www.pwc.com/in

Sharing insights

News Alert
23 August, 2012

pwc

Formation conditions under section 10A of the Act to be tested in the first year of claim

In brief

Recently, the Bombay High Court (the HC) in the case of Western Outdoor Interactive Pvt. Ltd.[1] (the assessee) held that if a claim under section 10A of the Income-tax Act, 1961 (the Act) has been accepted in the first assessment year (AY), such relief cannot be withdrawn in subsequent AYs unless there is a change in the facts.

Background

- The assessee develops and exports software for in-flight entertainment. The assessee has two units - one in fort, Mumbai which commenced operations in AY 1997-98 and the other at the Santacruz export processing zone (SEEPZ) which commenced operations during AY 2000-01.

- The assessee claimed the benefit under section 10A of the Act for its unit located at SEEPZ from AY 2000-01. This was allowed by the Revenue authorities till AY 2002-03.

[1] CIT *v.* Western Outdoor Interactive Pvt. Ltd. [TS-614-HC-2012(Bom)]

- Subsequently, the claim was rejected for AYs 2003-04 and 2004-05 on the ground that the SEEPZ unit was formed by splitting the business of the fort unit.

- The assessment for AY 2002-03 was reopened under section 147 of the Act. The deduction was denied by the assessing officer (AO) on the following basis:

  - Similar software was being exported by both units.

  - In most cases, export realisations were received in single payment by both units.

  - Expenses such as foreign travel were incurred by the fort unit and subsequently transferred or allocated to the SEEPZ unit.

- On appeal, the Commissioner of Income-tax (Appeals) (CIT(A)) set aside the order was of the AO and directed the AO to grant relief under section 10A of the Act to the assessee.

- On further appeal by the revenue authorities, the Income-tax Appellate Tribunal (the Tribunal) held that the SEEPZ unit is entitled to the benefit of section 10A of the Act, based on the following findings:

  - The claim for AYs 2000-01 and 2001-02 was allowed in a scrutiny assessment under section 143(3) of the Act.

  - The units were functioning independently at different locations.

  - The books of account and bank accounts for each unit were maintained separately.

  - There is no record to prove that plant, machinery or equipment has been transferred from the fort unit to the SEEPZ unit.

  - Similar products manufactured by both units cannot be a reason to conclude that they are not two separate units.

- The Tribunal dismissed the revenue authorities' appeal and held that section 10A benefit is available for the assessee.

- The revenue authorities appealed against the Tribunal's order before the HC on the substantial question of law.

Issue

Whether the Tribunal was justified in allowing exemption under section 10A of the Act for the SEEPZ unit

Assessee's contentions

- The formation conditions mentioned in section 10A(2)(ii) of the Act were tested by the Revenue authorities while completing the scrutiny assessment under section 143(3) of the Act for AYs 2000-01 and 2001-02. After examining the formation conditions, the Revenue authorities concluded that the benefit under section 10A of the Act is available for the SEEPZ unit as there was no splitting-up or reconstruction of the existing fort unit.

- The HC rulings in Paul Brothers[2] and Direct Information Pvt. Ltd.[3] were relied on. It was held that once a benefit of deduction was extended for a number of years, unless the benefit is withdrawn for the first year, it cannot be withdrawn for subsequent years, particularly, when there is no change in the facts.

- After examination of the evidence, the CIT(A) and the Tribunal concluded that the SEEPZ unit was independent and not formed by splitting-up of the fort unit.

[2] CIT *v.* Paul Brothers [1995] 216 ITR 548 (Bom)
[3] Direct Information Pvt. Ltd. *v.* ITO [2011] 203 Taxman 70 (Bom)

Revenue's contentions

- The SEEPZ unit was formed by splitting-up of the fort unit as they developed the same software, exported it to the same party and many a times had common remittances.
- The mere opening of a separate bank account, taking separate premises and purchasing few computers did not make the SEEPZ unit independent.
- Each assessment year is independent and there is no concept of *res judicata* in tax matters. The revenue authorities are entitled to take different views in subsequent years.

High Court ruling

- The HC relied on the ratio laid down in Paul Brothers and Direct Information Pvt. Ltd. (above). The benefit of deduction on the satisfaction of conditions cannot be withdrawn for subsequent years unless relief granted for the first assessment year is withdrawn or set aside.
- The Revenue authorities have no evidence to prove that there is a change in facts for subsequent years different from AYs 2000-01 and 2001-02. Therefore, the authorities cannot deny the benefit.
- Further, the facts relating to the formation of the SEEPZ unit have already been examined by the CIT(A) and the Tribunal who have recorded that the SEEPZ unit was not formed by splitting any existing unit.
- Accordingly, the HC concluded that no substantial question of law arises in the present facts and dismissed the Revenue authorities' appeal.

Conclusion

The HC relied on its earlier rulings and reiterated the principle that if a claim under section 10A has been accepted in the first AY, such relief cannot be withdrawn in subsequent AYs. This holds good unless there is a change in the facts or the benefit is withdrawn for the first AY.

Clearly, this indicates that formation stage conditions for 10A units are required to be satisfied in the first year of claim only and not on a year-on-year basis.

The ruling on this matter should be a good defense for assessees who are denied tax holiday in later years by the Revenue authorities.

Our Offices

For private circulation only

Ahmedabad President Plaza, 1st Floor Plot No 36 Opp Muktidham Derasar Thaltej Cross Road, SG Highway Ahmedabad, Gujarat 380054 Phone +91-79 3091 7000	**Bangalore** 6th Floor, Millenia Tower 'D' 1 & 2, Murphy Road, Ulsoor, Bangalore 560 008 Phone +91-80 4079 7000	**Bhubaneswar** IDCOL House, Sardar Patel Bhawan Block III, Ground Floor, Unit 2 Bhubaneswar 751009 Phone +91-674 253 2279 / 2296	**Chennai** 8th Floor, Prestige Palladium Bayan 129-140 Greams Road, Chennai 600 006 Phone +91-44 4228 5000	**Hyderabad** #8-2-293/82/A/113A Road no. 36, Jubilee Hills, Hyderabad 500 034, Andhra Pradesh Phone +91-40 6624 6600
Kolkata 56 & 57, Block DN. Ground Floor, A- Wing Sector - V, Salt Lake. Kolkata - 700 091, West Bengal, India Telephone: +91-33 2357 9101 / 4400 1111 Fax: (91) 033 2357 2754	**Mumbai** PwC House, Plot No. 18A, Guru Nanak Road - (Station Road), Bandra (West), Mumbai - 400 050 Phone +91-22 6689 1000	**Gurgaon** Building No. 10, Tower - C 17th & 18th Floor, DLF Cyber City, Gurgaon Haryana -122002 Phone : +91-124 330 6000	**Pune** GF-02, Tower C, Panchshil Tech Park, Don Bosco School Road, Yerwada, Pune - 411 006 Phone +91-20 4100 4444	For more information contact us at, pwctrs.knowledgemanagement@in.pwc.com