



Once deduction under Section 10AA has been accepted in the first year, it cannot be withdrawn in the subsequent year by examining factors which were required to be seen in the first year

Background

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Macquarie Global Services Pvt Ltd.¹ (the taxpayer) held that once the claim of deduction under Section 10AA of the Income-tax Act, 1961 (the Act) has been accepted in the first year of the operations, then in subsequent year it cannot be withdrawn by examining the factors which were required to be seen in the first year of the claim.

The Tribunal also held that the taxpayer had not violated any of the conditions stipulated under Section 10AA of the Act since there has been a substantial increase in the revenue in the Export Oriented Unit (EOU) even after setting up of Special Economic Zone (SEZ) unit. The taxpayer continued to make an addition to the fixed assets in the SEZ unit independently. Further, the majority of employees in the SEZ unit were new employees.

Facts of the case

- The taxpayer is a wholly owned subsidiary of Macquarie Global Services (Mauritius) Limited. It is a captive contract service provider, engaged in the business of provision of back office support services to its Associated Enterprises (AE). The taxpayer had set up an EOU in March 2007 which is eligible for deduction under Section 10A and 10B of the Act. From AY 2011-12, the deduction under Section 10A and 10B of the Act was not available due to sunset period of EOU unit.

- During the relevant AY 2011-12, the taxpayer has formed Special Economic Zone (SEZ) Unit. The taxpayer commenced operations from the SEZ unit from AY 2011-12 and accordingly claimed the deduction under Section 10AA of the Act which was duly supported by an audit report in Form 56F and such a claim has been allowed by the Assessing Officer (AO) in scrutiny proceedings after completing the assessment under Section 143(3) of the Act. Similarly, in the subsequent assessment year also, i.e., in AY 2012-13, a similar claim for deduction under Section 10AA has been allowed by the AO in the order passed under Section 143(3) of the Act.
- However, in the third year of operation, i.e., AY 2013-14, the AO denied deduction under Section 10AA and held that the taxpayer had formed SEZ Unit with an intention of shifting business of EOU to SEZ as the group company has reached to sun set clause under Section 10A of the Act. SEZ Unit was formed with splitting and diversion of the existing business. The taxpayer has been set up with the specific motive of shifting the business from taxable zone to SEZ Zone in the newly set up SEZ unit by splitting of existing business in the non-taxable area just to cheat the provisions of the section 10AA of the Act.
- The Dispute Resolution Panel (DRP) upheld the order of the AO.

¹ Macquarie Global Services Pvt. Ltd. v. DCIT (ITA No.: -6794/Del/2017) – Taxsutra.com

Tribunal's decision

- The conditions laid down in Section 10AA(4) of the Act have to be seen on the date of formation, whether the undertaking has violated any conditions prescribed therein or not. If the conditions stipulated in the section have been accepted, that is, once the eligibility of deduction under Section 10A or 10B or 10AA of the Act has been accepted in the initial AY, then it cannot be withdrawn in the subsequent years for a breach of certain conditions which are required to be seen or examined in the first year of claim.
- The Bombay High Court in the case of Western Outdoor Interactive Pvt. Ltd.² held that whether a benefit of deduction is available for a particular number of years on satisfaction of certain conditions and under the provision of Act, then without withdrawing or setting aside the relief granted for the first AY in which claim was made and accepted, the AO cannot withdraw the relief for subsequent assessment years. This ratio was laid down in the context of Section 10A of the Act. Subsequently, the similar ratio was upheld in various decisions³.
- The Delhi High Court in the case of Tata Communication Internet Services Ltd.⁴ in the context of 80IA(3) of the Act, concluded that bar as provided under Section 80-IA(3) is to be considered only for the first year of a claim for deduction under Section 80-IA and not in the subsequent years. In that case, the AO had raked up the issue of splitting up or reconstruction of already existing business in the subsequent year, when in the first year of claim this issue was not disturbed.
- Relying on various decisions, it has been held that, once the claim of deduction under Section 10AA has been accepted in the first year of the operations and also in the second year, then in the third year same cannot be withdrawn by examining the factors which were required to be seen in the first year of the claim. Thus, on this ground alone, the Tribunal held that the AO cannot deny the claim of deduction under Section 10AA to the taxpayer in this year and hence is directed to allow the same.
- On merits of the case, the Tribunal observed that there had been a substantial increase in the revenue in the EOU unit even after setting up of SEZ unit from the FY 2011-12 to FY 2016-17. Thus, it cannot be held that after the sun set period, the revenue of the EOU has gone down.

- It has been observed that the taxpayer continued to make an addition to the fixed assets in the SEZ unit independently and there is no material to show that the additions to the fixed assets have been by way of transfer from EOU units. Similarly, from the perusal of the list of technical manpower, it has been observed that except for two or three employees out of 30 employees are newly hired and therefore, it is not a case where the old employees of EOU unit have been entirely shifted to SEZ unit which seems to be the allegation of the AO.
- Thus, the Tribunal held that the taxpayer has not violated any of the conditions prescribed in Section 10AA of the Act and therefore, it is entitled for a claim of deduction under Section 10AA in this year.

Our comments

The issue with respect to the denial of deduction under Section 10AA in subsequent years when it was allowed in the first assessment year has been a matter of debate before the Courts.

The Bombay High Court⁵ has held that once a benefit of deduction was extended in respect of a provision for a particular number of years then 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.

The Tribunal in the present case has held that once the claim of deduction under Section 10AA has been accepted in the first year of the operations and also in the second year, then in subsequent year it cannot be withdrawn by examining the factors which were required to be seen in the first year of the claim. The Tribunal also observed that the conditions prescribed in Section 10AA of the Act need to be examined in the year of formation and not in the subsequent years.

² CIT v. Western Outdoor Interactive Pvt. Ltd. [2012] 349 ITR 309 (Bom)

³ CIT v. Arts & Crafts Exports [2012] 246 CTR 463 (Bom), CIT v. Macbrout Engineering (P) Ltd. [2014] 232 Taxman 406 (Bom)

⁴ CIT v. Tata Communication Internet Services Ltd. [2012] 204 Taxman 606 (Del)

⁵ CIT v. Paul Bros. [1995] 216 ITR 548 (Bom), Direct Information (P.) Ltd. v. ITO [2011] 203 Taxman 70 (Bom)

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