (which the assessee had admitted as being of capital nature) and royalty payment in consideration of providing technology services. The payment of royalty depended on the quantum of domestic as well as export sales which would decrease or increase every year depending upon the decrease or increase in the sales. This payment was not because of 'transfer' of technology but for providing technical services. In such circumstances, the payment of royalty which was a continuous process, should have been treated as revenue expenditure. "

13. Therefore, relying upon the judgment of the hon'ble Delhi High Court and on the basis of facts and circumstances of the case we do not find any infirmity in the order of the learned Commissioner

of Income-tax (Appeals). Therefore, ground No. 1of appeal is dismissed. "

30. Further, it is also seen that assessee has not paid any royalty during the assessment year. It is only for grant of license, technical assistance and improvement as per Technical Supplement Agreement III which was only for the prescribed period of five years. Thus, assessee does not get any exclusive rights of license and other technical assistance or improvement. Under these facts and circumstances, when payment of royalty is based on year to year basis on the net sales of the assessee and at no point of time the assessee is entitled to become the exclusive owner of the technical know-how, then such payment of royalty has to be recognised as revenue expenditure and deductible u/s 37(1). This principle has been upheld by the Hon'ble Jurisdictional High Court in the case of **CIT vs. Ekl Appliances Ltd. (2012)20 taxmann.com 509.** Further, the judgment cited by the Ld. Counsel on similar issue has been decided in favour of the assessee. Thus, respectfully following the ratio laid down by the Hon'ble Jurisdictional High Court, the payment of royalty made by the assessee is allowed as revenue expenditure.

31. In so far as the judgment of Hon'ble Supreme Court in the case of Southern Switchgear Ltd. vs. CIT, we find that it is clearly distinguishable, because the terms of agreement in that case provide for continuing rights of the assessee company even after the expiry of the term of agreement. The judgement was rendered on all together different set of facts and clearly distinguishable from the assessee's case, because here the agreement did not provide for continuing rights of the assessee company to use the rights granted under the agreement even after the expiry of the agreement which was the case for the Hon'ble Apex Court. Thus, on the facts and circumstances of

the present case royalty payment cannot be classified as capital in nature. The entire addition is deleted. Consequently, the revenue's appeal is dismissed.

32. In assessee's appeal the assessee has only challenged the part disallowance made by the Ld. CIT(A) on account of royalty payment. Since we have held that entire royalty payment is revenue expenditure, therefore, part disallowance made by the Ld. CIT(A) stands deleted.

33. In the result appeal of the revenue is dismissed and appeal of the assessee is allowed.

Order pronounced in the Open Court on 5th November, 2018.

sd/- sd/-

(L.P. SAHU) **(AMIT SHUKLA)**
ACCOUNTANT MEMBER **JUDICIAL MEMBER**

Dated: 5 /11/2018

Veena

Copy forwarded to

1. Applicant
2. Respondent
3. CIT
4. CIT (A)
5. DR:ITAT

ASSISTANT REGISTRAR
ITAT, New Delhi