R

IN THE HIGH COURT OF KARNATAKA, BENGALURU

DATED THIS THE 14th DAY OF AUGUST, 2015

PRESENT

THE HON'BLE MR. JUSTICE VINEET SARAN

AND

THE HON'BLE MR. JUSTICE ARAVIND KUMAR

ITA Nos.65/2014 C/W 66/2014

BETWEEN:

1. THE COMMISSIONER OF INCOME TAX, CIT (A),
C.R. BUILDING,
QUEENS ROAD,
BANGALORE.

2. THE ASSISTANT COMMISSIONER
OF INCOME TAX
CIRCLE-11(4)
RASHTROTHNA BHAVAN
NRUPATHUNGA ROAD
BANGALORE. ...COMMON APPELLANTS

(BY SRI. K.V. ARAVIND, ADVOCATE)

AND:

M/s.HEWLETT-PACKARD
GLOBALSOFT PVT. LTD.,
39/40, ELECTRONIC CITY,
PHASE-II, HOSUR ROAD,
BANGALORE-560 100. ...COMMON RESPONDENT

(BY SRI.T. SURYANARAYANA FOR M/S KING AND PARTRIDGE, ASSOCIATES, ADVOCATE)

ITA NO. 65/2014 IS FILED UNDER SECTION 260-A OF INCOME TAX ACT, 1961 PRAYING TO FORMULATE THE SUBSTANTIAL QUESTIONS OF LAW STATED ABOVE AND ALLOW THE APPEAL AND SET ASIDE THE ORDER PASSED BY THE ITAT, BANGALORE IN ITA NO.283/BANG/2012, DATED 30.09.2013 AND CONFIRM THE ORDER OF THE APPELLATE COMMISSIONER CONFIRMING THE ORDER PASSED BY THE ASSISTANT COMMISSIONER OF INCOME TAX, CIRCLE-11(4), BANGALORE.

ITA NO. 66/2014 IS FILED UNDER SECTION 260-A OF INCOME TAX ACT, 1961 PRAYING TO FORMULATE THE SUBSTANTIAL QUESTIONS OF LAW STATED ABOVE AND ALLOW THE APPEAL AND SET ASIDE THE ORDERS PASSED BY THE ITAT, BANGALORE IN ITA NO.267/BANG/2012, DATED 30.09.2013, CONFIRMING THE ORDER OF THE APPELLATE COMMISSIONER AND CONFIRM THE ORDER PASSED BY THE DEPUTY COMMISSIONER OF INCOME TAX, CIRCLE-11(4), BANGALORE.

THESE APPEALS BEING HEARD AND RESERVED, FOR ORDERS, COMING ON FOR PRONOUNCEMENT THIS DAY, **ARAVIND KUMAR J,** DELIVERED THE FOLLOWING:

JUDGMENT

Revenue has preferred these appeals calling in question the order passed by the Income Tax Appellate Tribunal, "C" Bench, Bangalore in ITA Nos. 283/BANG/2012 and 267/Bang/2012 dated 30.09.2013 whereunder the Tribunal, while

examining the validity of re-opening of the assessment, has set aside the same on the ground that Assessing Officer, on mere change of his opinion and without any tangible material, could not have reopened the concluded assessment and as such held that reopening is invalid.

2. We have heard the arguments of Sri K.V.Aravind, learned Advocate appearing for appellant-revenue and Sri.T.Suryanarayana, learned Advocate appearing on behalf of respondent-assessee.

3. The above appeals came to be admitted to consider the following substantial questions of law:

> "(1) Whether on the facts and in the circumstances of the case, the Tribunal was correct in holding that the reopening of assessment is by mere change of opinion, without appreciating the fact that the expenditure related to on-site development of computer software was not examined in the original assessment and as such is not a

deemed opinion to hold change of opinion?

(2) Whether on the facts and in the circumstances of the case the tribunal was correct in holding that reopening of assessment is mere change of opinion, when the assessing officer has not considered the eligibility of the income derived from rendering technical services abroad to be eligible for deduction under Section 10-A or not?"

4. Briefly stated facts are:

Assessee is a company engaged in the business of software development. For the assessment year 2003-04 return of income was filed whereunder the assessee claimed deduction under Section 10A of the Act. The assessee had excluded the expenses incurred in foreign currency for providing technical services. The return of income was processed and it was selected for scrutiny. After issuing statutory notice, assessment order under section 143(3) of the Income Tax Act, 1961 (for short `Act') came to be passed on 27.03.2006. While claiming deduction

under Section 10A of the Act, the assessee had excluded the expenses incurred in foreign currency for providing technical services and had included the profits derived from technical services in the eligible profits for deduction under section 10A of the Act. Hence, notice under section 148 came to be issued for reopening the concluded assessment on the ground that claim made by the assessee under Section 10A of the Act by including the profits derived from technical services in the eligible profits was excess claim. Thereafter re-assessment came to be completed on 31.12.2007 by excluding the profits derived from technical services from the eligible profits and consequently, the deduction under Section 10A came to be re-concluded. The said re-assessment order was challenged by the assessee before the CIT (A) questioning the validity of the re-opening on the ground that it would amount to change of opinion. Though appellate Commissioner confirmed the validity of re-opening of assessment

under Section 148 of the Act, partial relief was granted to the assessee on merits by order dated 28.11.2011. Hence, assessee as well as revenue filed separate appeals before the Tribunal against the order of CIT(A). The assessee challenged the confirmation of validity of re-opening of assessment. The revenue challenged the partial relief granted by the appellate Commissioner to the assessee. The Tribunal annulled the re-assessment proceedings and held it is not valid in law. In view of the same, the Tribunal did not examine other issues raised by the assessee and consequently, the appeal filed by the revenue also came to be dismissed. Hence, the revenue has filed these two appeals.

5. It is the contention of Sri K.V.Aravind, learned Advocate for the revenue that Tribunal erred in holding that assessing Officer sought to initiate the re-assessment proceedings by mere change of opinion, without considering the fact that the

expenditure related to onsite development of computer software and same had not been examined in the original assessment and as such, it is not a deemed opinion. He would submit that when the assessing Officer has not examined the eligibility of the income derived from rendering technical services abroad to be eligible for deduction under Section 10A or not, question of change of opinion did not arise. He would submit that eligibility of income derived from technical services was not to be included in the eligible profits under Section 10A of the Act and the assessing Officer, while framing the assessment proceedings, had not examined inclusion of income from technical services into the eligible profits for computing deduction under Section 10A. He would submit that assessee had claimed deduction under Section 10A of the Act by including the profits from rendering technical services in the eligible profits and as such deduction claimed under Section 10A of the Act by the assessee was excessive and Explanation to

Section 147 of the Act was attracted and it would amount to deemed escapement of income to tax. Hence, he contends that the re-opening of the concluded assessment is valid.

6. He would further submit that the assessing Officer had not expressed any opinion on the controversy regarding inclusion of profits derived from rendering technical services into the eligible profits and as such, no opinion had been expressed during assessment proceedings and thereby change of opinion would not arise. On these grounds, he would seek for substantial questions of law being answered in favour of the revenue and prays for allowing the appeal. In support of his submissions, he has relied upon the following judgments:

(i) **(2010) 320 ITR 561**
Commissioner of Income Tax vs. Kelvinator of India Ltd.

(ii) **(2007) 291 ITR 500 (SC)**
Assistant Commissioner of Income Tax vs. Rajesh Jhaveri Stock Brokers (P) Ltd.

(iii) **(2012) 348 ITR 485 (Delhi)**
Commissioner of Income Tax-VI vs. Usha International Limited.

(iv) **(2011) 242 CTR 425**
Commissioner of Income Tax & Another vs. Rinku Chakraborthy

(v) **(2013)350 ITR 651**
Export Credit Guarantee Corporation of India Ltd. vs. Additional Commissioner of Income Tax

(vi) **(2014) 265 CTR 540**
Commissioner of Income Tax & Another vs. Sasken Communication Technologies Ltd.

7. Per contra, Sri Suryanarayana, learned Advocate would support the order passed by the Tribunal and contends that the assessing Officer at the first instance had examined the issue of excluding certain sum from the export turnover on the ground it was expenditure incurred in foreign exchange for providing technical services outside India and in the reasons recorded for re-opening the assessment, he has taken the view that aforesaid amount cannot be considered as income derived from

export of articles or things or computer software at all. He would submit that by issuing the notice for re-assessment, the assessing Officer intends to re-examine the deduction claimed by the assessee under Section 10A which itself amounts to change of opinion and even if there was a failure on the part of the assessing Officer with regard to computation of export turnover, the only course of action left to the revenue was to take recourse under Section 263 of the Act. Hence, he prays for dismissal of the appeals.

In support of his submissions, he has relied upon the following judgments:

(i) **(2002) 256 ITR 1**
Commissioner of Income Tax vs. Kelvinator of India Ltd.

(ii) **(2001)116 Taxman 274 (Kar)**
Commissioner of Income – Tax vs. Hardware Trading Co.

(iii) **Replika Press Private Limited & Another vs. Deputy Commissioner of Income Tax Circle**
(W.P.(C) 7452/2010 dated 5th August, 2013)

(iv) **(2014) 363 ITR 603 (Bom)**
NDT Systems and another vs. Income-Tax Officer and others

(v) **(2014) 366 ITR 134 (Guj)**
Deepakbhai Ramjibhai Patel vs. Income-Tax Officer

8. Assessee is in the business of software development. For the assessment year 2003-04 return of income was filed on 31.10.2003 declaring income of ₹ 15,00,92,060/- after claiming deduction of ₹ 99,67,71,161/- under Section 10A of the Act. Assessment order came to be framed under Section 143(3) of the Act on 27.03.2006. The Assessing Officer reduced the claim of deduction from ₹ 99,67,71,161/- to ₹ 89,08,86,778/-. Notice under Section 148 of the Act was issued on the ground that excess deduction under Section 10A has been claimed and hence the deduction has to be recomputed. After considering the reply given by the assessee, order of reassessment was passed under Section 143(3) read with Section 147 on 31.12.2007.

This was carried in appeal by the assessee and was successful partially. The assessee being aggrieved by the finding recorded by the Appellate Commissioner that reopening being proper, filed further appeal before the Tribunal and the revenue being aggrieved by the grant of partial relief to the assessee by the Appellate Commissioner, filed an appeal before the Tribunal. Thus, both the appeals came to be taken up together by the Tribunal and by the impugned order set aside the reopening of the assessment on the ground that it is change of opinion and consequently allowed the appeal filed by the assessee and dismissed the appeal filed by the revenue. Hence, revenue has preferred these two appeals.

RE: SUBSTANTIAL QUESTIONS OF LAW Nos.1 & 2:

9. The validity of initiation of reassessment proceedings under Section 147 of the Act by the Assessing Officer was challenged by the assessee before the Assessing Officer, Appellate Commissioner

as well as Tribunal. Perusal of the original records would indicate that Assessing Officer for the reasons recorded in the order sheet dated 05.09.2006 to reopen the concluded assessment for the year 2003-04. It reads as under:

> "The expenses incurred in foreign currency in respect of technical service rendered outside India at Rs.34,5145,781 has been reduced from the export turnover as per clause (iv) of the Expl. 2 to Section 10A. Actually profits from providing technical services abroad should be excluded while computing deduction u/s 10A.
>
> In the instant case the expenditure for providing technical services at 11.71% of the total expenditure and the profits from providing technical services is to be estimated at 11.71% of the total profits, which is eligible for deduction u/s 10A.
>
> Consequent short levy of tax and surcharge works out to Rs.1,76,39,326/-. Therefore, I have reasons to believe that income chargeable to tax has escaped assessment for the Ay 2003-04".

As per Section 147 of the Act, if the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year he may, subject to provisions of Section 148 to 153, assess or reassess such income.

10. In the instant case, the Tribunal, while accepting the plea of the assessee that merely on change of opinion, the concluded assessment was being reopened, noticed that the Assessing Officer had already gone into specific issues arising under Section 10A of the Act. It can be noticed that from the reasons recorded for issue of notice under Section 148 of the Act, the assessing Officer wanted to hold that the entire sum towards employee's salary, overseas travel, in all totaling ₹ 154,05,83,125/- towards expenditure incurred in foreign currency for rendering technical services outside India ought to have been considered as not profits derived by an undertaking from export of articles or things or

computer software under Section 10A(1) of the Act and that the same should be totally excluded from the computation of deduction under Section 10A of the Act and as such, considering ₹ 38,51,45,781/- as part of the export turnover, while computing deduction under Section 10A of the Act was incorrect. Hence, the assessing Officer had proposed to re-assess. The assessee had contended that there was application of mind by the assessing Officer on all issues including the question as to whether the sum of ₹ 38,51,45,781/- is not profit derived by the assessee from the export of articles or things or computer software. The assessing Officer while completing the assessment under Section 143(3) of the Act, has gone into the question of excluding the sum of ₹ 38,51,45,781/- from the export turnover on the ground that it was expenditure incurred in foreign exchange for providing technical services outside India. However, the reasons recorded for re-opening the said assessment is that the aforesaid

sum cannot be considered as income derived from export of articles or things or computer software at all. Thus, it has to be seen whether it would be a different dimension or the income had escaped assessment or whether the assessing Officer had adopted one of the views possible and as such, he could not have taken recourse to re-assessment of the proceedings.

11. Jurisdiction under Section 147 of the Act can be invoked by the assessing Officer where he has reason to believe that income chargeable to tax has escaped assessment. However, such 'reason to believe' cannot be based on a mere change of opinion. It is not in dispute that the assessing Officer does not have jurisdiction to review his own order. The power of rectification of mistakes conferred on the assessing Officer is circumscribed by the provisions of Section 154 of the Act.

12. From the perusal of the provisions contained in Section 147 of the Act, as it stood up to 31.03.1999, it is evident that to confer jurisdiction under Section 147(a) of the Act, twin conditions were required to be satisfied namely, (1) the assessing officer must have reason to believe that income chargeable to tax has escaped assessment; and (2) he must also have a reason to believe that such escapement occurred by reason of either – (a) omission or failure on the part of the assessee to make a return of his income under Section 139 or (b) omission or failure on the part of the assessee to disclose fully and truly all material facts necessary for his assessment for that year. Both conditions are cumulative and in the given circumstances of the case, if these two conditions are not fulfilled, then necessarily notice issued by the assessing Officer would be wholly without jurisdiction.

13. The effect of amendment to Section 147 came to be examined by the Hon'ble Apex Court in **CIT vs KELVINATOR OF INDIA LIMITED** reported in **(2010) 320 ITR 561** and observed as under:

> "4. On going through the changes, quoted above, made to Section 147 of the Act, we find that, prior to Direct Tax Laws (Amendment) Act, 1987, reopening could be done under above two conditions and fulfillment of the said conditions alone conferred jurisdiction on the Assessing Officer to make a back assessment, but in Section 147 of the Act [with effect from 1st April, 1989], they are given a go by and only one condition has remained, viz., that where the Assessing Officer has reason to believe that income has escaped assessment, confers jurisdiction to reopen the assessment. Therefore, post 1st April, 1989, power to reopen is much wider. However, one needs to give a schematic interpretation to the words "reason to believe" failing which, we are afraid, Section 147 would give arbitrary powers to the Assessing Officer to reopen assessments on the basis of "mere change of opinion", which cannot be per se reason to reopen. We must also keep in mind the conceptual difference between power to review and power to reassess. The Assessing Officer has no power to review; he has the power to reassess. But reassessment has to be based on fulfillment of certain pre-condition and if the concept of "change of opinion" is

> removed, as contended on behalf of the Department, then, in the garb of reopening the assessment, review would take place. One must treat the concept of "change of opinion" as an in-built test to check abuse of power by the Assessing Officer. Hence, after 1st April, 1989, Assessing Officer has power to reopen, provided there is "tangible material" to come to the conclusion that there is escapement of income from assessment. Reasons must have a live link with the formation of the belief. Our view gets support from the changes made to Section 147 of the Act, as quoted hereinabove. Under the Direct Tax Laws (Amendment) Act, 1987, Parliament not only deleted the words "reason to believe" but also inserted the word "opinion" in Section 147 of the Act. However, on receipt of representations from the Companies against omission of the words "reason to believe", Parliament re-introduced the said expression and deleted the word "opinion" on the ground that it would vest arbitrary powers in the Assessing Officer. We quote hereinbelow the relevant portion of Circular No.549, dated 31st Oct., 1989 [(1990) 82 CTR (St) 1], which reads as follows xxx remain the same."

14. The phrase ***'reason to believe'*** found in Section 147 of the Act came up for scrutiny before the Hon'ble Apex Court in the matter of **ASSISTANT**

COMMISSIONER OF INCOME TAX vs RAJESH JHAVERI reported in **(2007) 291 ITR 500 (SC)** and held that the said expression cannot be read to mean that the assessing Officer should have finally ascertain the fact by legal evidence or conclusion of the fact of escapement of income from tax. It came to be held as under:

> "16. Section 147 authorises and permits the Assessing Officer to assess or reassess income chargeable to tax if he has reason to believe that income for any assessment year has escaped assessment. The word "reason" in the phrase "reason to believe" would mean cause or justification. If the Assessing Officer has cause or justification to know or suppose that income had escaped assessment, it can be said to have reason to believe that an income had escaped assessment. The expression cannot be read to mean that the Assessing Officer should have finally ascertained the fact by legal evidence or conclusion. The function of the Assessing Officer is to administer the statute with solicitude for the public exchequer with an inbuilt idea of fairness to taxpayers. As observed by the Delhi High Court in Central Provinces Manganese Ore Co. Ltd. v. ITO (1991) 98 CTR (SC) 161: (1991) 191 ITR 662 (SC), for initiation of

action under Section 147(a) (as the provision stood at the relevant time) fulfillment of the two requisite conditions in that regard is essential. At that stage, the final outcome of the proceeding is not relevant. In other words, at the initiation stage, what is required is "reason to believe", but not the established fact of escapement of income. At the stage of issue of notice, the only question is whether there was relevant material on which a reasonable person could have formed a requisite belief. Whether the materials would conclusively prove the escapement is not the concern at that stage. This is so because the formation of belief by the Assessing Officer is within the realm of subjective satisfaction (see ITO v. Selected Dalurband Coal Co. Pvt. Ltd. [(1996) 132 CTR (SC) 162: (1996) 217 ITR 597 (SC)]; Raymond Woollen Mills Ltd. v. ITO [(1999) 152 CTR (SC) 418: (1999) 236 ITR 34 (SC)].

17. The scope and effect of section 147 as substituted with effect from 1st April, 1989, as also Sections 148 to 152 are substantially different from the provisions as they stood prior to such substitution. Under the old provisions of Section 147, separate clauses (a) and (b) laid down the circumstances under which income escaping assessment for the past assessment years could be assessed or reassessed. To confer jurisdiction under Section 147(a) two conditions were required to be satisfied firstly the Assessing Officer must have reason to believe that income profits or gains

> chargeable to income- tax have escaped assessment, and secondly he must also have reason to believe that such escapement has occurred by reason of either (i) omission or failure on the part of the assessee to disclose fully or truly all material facts necessary for his assessment of that year. Both these conditions were conditions precedent to be satisfied before the Assessing Officer could have jurisdiction to issue notice under Section 148 read with Section 147(a). But under the substituted Section 147 existence of only the first condition suffices. In other words if the Assessing Officer for whatever reason has reason to believe that income has escaped assessment it confers jurisdiction to reopen the assessment. It is however to be noted that both the conditions must be fulfilled if the case falls within the ambit of the proviso to section 147. The case at hand is covered by the main provision and not the proviso."

15. Thus, it boils down to the fact that "escapement of income" from tax for whatever reason would suffice for the assessing Officer to initiate re-assessment proceedings by issuance of notice under Section 147 of the Act.

16. Keeping the above dicta in mind, when the facts on hand are re-examined, it would indicate that while completing the assessment under Section 143(3) of the Act, the assessing Officer has gone into the question of excluding the sum of ₹ 38,51,45,781/- from the export turnover on the ground that it was expenditure incurred in foreign exchange for providing technical services outside India. However, for re-opening the assessment the assessing Officer has intended to take a view that aforesaid sum cannot be considered as income derived from export of articles or things or computer software at all. It would not be out of place to mention that while concluding the assessment proceedings under Section 143(3) and during the course of assessment proceedings, the assessing Officer had called for clarifications from the assessee and in reply to the notice issued under Section 143(2)(ii) of the Act, the assessee on 06.03.2006 has categorically stated as under:

> "Based on the above definition, it may be appreciated that only such expenses by way of freight, telecommunication charges or insurance attributable to the delivery of computer software outside India, needs to be excluded from the export turnover in case of a company engaged in software development activities and expenses, if any, incurred in foreign exchange would need to be reduced only in the case of a company engaged in rendering technical services outside India.
>
> In this context, we wish to submit that the Company is primarily engaged in software development activities and is not involved in rendering any technical services outside India."

17. Considering the above explanation given by the assessee, the assessing Officer in the original assessment proceedings which resulted in order passed under Section 143(3) of the Act on 27.03.2006 has held to the following effect:

> "2.6. It is clear from the assessee's above submissions that the assessee is engaged in providing support services, which are nothing but technical services. The expenditure in foreign exchange is incurred for both development of software and providing technical services. However, the assessee has not been able to furnish a break-up of the expenditure incurred for development of

software and providing technical services. It has taken a stand that no technical services are provided and the entire expenditure is for development of software. Taking the functional analysis reproduced above into account, and in the absence of any break-up of the expenditure, 25% of the expenditure incurred under the following heads in foreign exchange is deemed to be the expenditure incurred in foreign exchange for providing technical services outside India.

Employees' salary	-	Rs.126,75,49,201
Overseas travel	-	Rs. 25,30,33,924
Total	**-**	**Rs.154,05,83,125**

2.7. Hence, the expenditure incurred in foreign currency for providing technical services is adopted at Rs.38,51,45,781/- and is allocated between the five STP Units in the ratio of the export sales. Similarly, from out of the communication expenses incurred in foreign currency of Rs.3,21,66,847/- an amount of Rs.7,03,50,677/- (as quantified by the assessee) is taken as attributable to the delivery of computer software and is allocated between the five STP Units in the same ratio of the Export Sales. Both these amounts are reduced from the export turnover in accordance with the definition of 'ETO' given in sec.10A."

18. Thus, it can be seen from the original assessment records that the claim of the assessee

under Section 10A of the Act was thoroughly scrutinized, the assessing Officer had examined the claim of expenditure incurred in foreign currency for providing technical services by allocating the sum of ₹ 38,51,45,781/- between the five STP units in the ratio of the export sales. In fact, the assessing Officer had raised certain queries during assessment proceedings and detailed reply given by the assessee, which is extracted herein above, would leave no doubt in our mind that the said issue was thoroughly addressed to by the assessing Officer, considered and the plea of the assessee came to be accepted. In that view of the matter, it cannot be construed that there was either non disclosure by the assessee or the assessing Officer had obtained material subsequent to the framing of the assessment order on 27.03.2006 so as to arrive at a conclusion that there was escapement of income from tax.

19. For the reasons aforestated, we are of the considered view that the Tribunal was fully justified in arriving at a conclusion that the re-opening of assessment was by change of opinion and the issue regarding eligibility of the income derived from rendering technical services abroad to be eligible for deduction under Section 10A or not had already been considered by the assessing Officer in the assessment concluded under Section 143(3) of the Act on 27.03.2006.

20. For the reasons aforestated, we proceed to pass the following:

ORDER

(1) Appeals are hereby dismissed by answering the substantial questions of law in favour of the assessee and against the revenue.

(2) Order of the Income Tax Appellate Tribunal, "C" Bench, Bangalore in ITA Nos. 283/Bang/2012 and 267/Bang/2012 dated 30.09.2013 are hereby affirmed.

(3) No order as to costs.

Sd/-
JUDGE

Sd/-
JUDGE

*sp