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T.C.(A).No.631 of 2010



IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 16-04-2026

CORAM

**THE HONOURABLE DR JUSTICE G. JAYACHANDRAN
AND
THE HONOURABLE MR.JUSTICE R.SAKTHIVEL**

Tax Case (Appeal).No. 631 of 2010

Commissioner Of Income Tax,
Chennai.

... Appellant
Vs.

M/s.Pentasoftware Technologies Ltd,
PAN: AAACP 1895R
25, I Main Road, I Main Road,
United India Colony,
Kodambakkam,
Chennai - 600 024.

... Respondent

Prayer: Appeal under Section 260A of the Income Tax Act, 1961, against the order of the Income Tax Appellate Tribunal Madras 'B' Bench, dated 24.03.2008 in ITA No.2148/Mds/2007.

For Appellant: Ms.V.Pushpa
For Respondent: Mr.G.Baskar,
for Mr.V.Muthukumar.

J U D G M E N T

(Order of the Court was made by G.Jayachandran J.)

The respondent company, *M/s.Pentasoftware Technologies Limited*, for the Assessment Year 2003-2004, filed its return of income on 01.12.2003, admitting a loss of Rs.43,72,45,148/- after claiming an exemption of Rs.13,72,05,309/- under Section 10A of the Income Tax Act. The return of income was processed



and the total income was determined at Rs.66,00,775/- as per Book Profits under Section 115 JB of the Act.

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2. The case was selected for scrutiny under Section 143(2) of the Act. As the aggregate value of the foreign transactions made by the assessee exceeded Rs.5 crores, the case was referred to the Transfer of Pricing Officer (TPO). Pending scrutiny, the assessee filed a revised return on 31.03.2005, increasing its returned loss to Rs.53,63,91,013/-. The increase in loss explained as being due to write-off of unrealised sales. For the request of the Assessing Officer to furnish evidence relating to such unrealised sales, the assessee failed to provide evidence to prove such unrealised sales. Hence, the revised computation of income filed by the assessee was rejected.

3. The Assessing Officer, after considering the materials available, held that the assessee engaged in exporting software from the Software Technology Park (STP) units and also done domestic sales from Non-STP units. The assessee, in its original return, claimed deduction of Rs.13.72 crores on the profits earned from STP units under Section 10A of the Income Tax Act. The Assessing Officer determined the 'total turn-over', including the domestic sales, at Rs.200,05,17,323/-, since in the formula for determining the quantum of eligible deduction


$$\frac{9/10 \times \text{Profits of the Undertaking} \times \text{Export Turnover (ETO)}}{\text{Total Turnover (TTO)}}$$

Under Section 10A =

Total Turnover (TTO)

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The total turnover was enhanced substantially and the claim under Section 10A was restricted to Rs.1,28,12,817/-. The Assessing Officer also declined to grant depreciation claimed by the assessee in respect of assets of STP units and IBM machines.

4. The Assessing Officer also found certain other deductions claimed by the assessee are not permissible and made the following disallowances /adjustments and recomputed the taxable income as below:-

“(a) Interest receipt of Rs.375,456/- which was netted off against the interest paid debited to the Profit and Loss Account (Schedule 17) of the Assessee company was brought to tax as "Income from Other Sources" and held as not entitled to deduction under Section 10A.

(b) Other receipts, of Rs.2,90,639/- accounted under the head "Other Income" comprising of sale of brochures, scrap, AMC income etc. were held to be not in the nature of profits and gains derived from export unit and hence not eligible for deduction under Section 10A of the Income Tax Act. Accordingly, the same were brought to tax under the head "Income from Other Sources".

(c) Depreciation claim of Rs.50,80,94,257/- on intangible assets of the non-STP units (in the form of



goodwill) was held inadmissible for reasons elaborated in Assessment Order for assessment year 2002-03.

(d) As the break up of rates and taxes amounting to Rs.38.07 lakhs was not furnished, the entire amount was disallowed as the capital expenditure by holding it as the fee paid for increasing the assessee's authorised share capital.

(e) While computing the eligible deduction u/s.10A, the Assessee-company had deducted expenditure in foreign exchange from both "Export Turnover" and "Total Turnover". The AO, however, did not allow the FOREX Expenditure as a deduction in computing the "Total Turnover". Likewise, the Assessing Officer also excluded the un-remitted sale proceeds of Rs.63,85,68,271/- from the 'export turnover'. As a result, the deduction u/s.10A got restricted to Rs.1,28,12,817/- as against the assessee's original claim of Rs.13,72,05,309/-.

(f) Delayed Employee contribution to ESI amounting to Rs.20/275/- paid beyond due dates was brought to tax u/s.36 (l)(va) as per qualification in Annexure 4A of the Tax Audit Report. Likewise, delayed ESI Employer's contribution of Rs.55,032/- was disallowed u/s.43B of the I.T.Act.

(g) On the basis of Annexure 5 to the Tax Audit Report, penal charges amounting to Rs.1,41,393/- was held as inadmissible u/s.37(l) and accordingly disallowed.

(h) Interest-free advance to subsidiaries amounting to Rs.70.39 crores was held not incurred wholly and exclusively for the purpose of business. Following the decision in the case of CIT vs. M/s.T.S.Hajee Moosa &



Company, 153 ITR 422 (Mad), interest proportionate to such advance amounting to Rs.8,90,35,174/- was disallowed out of total interest payment of Rs.12.96 crore.”

5. The assessee, on being aggrieved by the additions/disallowance/adjustments made in the assessment order, filed appeal before the Commissioner of Income Tax (Appeal)-V, Chennai. The Appellate Authority, taking into account the grounds of appeal, partly allowed the assessee's appeal. Insofar as the plea to exclude the foreign exchange expenditure from the total turnover for the purpose of computation of deduction under Section 10 A. It is further directed the Assessing Officer to allow the claim of write-off of unrealised sales to the extent of Rs.23,53,51,174/- from the profits of the assessee company. The Assessing Officer directed to verify the depreciation claim of the assessee's STP units as per the Income Tax Rules and to allow the same in proportion to the income of the STP Unit brought to tax. The disallowance of depreciation claimed in respect of IBM Machine was reversed.

6. In respect of treating the bank interest income as income from 'other sources' and excluding the same from the eligible business profits, for the purpose under Section 10A, the exclusion of miscellaneous receipts from the



business profits and assessing the same as 'other sources' income and the treatment of foreign exchange fluctuation gain as 'other source' income and their exclusion from the business profits, the Appellate Authority upheld the view of the Assessing Officer.

7. As against the order of the Commissioner of Income Tax (Appeal) passed in ITA.No: 135/06-07, appeals before the ITAT filed by the assessee in respect of the dismissal portion and by the revenue in respect of the allowed portion. Few other appeals filed against the similar orders passed by the Commissioner of Income Tax (Appeal) in respect of *M/s.Pentamedia Graphics Ltd.*, were also taken up for consideration by the ITAT together since the issues were one and the same.

8. The order impugned in this T.C.(A).No:631/2010 is the appeal filed by the Revenue against the dismissal of its appeal in ITA No: 2148/Mds/2007, dated 24/03/2008. The Income Tax Appellate Tribunal, in its order impugned held that what is to be excluded from the export turnover is also to be excluded from the total turnover. The deduction under Section 10A can be properly be computed only by deducting the expenditure incurred in foreign exchange both from the total turnover and from the export turnover. The ITAT upheld the view of the Commissioner of Income Tax (Appeal) in respect to the proportionate



allowability of depreciation on the assessee's STP units. Also, in respect of deleting the disallowance of Rs.8,90,35,174/- being the proportionate interest relating to interest free advances to subsidiaries, held in favour of the assessee by holding that, the aforesaid amount was due from wholly owned subsidiaries. It was reflected under the caption 'Sundry debtors'. It was transferred by the assessee to the "Loans and Advances" account, since the assessee was contemplating to obtain shares in those subsidiaries in lieu of the prevailing debt. The amount kept by the assessee under the head 'Loans and Advances', subject to final approval of the RBI with regard to the aforesaid transaction. Therefore, affirmed the conclusion of the CIT (A) that the increase in advances to subsidiaries resulted only from the transaction which was only a book entry, without any actual diversion of funds.

9. Unsatisfied by the above reasoning of Income Tax Appellate Tribunal for the dismissal of their appeal, the Department is before us.

10. At the time of admission, the following four substantial questions of law were framed by this Court.

1. Whether on the facts and circumstances of the case the Tribunal was right in detection of expenditure in foreign exchange is allowable from the total turnover



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while computing deduction under section 10-A?

2. Whether on the facts and circumstances of the case, the Tribunal was right in holding that the assessee was entitled to depreciation on goodwill on the ground that the assessee was permitted to use the trade name “Pentasoftware”, failing to see that the assessee had used the name even before the agreement with M/s.Pentamedia Graphics Ltd. and as such, had not really acquired any fresh right by the agreement?

3. Whether in the facts and circumstances of the case, the Tribunal was right in confirming the CIT (A) direction to the assessing officer to apportion the total disallowance of 27.88 lacs relating to ROC Fee, Penalty, 43B Disallowance between STP activities / Non STP Activities and allow the amounts relating to STP Activities?

4. Whether in the facts and circumstances of the case, the Tribunal was right in deleting the addition of interest of Rs.8,90,35,174/- made towards diversion of interest bearing funds to subsidiaries without interest?

Substantial Question of Law: No.1

The identical substantial question of law came up before the Hon'ble Division Bench of this Court in respect of the same assessee, formerly *M/s.Pentamedia Graphics Ltd.* This Court, following the dictum laid down in



Commissioner of Income-Tax, Central-III vs. HCL Technologies Limited,
reported in [2018] 404 ITR 719 (SC), held as follows:

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“20. Even in common parlance, when the object of the formula is to arrive at the profit from export business, expenses excluded from export turnover have to be excluded from total turnover also. Otherwise, any other interpretation makes the formula unworkable and absurd. Hence, we are satisfied that such deduction shall be allowed from the total turnover in same proportion as well.”

In view of the above, position of law settled by the Division Bench of this Court following the dictum laid by Hon'ble Supreme Court in HCL Technologies Limited case cited supra. The substantial question of law held in favour of the assessee.

Substantial question of law No.2

In a batch of cases identical issue came up before the Hon'ble Supreme Court, the lead case is ***Sharp Business Systems vs. Commissioner of Income Tax*** reported in ***[2025] 181 Taxmann.com 657 (SC)***. The Hon'ble Supreme Court had laid down certain parameters to decide about the investment made to acquire goodwill and non-compete fees and remitted the matter back to the respective ITAT to hear afresh following the ratio laid by them in that judgment



and pass appropriate orders. The case of the present assessee is also one among the batch of cases decided. Hence, we are of the view that this issue to be heard afresh as per the judgment of the Hon'ble Supreme Court passed in *Sharp Business Systems (cited supra)*. Hence, the matter is remitted back to the Income Tax Appellate Tribunal for reconsideration as per the dictum laid by the Hon'ble Supreme Court in *Sharp Business Systems* case (cited supra).

Substantial question of law No.3

As far as this question is concerned, we find that the Appellate Authority as well as the Tribunal has held that disallowance *in toto* by the Appellate Authority is improper and, therefore had directed the Assessing Officer to apportion the total disallowance amount of Rs.27.88 lakhs between STP / Non-STP units.

The Learned Counsel for the Department relied upon the judgment of the Hon'ble Supreme Court in *Punjab State Industrial Corporation Limited vs. Commissioner of Income Tax reported in [1997] 93 Taxman 5 (SC)*, wherein it has held that the amount paid by the Company to the ROC as filing fees for enhancement of capital base of the Company cannot be allowed as revenue expenditure.



Whereas, in this case, the issue is not whether the ROC Fee paid to be disallowed invoking Section 43B of the Act. The issue is regarding apportioning of the fees between the STP and Non-STP units. The said apportionment has to be done for computing the taxable income. Being the fact finding, authorities, both the Appellate Authority as well as the Tribunal have held concurrently. We, therefore, confirm the order of the Tribunal and we hold this issue in favour of the assessee.

Substantial question of law No.4

This substantial question of law requires a fresh appreciation of facts. Based on the book entries, the Assessing Officer has considered the sum of Rs.70.39 crores as 'Loans and Advances' to the subsidiary Company and disallowed the proportionate interest. However, the statement of accounts and other material placed before the Appellate Authority had brought to light that no cash transaction was effected to the subsidiaries. Pending RBI approval, for the value of the material supplied to the subsidiary company, the assessee Company been paid as shares of the subsidiary Company. This explanation of the assessee been accepted by the Appellate Authority as well as the Tribunal and disallowance been reversed.



However, we find that whether the said investment in the subsidiary company is connected to any business expenditure is not been discussed either by the Appellate Authority or by the Tribunal. The version of the assessee regarding the said investment has to be tested by the Assessing Officer afresh after affording opportunity to the assessee to provide necessary materials. For that limited purpose, the matter is remitted back to the Assessing Officer for fresh processing of computing the tax in respect of this transaction and complete the assessment preferably within three months.

11. Accordingly, the Tax Case Appeal is disposed as per the above direction. There shall be no order as to costs.

(G.JAYACHANDRAN J.)(R.SAKTHIVEL J.)
16-04-2026

Index :Yes/No
Neutral Citation :Yes/No
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To,
The Income Tax Appellate Tribunal, Madras.



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