

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

+ **ITA No.928/2010**

% Date of Decision: 25.05.2011

COMMISSIONER OF INCOME TAX

... Appellant

Through:

Versus

M/S. S.T. MICRO ELECTRONICS PVT. LTD.

... Defendant

Through:

CORAM:

HON'BLE MR. JUSTICE A.K.SIKRI

HON'BLE MR. JUSTICE M.L.MEHTA

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| 1. Whether the Reporters of local papers may be allowed to see the judgment? | Yes |
| 2. To be referred to Reporter or not? | Yes |
| 3. Whether the judgment should be reported in the Digest? | Yes |

M.L.MEHTA, J. (Oral)

1. This is an appeal against the order of the Income Tax Appellate Tribunal ('the Tribunal' for short) dated 13th November, 2009 passed in ITA No.1182/Del/2005 & 4743/Del/2005 for the Assessment Year (AY) 2001-02 & 2002-03 respectively. The present appeal relates to AY 2001-02. The assessee company had two units; one 100% export oriented unit at NOIDA for the export of software and another division which was doing sales and marketing. The assessee filed return under Section 143(1) of the Income Tax Act ('the Act' for short). Subsequently, the case was selected for scrutiny under Section 143(3)

of the Act. Notice under Section 143(2) of the Act was issued. Detailed questionnaire along with notice under Section 143(1) of the Act was also issued. The Assessing Officer noticed deficiencies on three counts. Firstly, it was noticed from the Profit and Loss Account that assessee had shown total receipts of Rs.11,015.16 lacs which included sale of computer software designs and applications at Rs.10,625.98 lacs and other income to the extent of Rs.389.19 lacs. The ratio of export income from sale of computer software and income from Service & Marketing activities (S&M Activities) was 97.55% and 2.45% respectively. The expenses attributed to S&M division was of two types; (i) direct expenses pertaining to S&M division e.g. expenses on salaries, PF contribution, staff welfare, hire charges, travelling, miscellaneous etc. and (ii) common expenses which have been apportioned between S&M division and the software division on the employee head-count basis. Secondly, it was noticed that the assessee followed a system of rewarding its employees by paying an incentive based on achievement of certain targets. This incentive was termed as Management by Objectives incentive (MBO incentive). It was linked to the employee's productivity and overall performance. This scheme was operated on a calendar year basis and the amount payable to each employee was on the basis of performance evaluation made as on 31st December. Further, the incentive for the period January to March was carried over to the subsequent financial year. Thirdly, it was also noticed that the assessee had made late payment in respect

of employees' as well as employer's contribution to PF. The amount of Rs.9,62,855/- and Rs.10,68,096/- being towards employees' and employer's contribution respectively to PF for the month of July, 2000 was deposited late.

2. With regard to allocation of expenses, both direct as well as common, the Assessing Officer (AO) recorded the same to be not proper. He observed that certain expenses attributed to S&M division were disproportionately higher compared to employees working in S&M division. S&M division had 12 employees and the Export Unit had 714 employees. The AO reduced the quantum of expenses allocated to the S&M division from Rs.2,45,24,090/- to Rs.1,22,25,968/- which resulted in the AO making disallowance of Rs.1,22,98,122/-.

3. With regard to the MBO incentive as claimed by the assessee, the AO held that the provision made on this account represented unascertained liability since the assessee could not foresee whether any particular employee would meet the target or not, or whether the said employee would continue in service or not. Accordingly, the AO disallowed the entire provision of Rs.76,23,754/-.

4. With regard to late payments made by the assessee in respect of employees' and employer's contribution to PF, the AO noted that the due date prescribed under the PF Act is 15th of the following month. He

noted that the cheque payment was made on 19th July, 2000 i.e. 4 days after the due date and the same was cleared only on 22nd July, 2000. He recorded that since the payment was made belatedly, the same was not allowable in terms of provisions of Section 43B of the Act.

5. Aggrieved by the order of AO, the assessee filed an appeal before the Commissioner of Income Tax (Appeals) [CIT(A)]. With regard to apportionment of expenses, the CIT(A) held that when any apportionment of expenses was required to be made as a general proposition, the yardstick to be applied first was that of actual expenditure. The CIT(A) found the head-count basis of common expenditure to be irrational and consequently deleted the addition of Rs.1,22,98,122/-.

6. With regard to the issue of provision for MBO incentives, the CIT(A) had deleted the addition stating the same to be squarely covered by the decision of the Supreme Court in the case of **Bharat Earth Movers Ltd. Vs. CIT**, 2000(112) Taxman 61.

7. On the issue of disallowance on the point of delayed payment of employees' and employer's contribution to PF, the CIT(A) deleted the addition on the ground that the second proviso to Section 43B of the Act and also Circular No. E-128(I) 60-III dated March 19, 1964 take care of such a situation by providing that where the payment has been

made otherwise than in cash, the grace period of 5 days beyond the statutory due date would be allowable.

8. Against the order of CIT(A), the Revenue went in appeal before the Tribunal which has upheld the order of the CIT(A) vide the impugned order.

9. It is noted that certain additional evidence was accepted by the CIT(A) observing that additional details had not been called for by the AO and adequate opportunity was not afforded to the assessee for filing further details. The AO had adopted three different criteria for apportionment of the expenses in respect of various items of the S&M division and Export Unit. These were (i) number of employees; (ii) actuals; (iii) ratio of turnover. The CIT(A) recorded, as a matter of fact, that in respect of direct expenses, the apportionment done by the AO was unwarranted inasmuch as it ought to have been done on the basis of actual expenses incurred. The CIT(A) rightly observed that what was required to be apportioned was the common expenditure of the two units and not the total expenses. The assessee had apportioned common expenses on the basis of head-count, whereas direct expenses on the basis of actuals. It was noticed by the CIT(A) and rightly so that by applying head-count ratio, the appellant has claimed expenses attributable to S&M division as 1.65%, whereas on the basis of turnover ratio, it would have been 2.45% of the total. That being so,

it was observed that the assessee itself had applied a conservative ratio for apportioning the common expenses to S&M division. It was rightly held by both the appellate authorities below that in the case of common expenses, reasonable and conservative system would be most appropriate than a hybrid criteria of different methods. In deleting expenses of Rs.1,22,98,122/- on account of apportionment, the CIT(A) recorded as under:

“Having considered the submissions and facts, I am of the opinion that the bifurcation of common expenses by the appellant on the basis of ratio of employees (headcount) was reasonable, conservative and justified. In view of the above, I hold that the disallowance of Rs.1,22,98,122/- on account of apportionment of direct and common costs was not justified and is directed to be deleted.”

This was confirmed by the Tribunal in the following manner:

“Further it is also noticed that the method as followed by the assessee is consistently being followed. In these circumstances, as no evidence to disturb the findings as given by the Id. CIT(A), more specifically in para 2.7 of his order, has been placed before us by the revenue, we are of the view that the findings of Ld. CIT(A) on this issue is liable to be upheld and we do so.”

10. With regard to the disallowance of Rs.76,23,754/- on account of provision of MBO incentive, the CIT(A) noted that the assessee followed mercantile system of accounting. In such system if a liability has arisen or accrued during the accounting period, even though paid subsequently, it would constitute an allowable expenditure. The assessee was following this system consistently in the past. In the

case of ***Bharat Earth Movers Ltd. Vs. CIT***, 2000(112) Taxman 61 it was held that in case of provision made for payment of leave encashment, if a scientific method of valuation has been followed for calculation of the liability, the same would be allowable expenditure. In the present case, since the assessee has been making a provision for this liability in the past and the liability stood proved and crystallized during the previous year itself and there being insignificant difference between provision made and actual payments made in the preceding years, the method adopted by the assessee could be said to be scientific one. The business liability having definitely arisen in the accounting year, the deduction can be allowed both for the liability quantified and discharged on a future date and the provision made permitting such liability incurred would be deductible expenditure. We do not see any infirmity in this finding recorded by the both appellate authorities.

11. With regard to disallowance of Rs. 9,62,855/- and Rs. 10,68,096/- on account of belated payment of employees' and employer's contribution to PF, also both the appellate authorities have held that the payment was made by cheque within the grace period of five days beyond the statutory period and that being so, the same would constitute the payment in due date within the definition of Section 36(1) (V-a) read with Circular No. E-128(I) 60-III dated March 19, 1964. On this ground also, we do not see any illegality or infirmity in the impugned order.

12. For the above reasons, we do not see any substantial question of law having arisen. Consequently, the appeal is hereby dismissed.

**M.L.MEHTA
(JUDGE)**

**A.K.SIKRI
(JUDGE)**

MAY 25, 2010
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