

\$~

*

IN THE HIGH COURT OF DELHI AT NEW DELHI

12.

+

W.P.(C) 1739/2015 & CM No. 3109/2015 (for stay)

M/s MICROSOFT CORPORATION (INDIA)
PVT. LTD.

..... Petitioner

Through: Mr. Nageswar Rao with Mr. Sandeep S.
Karhail, Advocates.

versus

DEPUTY COMMISSIONER OF INCOME TAX
& ANR.

...Respondents

Through: Mr. Rahul Chaudhary, Senior Standing
counsel.

CORAM:
JUSTICE S. MURALIDHAR
JUSTICE VIBHU BAKHRU

ORDER
07.04.2016

%

1. The Petitioner (hereafter 'the Assessee') has filed the present petition, *inter alia*, impugning a notice dated 30th March, 2014 issued under Section 148 of the Income Tax Act, 1961 (hereafter 'the Act') for reopening the assessment in respect of Assessment Year (AY) 2009-10. The Assessee also impugns an order dated 21st January, 2015 passed by the Assessing Officer (hereafter 'AO') disposing of the Assessee's objections to reopening of assessment.

Factual background

2. The Assessee is a wholly-owned subsidiary of Microsoft Corporation,

USA and its principal business includes providing marketing support services to its Associated Enterprises (hereafter 'AE').

3. On 1st July, 2006, the Assessee entered into a Market Development Agreement with Microsoft Operations Pte Ltd., a company incorporated in Singapore (hereafter 'Microsoft Singapore'). In terms of the said agreement, the Assessee was appointed to provide marketing support services and product support services for Microsoft products in the territories of Bhutan, India, Maldives, Nepal and British Indian Ocean. The Assessee was entitled to remuneration on cost plus 15% mark up basis.

4. The Assessee filed its return of income for the AY 2009-10 on 30th September, 2009 declaring a total income of Rs.1,76,14,60,024/- and claimed a refund of Rs.8,02,83,280/-. The aforesaid return was revised and the Assessee claimed a higher TDS of Rs.7,93,20,259/-; consequently, the refund claimed by the Assessee was revised to Rs.8,55,99,997/-. The income declared by the Assessee remained unchanged.

5. The return filed by the Assessee was picked up for scrutiny and notices under Section 143(2)/142(1) of the Act were issued. Since the income of the Assessee also included income from international transactions with AE's, the AO made a reference to the Transfer Pricing Officer (hereafter 'TPO') to determine the Arm's Length Price (hereafter 'ALP') in respect of those international transactions. In the proceedings before the TPO which ensued thereafter, the Assessee filed all the relevant material including the Market Development Agreement dated 1st July, 2006 entered into with Microsoft Singapore. The TPO passed an order dated 30th January,

2013 proposing an upward adjustment of Rs.51,75,67,512/- on account of difference in the ALP. The AO, thereafter, passed a draft assessment order against which the Assessee preferred its objections before the Dispute Resolution Panel. The final assessment order under Section 143(3) read with Section 144C of the Act was passed by the AO on 28th February, 2014 assessing the Assessee's total income at Rs.2,13,18,89,940/-. The Assessee has preferred an appeal against the said assessment order before the Income Tax Appellate Tribunal (hereafter 'ITAT') which is stated to be pending.

6. In the meanwhile, the Commissioner of Service Tax (hereafter 'CST') raised a demand of Rs.2,56,07,36,626/- on account of service tax (including penalty) on the Assessee for the period of April 2006 to December, 2007. The Assessee's contention that the services rendered under the Market Development Agreement qualified as 'export of services' and were thus exempt from service tax, was not accepted by the CST.

7. Aggrieved by the order dated 23rd September, 2008 passed by the CST, the Assessee preferred an appeal along with an application seeking waiver of pre-deposit before the Central Excise and Service Tax Appellate Tribunal (CESTAT). By an order dated 31st July, 2009, CESTAT stayed the recovery of the disputed demand of service tax subject to the Petitioner making a deposit of Rs.70 crores. The Assessee made the aforesaid deposit on 30th November, 2009, that is, during the financial year 2009-10 relevant to AY 2010-11.

8. The appeal preferred by the Assessee before the CESTAT was considered by a Division Bench but due to difference of opinion, it was

referred to a third Member, who on 23rd September, 2014 held that the marketing support services rendered by the Assessee to Microsoft Singapore qualified as 'export of services' and was, thus, exempt from service tax. Mr Nageswar Rao, learned counsel appearing for the Assessee further states that the sum of Rs.70 crores deposited by the Assessee has since been refunded.

9. Whilst the proceedings before the CESTAT were pending, the Assessee in its computation of income for AY 2010-11, claimed a deduction of Rs.70 crores which was paid during the relevant financial year. However, the same was disallowed.

10. On 30th March, 2014, the AO issued the impugned notice under Section 148 of the Act for reassessing the income of the Assessee for AY 2009-10. On receipt of the aforesaid notice, the Assessee requested for the reasons for issuance of notice which was provided to the Assessee. The Assessee filed its objections against the aforesaid reasons on 4th August, 2014 before the AO, which were disposed of by the impugned order dated 21st January, 2015.

11. Mr Nageswar Rao, learned counsel appearing for the Assessee referred to the reasons recorded by the AO and submitted that the same indicated that the AO had proceeded on the basis that the Assessee was entitled to a mark up of 15% on the service tax element which was *ex facie* erroneous and without any basis. He drew the attention of this Court to clauses 6.1 and 6.2 of the Agreement dated 1st July, 2006 which expressly indicated that the compensation payable to the Assessee was exclusive of any applicable service tax. He contended that the Assessee was not entitled

to any mark up on the element of service tax and, therefore, the fact that service tax demand had been raised on the Assessee could not possibly lead to an inference that any income had escaped assessment. Mr Nageswar Rao also handed over a copy of the assessment order dated 23rd March, 2015 passed under Section 143 read with Section 147 of the Act which also proceeded on the basis that the Assessee was entitled to receive a mark up on the service tax demanded from the Assessee.

12. Mr Rahul Chaudhary, learned senior standing counsel appearing for the Revenue fairly conceded that since the service tax demand have been quashed and the Assessee's contention that the services rendered by it qualified as export of services had been accepted, the additional income as assessed by the AO would not be sustainable. He, however, contended that the AO's reason to believe that Assessee's income had escaped assessment would have to be considered on the facts as available on that date. He submitted that since the Assessee had claimed deduction of Rs.70 crores as service tax paid during the FY 2009-10 in its computation of income for AY 2010-11, the AO had sufficient reasons to believe that the Assessee was entitled to a mark up of 15% on service tax. Therefore, the impugned notice under Section 148 of the Act could not be faulted. He emphasized that since the Assessee had itself treated payment of service tax as an element of cost, the Assessee could not dispute that it would be entitled to a mark up of 15% on service tax.

13. We have heard the learned counsel for the parties.

14. At the outset, it would be relevant to refer to the reasons recorded by

the AO for reopening of the assessment which reads as under:-

"Reasons recorded under section 147 of the Act.

The assessee company has filed its return of income for the A.Y. 2009-10 declaring total income of Rs.177,71,71,615/- on 31.03.2011. Subsequently the case was selected for scrutiny and assessment u/s 143(3) was completed on 28.02.2014 at total income of Rs.213,18,89,940/-.

It has been observed from the submissions filed by the assessee company, during the course of assessment proceedings of the assessee i.e., M/s Microsoft Corporation India Pvt. Ltd. for the AY 2010-11 that a Service Tax Demand of Rs.256,07,36,626/- was raised by the Commissioner of Service Tax in the FY 2008-09 against the assessee. The assessee itself has claimed the above demand as ascertained liability for the AY 2009-10 and has claimed deduction u/s 43B, for the payment of Rs. 70 crores, out of the above demand in FY 2009-10 as per the ratio of the judgment of Hon'ble Supreme Court given in the case of Bharat Carbon & Rubber Manufacturing 239 ITR 505. Since, the assessee itself has claimed the above demand as its ascertained liability for the AY 2009-10 on the basis of the above judgment of Hon'ble Supreme Court, hence, the corresponding revenue of Rs. 294,48,47,120/- on Cost Plus 15% Mark Up as per the terms of agreement of the assessee with M/s Microsoft USA has also accrued to the assessee. Thus, the amount of Rs. 38,41,10,494/- (Rs.294,48,47,120 - Rs. 256,07,36,626/-) has escaped assessment for the AY 2009-10 within the meaning of Section 147.

Therefore after examination of the relevant material available I have reason to believe that there is failure on the part of the assessee to disclose true and full particulars of its income and I am satisfied that income of Rs.38,41,10,494/- has escaped the assessment and it is a fit case to be reopened u/s 147 of the Income Tax Act by issue notice u/s 148."

15. A plain reading of the aforesaid reasons indicate that the AO had proceeded on the basis that since a service tax demand of Rs.2,56,07,36,626/- was raised, the Assessee would be entitled to a corresponding revenue of Rs.2,94,48,47,120/- and the same implied that a sum of Rs.38,41,10,494/- being 15% mark up on service tax had escaped assessment. In other words, the AO proceeded on the basis that the Assessee was entitled to 15% mark up on service tax. This is palpably erroneous as the agreement dated 1st July, 2006 entered into between the Assessee and Microsoft Singapore clearly indicated that the reimbursement and additional compensation would be exclusive of service tax which would be the responsibility of Microsoft Singapore. The Assessee had pointed out the same in its objections and had drawn the attention of the AO to clauses 6.1 and 6.2 of the said agreement dated 1st July, 2006 which read as under:-

"6.1 Product Support Services and Consulting Services. For product support services and consulting services rendered pursuant to Article 2, MO shall pay Subsidiary an amount equal to one hundred and fifteen percent (115%) of Subsidiary's actual expenses, less revenues, incurred in connection with its duties, provided such expenses comply with Subsidiary's budget, as adjusted from time to time, and provided, further, such expenses are not already covered by another section of this Agreement or covered in another agreement between Subsidiary and MO or any MO affiliate. The reimbursement and additional compensation shall be exclusive of any applicable consumption tax such as a Value Added Tax or a Goods and Services Tax, which consumption tax shall be the responsibility of MO.

6.2 Marketing of Microsoft Products. For assistance in the marketing of Microsoft Products under Article 3, MO shall pay Subsidiary one hundred and fifteen percent

(115%) of Subsidiary's actual expenses, less revenues, incurred in connection with its duties as defined in Article 3, provided such expenses comply with Subsidiary's budget, as adjusted from time to time, and provided, further, such expenses are not already covered by another section of this Agreement or covered in another agreement between Subsidiary and MSFT or any MSFT affiliate.

Taxes, insurance, duties, freight and other charges not attributable to the Microsoft Product itself paid by the customer shall not be considered in calculating the amount of commission. The commission payments shall be exclusive of any applicable consumption tax such as a Goods and Services Tax or a Value Added Tax which consumption tax shall be the responsibility of MO."

16. In view of the plain language of the aforesaid agreement, the fact that the service tax demand has been raised could not possibly lead to an inference that the Assessee was entitled to a mark up on the said amount which had escaped assessment.

17. The belief that income of an Assessee has escaped assessment must be made on some tangible material which could reasonably lead to such a belief. In the present case, the demand of service tax on the Assessee could not possibly lead to any such inference as under the Agreement between the Assessee and Microsoft Singapore, the Assessee was not entitled to any mark up on service tax.

18. We are also constrained to mention that despite the Assessee pointing the same out in its objections and also referring to the relevant clauses (Clauses 6.1 and 6.2) of the agreement dated 1st July, 2006, the AO had

completely ignored the same while disposing of the said objections by his order dated 21st January, 2015. Although the AO adverted to several decisions, he failed to apply the principles enunciated in those decisions. In **ACIT v. Rajesh Jhaveri Stock Brokers P. Ltd.:** (2007) 291 ITR 500 (SC), the Supreme Court had explained that *"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 has escaped assessment, it can be said to have reason to believe that an income had escaped assessment."*

19. In **ITO v. Lakhmani Mewal Das:** (1976) 103 ITR 437, the Supreme Court held that *"The reasons for the formation of the belief contemplated by section 147(a) of the Income-tax Act, 1961, for the reopening of an assessment must have a rational connection or relevant bearing on the formation of the belief. Rational connection postulates that there must be a direct nexus or live link between the material coming to the notice of the Income-tax Officer and the formation of his belief that there has been escapement of the income of the assessee from assessment in the particular year because of his failure to disclose fully and truly all material facts."*

20. In the present case, a mere reference to the agreement on the basis of which the AO held that the Assessee was entitled to cost plus 15% mark up, would indicate that such mark up was not available on any levy of service tax. Thus, there was no material for the AO to infer that the Assessee was entitled to 15% mark up on service tax. Consequently, he could have no reason to believe that the income of the Assessee had escaped assessment.

21. By an order dated 23rd February, 2015, this Court permitted the Assessing Officer to pass an assessment order but directed that the same shall not be given effect to, till further orders. The AO thereafter proceeded to pass the reassessment order on 23rd March, 2015 and although, the submissions made by the Assessee had been reproduced including the relevant portion of clause 6.1 and 6.2 of the agreement in question, curiously the AO has failed to address the same. The only part of the assessment order that indicates the reasons for enhancing the assessment is para 3.3 of the said reassessment order that reads as under:-

"3.3 In this case the issue is that whether income being Markup on the service tax liability has been escaped to tax. During the assessment proceedings of assessment year 2010-11, it had been observed that a Service Tax Demand of Rs. 256,07,36,626/- was raised by the Commissioner of Service Tax in the FY 2008-09 against the assessee. The assessee itself has claimed the above demand as ascertained liability for the AY 2009-10 and has claimed deduction u/s 43B, for the payment of Rs.70 crores, out of the above demand in FY 2009-10 as per the ratio of the judgement of Hon'ble Supreme Court given in the case of Bharat Carbon & Rubber Manufacturing 239 ITR 505. The assessee has an agreement with it's foreign associated concern to receive Cost + 15% on all liabilities incurred. Since, the assessee itself has claimed the above demand as its ascertained liability for the AY 2009-10 on the basis of the above judgement of Hon'ble Supreme Court, hence, the corresponding revenue of Rs.294,48,47,120/- on Cost Plus 15% Mark Up as per the terms of the agreement of the assessee with M/s Microsoft USA has also accrued to the assessee. Thus, the amount of Rs.38,41,10,494/- (Rs.294,48,47,120 - Rs.256,07,36,626/-) has escaped assessment for the AY 2009-10 within the meaning of Section 147."

22. It is plainly evident from above that the AO has merely reproduced the reasons recorded for reopening the assessment and has failed to apply its mind to the submissions made by the Assessee. Although, the AO notes that CESTAT had passed an order accepting the Assessee's contention that it was not liable to pay its service tax, the same has also been rejected by holding that the CESTAT's order dated 29th September, 2014 is likely to be appealed against and, therefore, is not final. It appears to us that the AO has approached the entire matter with the pre-determined mind to raise a demand oblivious of the relevant facts.

23. In view of the above, the impugned notice dated 30th March, 2014 and the impugned order dated 21st January, 2015 are set aside. The assessment order dated 23rd March, 2015 passed pursuant to the impugned notice is also set aside. The writ petition is allowed. The pending application stands disposed of. In the circumstances, the parties are left to bear their own costs.

S. MURALIDHAR, J

VIBHU BAKHRU, J

APRIL 07, 2016/RK