

**Zycus Infotech Pvt. Ltd. Vs. Ito**

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**Court :** Income Tax Appellate Tribunal ITAT Mumbai

**Decided On :** Jun-29-2007

**Judge :** K Thangal, Vice, D Srivastava

**Appellant :** Zycus Infotech Pvt. Ltd.

**Respondent :** ito

**Judgement :**

1. The assessee has filed both the appeals. They relate to assessment year 2001-02. While ITA No. 8854/ Mum./2004 is directed against the assessment of income, the other appeal, i.e., ITA No. 5641/Mum./2006 is directed against the order of the Commissioner (Appeals) confirming the penalty levied by the assessing officer under Section 271(l)(c) of the Income Tax Act as a result of the aforesaid assessment of income. We therefore find it convenient to dispose off both these appeals by a consolidated order.

1.1 The Id. Commissioner (Appeals) erred in confirming the action of the assessing officer (i) by not giving sufficient proper and effective opportunity of being heard to the appellant, and (ii) by failing to appreciate that the assessing officer had framed the assessment order without giving proper, effective and sufficient opportunity of being heard to the appellant.

1.2 It is submitted that the appellate order requires to be held bad and illegal as the same is passed in violation of the principles of natural justice.

The Id. Commissioner (Appeals) erred in confirming the action of the assessing officer v/hereby the assessing officer denied the benefit of Section 10A of the Income Tax Act, 1961 to the appellant.

While doing so, the Id. Commissioner (Appeals) failed to appreciate that: (i) there was no change in beneficial ownership of the appellant company with respect to the shares carrying more than 51 per cent of voting power, and (ii) the appellant company's case was not covered by Sub-section (9) read with Explanation 1 to Section 10A of the Act.

2.3 It is submitted that in the facts and the circumstances of the case, and in law, the, appellant is entitled to the benefit under Section 10A of the Act and accordingly, the action of the assessing officer requires to be reversed.

3. Briefly stated, the facts of the case are that the assessee, a private limited company, was engaged in the business of software development and services during the previous year relevant to the assessment year under appeal. In Annexure "A" to the report dated 11-10-2001 of the Chartered Accountants under Section 10A of the Income Tax Act, 1961 in Form No. 56F, the nature of the business of the assessee has been shown thus: "Service providers of Job content management for online recruitment companies in the United States of America and caters to E-Catalog and Knowledge Management areas with the State of the Art Product/ Solutions". The assessment year under appeal is the first year for which exemption has been claimed under Section 10A of the Income Tax Act. The assessing officer examined the claim of the assessee for exemption under Section 10A in the light of the provisions of Sub-section (9) thereof which provided that the deduction under Section 10A would not be allowed if the ownership or the beneficial interest in the undertaking was transferred by any means during any previous year. He noted that Shri Aatish Dedhia and Shri Nanji Dedhia held 50 per cent each of the voting power and shareholding in the assessee-company as on 31-3-1998. In other words, the aforesaid two persons enjoyed 100 per cent shareholding, voting power and beneficial interest in the assessee-company in the year ended 31 -3-1998, ie., the financial year in which the undertaking was set up.

The assessing officer also noted that the shareholding/ beneficial interest and voting power of both the aforesaid two persons put together had gone down to 42.63 per cent and 51.42 per cent respectively during the previous year relevant to the assessment year under appeal. Since the shares of the assessee-company carrying not less than 51 per cent of voting power were not beneficially held, on the last day of the previous year relevant, to the assessment year under appeal, by Shri Aatish Dedhia and Shri Nanji Dedhia who had earlier held the shares of the assessee-company carrying not less than 51 per cent of the voting power on the last day of the year in which undertaking was set up, the assessing officer held that the claim of assessee for exemption under Section 10A was hit by Sub-section (9) thereof and accordingly denied the exemption to the assessee-company.

4. On appeal, the Id. Commissioner (Appeals) confirmed the order of the assessing officer in this behalf with the following observations: 9. I have carefully considered the facts of the case, findings of the assessing officer and submissions of the appellant before Assessing Officer as well as in appellate proceedings. It is very evident from the chart given above that shareholding pattern of the company has changed during the previous year. As mentioned above, the company has incorporated on 9-9-1997 and Mr. Aatish Dedhia and Nanji Dedhia were holding 50 per cent of the shares and voting power of the company each on 31-3-1998. Their shares holding percentage together reduced to 42.60 per cent as on 31-3-2001 which clearly reveals that the percentage of the shares of the company held by shareholders in the year the undertaking was set up, as got reduced to less than 51 per cent i.e., 42.60 per cent of the shares as against 100 per cent held previously. So it is clearly established that the beneficial interest in the undertaking is transferred.

Hence in view of the provisions of Section 10A(9) read with Explanation 1 to said Section the claim of the assessee-company for deduction under the provision was rightly disallowed by the assessing officer. No interference is called for in the order of assessing officer. Hence ground of appeal is dismissed.

5. The assessee is now in appeal before this Tribunal. Supporting the case of the assessee, the Id. Counsel for the assessee submitted that Shri Aatish Dedhia, the promoter of the assessee-company, after doing his B-Tech from IIT, Mumbai and MS from Cornwell University (USA), had worked for Intel in the USA. According to him, he was awarded a patent for a new technique in designing a power saving adder and then came to India in 1997 and promoted the assessee-company together with his father holding 100 per cent shareholding in the company. He submitted that as the assessee-company had high potential, two well known foreign strategic financial investors, namely, Citicorp International and GE decided to make investments in the assessee-company and accordingly the assessee-company issued shares to them in the year under appeal with the result that the shareholding as also beneficial interest of S/Shri Aatish Dedhia and Nanji Dedhia got reduced to 42.63 per cent in the year under consideration while they continued to have voting power to the extent of 51.42 per cent as a result of allotment of shares not carrying any voting power to the aforesaid foreign strategic financial investors. He further submitted that the intention behind the investment was to take benefit of the high potential of the assessee-company and that the investors were not interested in the management and control of the company, which was evident from the fact that the shares allotted to them did not carry any voting rights. He reiterated that though the shareholding and beneficial interest of the promoters got reduced to 42.63 per cent in the year under appeal, they retained voting power of 51.42 per cent and that Shri Aatish Dedhia continued to have full control and management over the company. He submitted that the assessing officer has disallowed the claim of the assessee for exemption under Section 10A by invoking the provisions of Sub-section (9) thereof by holding that transfer of ownership or beneficial interest in the undertaking has taken place so as to reduce the beneficial interest to less than 50 per cent. According to him, the case of the assessee is that since more than 51 per cent of the voting power was still retained by the promoters in the assessment year under appeal, the case of the assessee was not hit by the bar contained in Sub-section (9) in view of specific clarification given in Explanation 1 to Section 10A.6. In support of his submissions, the Id. Counsel has invited our attention to Explanation 1 to Section 10A and submitted that the said Explanation clearly laid down the circumstances in which the

ownership or beneficial interest in the undertaking can be said to have been transferred. He submitted that a company shall be presumed to have transferred its ownership or the beneficial interest in the undertaking only when the shares of the company carrying not less than 51 per cent of the voting power are not beneficially held, on the last day of any previous year, by persons who held the shares of the company carrying not less than 51 per cent of the voting power on the last day of the year in which the undertaking was set up. According to him, the Legislature has consciously and deliberately chosen to keep voting power as the sole criterion and not shareholding pattern simpliciter as criterion for deciding the transfer of ownership or beneficial interest in the companies. According to him, the emphasis was on change in shareholding pattern affecting voting power by more than 51 per cent and not in any other change in the pattern of shareholding not accompanied by change in voting pattern. He contended that the aforesaid interpretation placed by him on Sub-section (9) of Section 10A was in consonance with the real intention and object of Sub-section (9) which was to ensure that the majority of the decision-making people continued to remain the same i.e., to ensure that persons having control over decision-making remains unchanged. In support of his submissions, he has placed reliance on CIT v. Italindia Cotton Co. (P.) Ltd. . He submitted that Sub-section (9) of Section 10A should be interpreted on the same pattern as Section 79 of the Income Tax Act. According to him, the role of the Explanation was to explain and to clear up any ambiguity in the section and that both the Explanation as also Sub-section (9) should be read harmoniously and together. In support of his case, he has placed reliance on the following decisions: C.A. Abraham v. ITO (xvii) Federation of Andhra Pradesh Chambers of Commerce & Industry v. State of Andhra Pradesh (2001) 247 ITR 363 (SC) Vidarbha Irrigation Development Corpn. v. Addl CIT CIT v. Madurai Soft Drinks (P.) Ltd. 7. In reply, the Id. departmental Representative supported the orders of the departmental authorities.

8. We have heard both the parties, perused the orders of the departmental authorities and other materials placed before us. There is no dispute with regard to the factual aspects of the case. It is true that the shares were allotted to foreign strategic financial investors without voting rights during the year under appeal with the result that original promoters continued to have 51 per cent or more of the

voting power without beneficially holding shares carrying not less than retaining 51 per cent of the voting power in the year under appeal. On this factual matrix the short question is whether the claim of the assessee for exemption under Section 10A is hit by Sub-section (9) thereof.

9. For the sake of convenience it may be useful to reproduce Sub-section (9) of Section 10A as it stood at the relevant point of time.

(9) Where during any previous year, the ownership or the beneficial interest in the undertaking is transferred by any means, the deduction under Sub-section (1) shall not be allowed to the assessee for the assessment year relevant to such previous year and the subsequent years.

Explanation 1 For the purposes of this section, in the case of a company, where on the last day of any previous year, the shares of the company carrying not less than fifty-one per cent of the voting power are not beneficially held by persons who held the shares of the company carrying not less than fifty-one per cent of the voting power on the last day of the year in which the undertaking was set up, the company shall be presumed to have transferred its ownership or the beneficial interest in the undertaking: Provided that nothing contained in this Explanation shall apply to any change in the shareholding of the company as a result of (a) its becoming a company in which the public are substantially interested; or (b) disinvestments of its equity shares by any venture capital company or venture capital fund.

10. The scope and effect of Sub-section (9) of Section 10A effective from 1-4-2001 has been explained in the departmental Circular 14 of 2001 (245 ITR (St.) 102-03) as under: 21.3 Sub-section (9) provides that where during any previous year, the ownership or beneficial ownership interest in the undertaking is transferred, the benefit of the deduction would not be allowed for that year and subsequent years. An explanation applicable in cases of companies further provides that where 51 percent of shares are not beneficially held by persons, who held these shares at the time of setting up of the unit, it will be deemed to be a transfer of ownership.

21.4 Owing to difficulties in monitoring change in shareholding pattern in listed companies in which the public are substantially interested, the amendment provides that the provisions of Sub-section (9) would not be applicable in the case of a company where its shareholding undergoes any change as a result of its becoming a company in which public are substantially interested. The proviso would also not be applicable to a company in which public are substantially interested at the time of setting up of the undertaking. In other words, the proviso will not apply to companies in which public are substantially interested either at the time of setting up or later on its becoming a company in which public are substantially interested. The proviso also applies to any change in the shareholding pattern of any venture capital company or a venture capital funds, which have to necessarily disinvest at some stage.

11. It is quite clear on careful perusal of Sub-section (9) of Section 10A that deduction under Section 10A shall not be available to an assessee for any previous year during the course of which he transfers the ownership or the beneficial interest, in the undertaking by any means. Thus, where an undertaking, which is eligible for deduction under Section 10A for assessment year 2001-02, transfer its ownership or beneficial interest during the said previous year, deduction under Section 10A shall not be available to the said assessee for the said assessment year i.e., assessment year 2001 -02. The provision of Section 10A(9) is intended to forfeit exemption in case of transfer of ownership or beneficial interest in the undertaking otherwise eligible for relief.

12. We shall now turn to Explanation 1 to Section 10A on which the Id.

Counsel for the assessee has relied heavily in support of his case.

Explanation 1, applicable to the companies, takes care of a situation" where on the last day of any previous year, the shares of the company carrying not less than 51 per cent of the voting power are not beneficially held by the persons who held the shares of the company carrying not less than 51 per cent of the voting power on the last day of the year in which the undertaking was set up" and creates a legal presumption that the company, in such a case, shall be presumed to have transferred its ownership or the beneficial interest in the undertaking. The use of

the word "carrying" in the aforesaid limbs of the Explanation makes it amply clear that it is the holding of the shares carrying not less 51 per cent of the voting power which is crucial and not mere exercise of 51 per cent of voting power without holding matching shares. In order to apply Explanation 1 it must be shown that those very persons who held the shares of the company carrying not less than 51 per cent of the voting power on the last day of the year in which the undertaking was set up have ceased to beneficially hold shares carrying not less than 51 per cent of the voting power as on the last day of the relevant previous year. The emphasis of Explanation 1 is that the shares of the company carrying not less than 51 per cent of the voting power must continue to be beneficially held by those persons who held shares carrying not less than 51 per cent of the voting power in the year in which the undertaking was set up. The relevant question to ask in this behalf is whether those very persons who held shares of the company carrying not less than 51 per cent of the voting power in the year in which the undertaking was set up continue to beneficially hold the shares carrying not less than 51 per cent of the voting power in the relevant previous year. The focus of the Explanation is on the beneficial holding of the shares of the company carrying not less than 51 per cent of the voting power and not on holding 51 per cent of the voting power.

In the case before us, the persons who held the shares carrying not less than the 51 per cent of the voting power in the year in which the undertaking was set up have ceased to beneficially hold shares carrying not less than 51 per cent of the voting power in the year under appeal.

In fact their shareholding has declined to 42.60 per cent as on 31 -3-2001. They would therefore, have voting power to the extent of their shareholding only. They however continued to control and manage the company as they had majority of the voting power not by virtue of their holding the shares carrying not less than 51 per cent of the voting power but by virtue of the shares allotted to the foreign strategic financial investors without giving any voting right to them. It is thus clear that the promoters in the present case have ceased to beneficially hold shares carrying not less than 51 per cent of voting power.

13. We have duly taken note of all the authorities cited at the bar.

However, none of the decisions relied upon by them is with reference to the provisions of Section 10A(9) of the Income Tax Act in the context of the facts presented before us. As regards the plea of the assessee that sufficient opportunity was not given by the assessing officer and Commissioner (Appeals), we find that they have passed their respective orders after giving reasonable opportunity for hearing to the assessee.

The assessee has brought no evidence before us that it wanted more time to properly prepare its case and the departmental authorities have refused to grant the time. In any case, we have granted adequate hearing to the assessee. We are therefore of the view that no useful purpose will be served by remanding the matter back to the departmental authorities.

1.1 The Id. Commissioner (Appeals) erred in confirming the action of the assessing officer whereby the assessing officer levied a penalty of Rs. 35,95,187 under Section 271(1)(c) of the Income Tax Act, 1961 alleging that the appellant had concealed its particular of income by filing inaccurate particulars.

1.2 While doing so, the Commissioner (Appeals) failed to give adequate, proper and sufficient opportunity of being heard to the appellant.

(a) the ground on which the assessing officer had denied the benefit under Section 10A of the Act to the appellant is of a highly technical nature, involving interpretation of a provision of that section; and (b) in any case, the appellant's claim under Section 10A was a bona fide claim which was supported by the certificate of a qualified chartered accountant.

1.4 It is submitted that in the facts and circumstances of the case, and in law, no such penalty was called for.

1.5 The appellant submits that the penalty of Rs. 35,95,187 levied by the Id. Assessing Officer and confirmed by the Commissioner (Appeals) be cancelled in toto.

16. Briefly stated, the facts of the case are that the assessing officer, while completing the assessment, initiated the proceedings for levy of penalty under

Section 271(1)(c). In view of his order denying exemption to the assessee under Section 10A. After hearing the assessee, the assessing officer has imposed the impugned penalty.

On appeal, the Id. Commissioner (Appeals) has confirmed the penalty levied by the assessing officer as he held the belief that the assessee has, wrongly claimed deduction under Section 10A by furnishing inaccurate particulars of income. He has held that the case of the assessee for levy of penalty falls squarely under Explanation 1 to Section 271(l)(c) of the Income Tax Act. He has also recorded the finding that the assessee has not been able to substantiate its explanation and hence the explanation given by the assessee is not bona fide.

17. The assessee is now in appeal before this Tribunal. It is the case of the assessee that the explanation given by the assessee is bona fide and the nature of the default committed is technical and hence it should be excused from the levy of penalty. He has relied upon more than 30 decisions in support of the proposition that no penalty for concealment is possible if there is no evidence that the explanation given by the assessee is false. According to him, the penalty is not automatically attracted even if the explanation given by the assessee is rejected.

18. In reply, the Id. departmental Representative has supported the order of the Commissioner (Appeals) and the assessing officer.

19. We have heard the parties, We find that the assessee has made full and true disclosure of all facts materials to the computation of its income in the documents accompanying the return of income. It is not the case of the departmental authorities either that the assessee has concealed any such particulars from the department. The assessee however preferred to claim exemption under Section 10A on its own understanding of law. It is a quite different thing that neither the departmental authorities nor this Tribunal has agreed with the claim made by the assessee. But every rejection of the claim made by the assessee does not lead to automatic imposition of penalty under Section 271(1)(c). In order to attract the levy of penalty, there must be failure on the part of the assessee in making full and true disclosure of the facts material to the computation of income and then only it can be said that he has concealed the particulars of his income or furnished inaccurate

particulars of his income. This is not the case here.

On the facts of the case, we are satisfied that this is not a fit case for levy of penalty. We therefore cancel the impugned penalty levied by the assessing officer and confirmed by the Commissioner (Appeals).

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