

Income Tax Case laws decided in the month of March 2016

Prepared by

CA Raju S Narayanan

carajusn@gmail.com

Important note:

This document contains Income Tax Case laws decided in the month of March 2016 by various authorities in India. If you want details of similar case laws decided during the period Jan to Dec 2015, feel free to contact me.

HIGH COURT OF DELHI

ANZ Grindlays Bank

v.

Deputy Commissioner of Income-tax*

S. MURALIDHAR AND VIBHU BAKHRU, JJ.

IT APPEAL NO. 32 OF 2004†

MARCH 1, 2016

JUDGMENT

Vibhu Bakhru, J. - The present appeal has been filed by Standard Chartered Grindlays Bank Ltd., formerly known as 'ANZ Grindlays Bank Ltd.' (hereafter the 'Assessee') under Section 260A of the Income Tax Act, 1961 (hereafter the 'Act') impugning an order dated 29th August, 2003 passed by the Income Tax Appellate Tribunal (hereafter 'the Tribunal') in ITA No. 1442/Del of 1997. The said appeal, ITA 1442/Del of 1997, was preferred by the Assessee against an order dated 14th January, 1997 passed by the Commissioner of Income Tax (Appeals) [hereafter 'CIT(A)'] in Appeal No.164/96-97 which in turn was preferred by the Assessee against the assessment order dated 25th March, 1994 passed in respect of Assessment Year (AY) 1991-92.

2. The controversy involved in the present appeal relates to the denial of deduction of expenses - by virtue of provision of Section 40(a)(iii) of the Act -for failure on the part of the Assessee to deduct and deposit Tax Deducted at Source (TDS) within the prescribed time. This appeal was admitted on 28th April, 2005 and two questions of law were framed. At the hearing on 22nd December 2015, the Assessee did not press for one of the questions as it was stated that it had since obtained relief in respect thereof. Consequently only the following question of law arises for consideration:

"Whether the Income Tax Appellate Tribunal was right in law in holding that salaries paid to ex-patriate employees overseas on which tax was paid in accordance with CBDT Circular dated 685 dated 17/20 June 94 and Circular 686 dated 12.8.94, is not permissible as a deduction in computation of taxable business income in view of the provisions of Section 40 (a)(iii) of the Income Tax Act, 1961 read with Article 7 of the Indo- UK Double Taxation Avoidance Treaty?"

3. The aforesaid question has to be considered in the following context:

3.1 During the relevant period - financial years 1984-85 to 1993-94 - the Assessee was a non-resident banking company and its principal place of business was situated outside India. The Assessee also carried on banking business in India through its branches situated within

the country. During the relevant period, the Assessee seconded some of its employees from overseas to its branches in India. These expatriate employees were employed for the business carried on in India. They received a part of their remuneration by way of salaries and perquisites in India which were duly reflected in the Profit and Loss Account drawn up by the Assessee in respect of its Indian operations. The Assessee also deducted tax at source on so much of the remuneration that was payable to the aforementioned expatriate employees in India. Undisputedly, such TDS was deposited with the Government.

3.2 In addition to the remuneration paid to the aforementioned expatriate employees in India, the Assessee's head office situated overseas also made certain payments to and/or for the benefit of such expatriate employees. However, the Assessee did not account for such payments, which were in the nature of salaries, allowances and perquisites, in its Profit and Loss Account drawn up in respect of its business in India. The Assessee neither claimed such payments as a deduction for the purposes of computing its income chargeable to tax in India nor deducted any tax under Chapter XVII B of the Act.

3.3 During the relevant period, some of the other non-resident assesseees, who had employed expatriate employees in India, had also not deducted TDS on payments made to and/or for the benefit of such employees abroad on an erroneous understanding that payments made abroad were not subject to withholding tax in India. In order to clarify the position, the Central Board of Direct Taxes (CBDT) issued a Circular i.e. Circular No. 685 dated 17/20th June, 1994. By the aforesaid Circular, the CBDT clarified that all payments made and perquisites provided to employees overseas for services rendered in India are taxable in India irrespective of the place where such payments or perquisites have been made or provided. Accordingly, if the employees have rendered services in India, the employers are liable to deduct tax at source even in respect of payment of salary, allowances and perquisites paid and/or provided to such employees overseas. The said circular also indicated that in order to encourage immediate voluntary compliance, CBDT had decided that penalty proceedings under Section 221 and 271C of the Act and prosecution under Section 276B of the Act would not be initiated in cases where the employers came forward and paid the entire amount of tax due under Section 192 of the Act along with interest before 31st July, 1994.

3.4 Pursuant to the aforesaid Circular (CBDT Circular No.685 dated 17/20th June, 1994), the Assessee deposited a sum of Rs.9,69,43,214/-, being the amount of TDS pertaining to the payments made abroad to and/or for the benefit of the employees serving in India during the financial years 1984-85 to 1993-94 and the interest due thereon, with the Income Tax Authorities.

3.5 The tax and interest deposited by the Assessee was duly verified and accepted by the income tax authorities and the concerned Commissioner of Income Tax issued a communication on 11th November, 1994 duly informing the Assessee that in view of the

payments made, no penalty or prosecution action would be initiated in respect of the payments made overseas to and/or for the benefit of the expatriate employees.

3.6 The assessments for the six assessment years from AY 1985-86 to 1990-91 stood concluded as on 28th July, 1994 and, thus, the Assessee could not claim any deduction on account of the payments made in respect of the said years. However, the Assessee's appeal in respect of AY 1991-92 was pending before CIT(A) and the Assessee sought to claim a deduction of an amount of Rs.1,32,46,994/- in respect of payments made pertaining to the financial year 1990-91. The CIT(A) rejected the Assessee's claim by holding that such claim could not be made in appellate proceedings. He also observed that no deduction could be claimed in view of Section 40(a)(iii) of the Act. He doubted whether the entire tax due had been paid by the Assessee since the amount of tax paid would also be includable as income of the employees and, therefore, have the effect of increasing their income and consequently, the tax payable thereon. He further observed that it was possible that the salaries paid to the employees overseas were a part of the head "office expenses".

3.7 On appeal, the Tribunal permitted the Assessee to urge the additional ground but rejected the same principally as falling foul of Section 40(a)(iii) of the Act. The Tribunal observed that Section 40 of the Act is a 'prohibitive' or 'disincentive' provision and, thus, had to be considered strictly. It held that since no tax had been deducted at source under Chapter XVII B of the Act within the prescribed time, no deduction under Section 40(a)(iii) was permissible. The Tribunal was of the view that a deduction would be permissible only if the provisions of Chapter XVII B are strictly complied with and TDS is deducted and paid within the prescribed time. It observed that the CBDT Circular only gave immunity to the Assessee from penalty and prosecution but did not remove the disincentive under Section 40 of the Act.

3.8 The Tribunal also referred to Section 40(a)(i) of the Act which expressly provided that no deduction would be allowed in respect of any interest, royalty, fees for technical services or other sum chargeable under the Act which is payable outside India and in respect of which no tax has been deducted and paid under Chapter XVII B of the Act. The Tribunal noted that proviso to Section 40(a)(i) of the Act expressly provided that where tax in relation to any sum mentioned in sub clause (i) of clause (a) of Section 40 of the Act is paid or deducted in any subsequent year, the deduction would be allowed in the previous year in which such tax was paid or deducted. The Tribunal reasoned that since no such similar provision existed in respect of sub clause (iii) of clause (a) of Section 40 of the Act, no deduction would be permissible for payments which are chargeable under the head "Salaries" if tax had not been paid or deducted under Chapter XVII B.

4. The question whether an assessee is liable to deduct tax at source on the aforementioned payments made to and/or for benefit of its employees seconded from its head office situated outside India, is no longer res integra in view of the decision of the Supreme Court

in *CIT v. Eli Lilly & Co. (India) (P.) Ltd.* [\[2009\] 312 ITR 225/178 Taxman 505](#). The same is also not a subject matter of dispute in the present appeal.

5. It cannot be disputed that the Assessee has paid the tax which it was required to withhold under the provisions of Section 192 of the Act. Although before the CIT(A), the Revenue had sought to contend that the amount paid to the employees has not been verified as it did not form a part of the Profit and Loss Account submitted by the Assessee, however, the same is without merit as the communication dated 11th November, 1994 issued by the Commissioner of Income Tax (hereafter also referred to as "CIT") duly indicates that the Assessee had made a disclosure of the payments made outside India for financial years 1984-85 to 1993-94 in respect of its expatriate employees and further had provided "full details". The Commissioner of Income Tax had also obtained a report from the lower authorities and the TDS payments made were duly verified. The AO had also examined the exchange rates applied by the Assessee while determining the amount of tax to be deposited. It is only after duly verifying the relevant facts that the CIT had issued the communication accepting that no action for penalty or prosecution would be initiated in respect of the payments made to expatriate employees.

6. Undisputedly, the entire tax payable on the salaries along with interest due thereon has been received by the Revenue. Even before us, Mr P. Roy Chaudhari, learned Senior Standing Counsel for the Revenue did not dispute that the Assessee had paid the requisite amount of tax.

7. Concededly, the powers of a CIT (A) are wide and in an Appeal against an Assessment order, it may confirm, reduce, enhance or annul the assessment. Thus, in cases where there is dispute as to the material facts for entertaining a claim, the CIT (A) would be well within his powers to do so. In the present case, the reliance placed by the CIT (A) on the decision of *Addl. CIT v. Gurjargravures (P.) Ltd.* [\[1978\] 111 ITR 1 \(SC\)](#) is mis-placed as in that case neither any claim was made before the AO nor was there any material on record to support the claim. The Supreme Court specifically noted the same and held that on the facts of that case, the question referred to the High Court should have been answered in the negative. In the present case, there is no dispute as to the material facts required for allowing the deduction as claimed by the Assessee. The TDS paid on the expenses claimed have been duly verified and the tax on the payments made which are chargeable under the head 'Salaries' have been recovered by the Government. The only reason for denying the claim is non-deposit of TDS within the prescribed time. The TDS having been deposited, there is no impediment for Assessee to claim the related expense.

8. In the aforesaid circumstances, the principal issue to be addressed is whether the provisions of Section 40(a)(iii) disentitles an assessee to claim a deduction on account of Salaries paid to its employees if the tax is not paid within the specified time but is paid subsequently. Mr Chaudhari, learned Senior Standing Counsel for the Revenue has contended that there are twin requirements to be fulfilled; the first being that tax should

have been deducted under Chapter XVII B of the Act; and second being that tax should have been paid. He argued that even if the tax is paid in subsequent years, deduction on account of expenses could not be allowed because the second condition which is deduction of tax at the time of payment of the amount as required under Section 192 of the Act would not be fulfilled. According to him, if the tax is not deducted and paid within the time prescribed for such deduction or payment under the relevant provisions, an assessee would not be entitled to claim that it had deducted or paid the tax under Chapter XVII B of the Act. He also referred to the decision of the Supreme Court in *Eli Lilly & Co. (India) (P.) Ltd. (supra)* in support of his contention that Section 40(a)(iii) was an integrated code and Section 40(a)(iii) would have to be read in conjunction with Section 192 of the Act which required an employer (assessee) to deduct and deposit the tax payable in respect of payments chargeable under the head "Salaries".

9. Mr Chaudhari further supported the Tribunal's view that absence of proviso similar to that as under Section 40(a)(i) also indicated that no deduction under Section 40(a)(iii) was allowable in case where tax was not deducted or paid within the prescribed time under Chapter XVII B of the Act.

10. In order to address the controversy, it is necessary to refer to the provisions of sub-clauses (i) and (iii) of clause (a) of Section 40 of the Act as in force during the relevant period and the same are reproduced hereunder:

'40 Notwithstanding anything to the contrary in sections 30 to 38, the following amounts shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession",—

(a) in the case of any assessee—

(i) any interest (not being interest on a loan issued for public subscription before the 1st day of April, 1938), royalty, fees for technical services or other sum chargeable under this Act, which is payable outside India, on which tax has not been paid or deducted under Chapter XVII-B;

Provided that where in respect of any such sum, tax has been deducted under Chapter XVII-B or paid in any subsequent year, such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.

**

**

**

(iii) Any payment which is chargeable under the head "Salaries" if it is payable outside India and if the tax has not been paid thereon nor deducted therefrom under Chapter XVII B.'

11. Section 40 of the Act begins with the non obstante clause and, thus, expressly disentitles an assessee to claim deductions which may otherwise be allowable under Sections 30 to 38 of the Act. Thus, even though an amount is deductible in computing the income chargeable

under the head "profits and gains of business or profession", the same would not be deductible if it falls foul of any of the clauses of Section 40 of the Act. A plain reading of Section 40(a)(iii) of the Act as was in force during the relevant year indicates that no deduction would be allowable in respect of any payments chargeable under the head "Salaries" if (a) the same are payable outside India and (b) if tax has not been paid or deducted thereon under Chapter XVII B of the Act. The said clause (iii) was substituted by virtue of the Finance Act, 2003 with effect from 1st April 2004. By virtue of the aforesaid amendment, the rigor of sub clause (iii) of clause (a) of Section 40 of the Act now also extends to any amount payable as salaries in India. Plainly, the principal object of the aforesaid sub clause (iii) is to provide a further disincentive for non-compliance of provisions of Section 192 of the Act.

12. The provisions of Section 192 fall within Chapter XVII B of the Act which relates to collection and recovery of tax. Provisions for deduction of tax at source are a part of the machinery provided for collection of taxes payable by a payee (recipient of income) by directly imposing upon the payer an obligation to withhold the tax due and deposit the same with the Government. Such tax is deposited to the credit of the payee and not the payer. In case of salaries, any person responsible for paying the income chargeable under the head "Salaries" - who would inevitably be the employer - is obliged to deduct the tax chargeable on the income of the employee (payee) under the head "Salaries". Thus, in the present case, the tax deposited by the Assessee is clearly in discharge of its obligation under Chapter XVII B of the Act. In this view, the contention advanced by Mr Chaudhari that the condition that the Assessee has not deducted and deposited the tax under Chapter XVII B of the Act, cannot be accepted. Indisputably, the Assessee has deposited the requisite amount which it was required to deposit in respect of amounts chargeable under the head "Salaries" that was payable to and or for the benefit of employees outside India. The said tax is deposited to the credit of such employees. Thus, for all intents and purposes the same is considered as a part of their Salaries which has not been paid to them but has been deposited directly with the Government.

13. It is also relevant to mention that Circular No. 685 dated 17/20th June, 1994, in compliance of which the Assessee had deposited the amount of tax, was issued under Chapter XVII B of the Act; the said Circular granted amnesty from penalties and prosecution to the assessee who complied with their obligation to deposit TDS in terms of Section 192 of the Act for the preceding years for which they had not done so, on or before 31st July, 1994. The said circular clarified the position regarding the applicability of provisions to withhold and deposit tax in respect of payments made abroad and required the employers to immediately comply with the provisions of Section 192 of the Act. Such compliance was also incentivised by granting the amnesty as aforesaid. In the circumstances, it can hardly be disputed that the tax deposited by the Assessee was in discharge its obligations, albeit belatedly, as imposed under Chapter XVII B of the Act. That being so, the Assessee had also overcome the rigor of sub-clause (iii) of clause (a) of Section 40 of the Act as the necessary

condition for applicability of the said provision, that is, non-deduction and payment of TDS under Chapter XVII B of the Act, no longer held good. Having complied with the said obligation, the Assessee could not be denied the deduction which was otherwise allowable under Section 37 of the Act.

14. In our view, an absence of a provision similar to the proviso to sub-clause (i) of clause (a) of Section 40 of the Act cannot be read as to disentitle an Assessee to claim a deduction even though it has complied with the condition under sub-clause (iii) of clause (a) of Section 40 of the Act. A plain reading of proviso to sub-clause (i) of clause (a) of Section 40 of the Act indicates that where an Assessee has not deducted or paid the tax at source in terms of Chapter XVII B in respect of any sum as specified under sub-clause (i) of clause (a) of Section 40 of the Act, the Assessee can, nonetheless, claim a deduction in the year in which the assessee deposits the tax. This benefit is not available to an assessee in respect of payments chargeable under the head "Salaries" which fall within sub-clause (iii) of clause (a) of Section 40 and not sub-clause (i) of clause (a) of Section 40 of the Act. Thus, an assessee would not be entitled to claim deduction on account of salaries if it fails to deduct or pay the amount under Chapter XVII B of the Act. In cases where such assessee deposits the amount in a subsequent year, the Assessee would still not be able to claim the deduction in the year in which such tax is deposited; his claim for deduction can be considered only in respect of the year to which such expense relates. Therefore, in cases where the assessments stand concluded, the Assessee would lose the benefit of deduction for the expenses incurred on account of its failure to have deposited the tax at source. Thus, concededly, in the present case the Assessee has lost its right to claim a deduction for a period of six years - AY 1985-86 to AY 1990-91- even though the Assessee has paid the TDS on the expenses pertaining to said period.

15. If a provision similar to the proviso to Section 40(a) (i) was applicable to Section 40(a) (iii) then the Assessee would have been entitled to claim the entire expenses on account of salaries paid overseas pertaining to financial years 1984-85 to 1993-94 in the financial year 1994-95 relevant to AY 1995-96 as the payment for the tax for the aforesaid years was paid on 20th July, 1994. However, absence of a provision similar to that under sub-clause (i) of clause (a) of Section 40 does not mean that the Assessee would also be disentitled to claim deduction on account of salaries in the year to which such expenses pertained even though the Assessee has subsequently discharged its obligation to deposit the tax and has thus overcome the rigor of sub-clause (iii) of clause (a) of Section 40 of the Act.

16. The Tribunal has proceeded on the basis that if the tax due on salaries paid overseas is not deposited strictly within the time prescribed under Chapter XVII B of the Act, Section 40(a) (iii) would be applicable. In our view, this added condition that the tax must be deducted and paid within time, cannot be read in Section 40(a) (iii) of the Act. The plain language of the Section 40(a) (iii) does not permit such interpretation. If the parliament so desired, it would have specifically enacted so. This becomes apparent when one reads the legislative amendments made to Section 40 of the Act.

17. Sub-clause (i) and sub-clause (iii) of clause (a) of Section 40 were substituted by Finance Act, 2003 w.e.f. 1st April, 2004. The said sub-clauses as substituted read as under:—

'(i) any interest (not being interest on a loan issued for public subscription before the 1st day of April, 1938), royalty, fees for technical services or other sum chargeable under this Act which is payable,

(A) Outside India: or

(B) In India to a non-resident, not being a company or to a foreign company, on which tax has not been deducted or, *after deduction, has not been paid before the expiry of the time prescribed under sub- section (1) of section 200* and in accordance with other provisions of Chapter XVII-B:

Provided that where in respect of any such sum, tax has been deducted under Chapter XVII-B or paid in any subsequent year, such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.

Explanation. For the purposes of this sub-clause,

(A) "royalty" shall have the same meaning as in Explanation 2 to clause (vi) of sub-section (1) of section 9;

(B) "fees for technical services" shall have the same meaning as in Explanation 2 to clause (vii) of sub-section (1) of section 9;"

**

**

**

"(iii) any payment which is chargeable under the head "Salaries", if it is payable—

(A) Outside India; or

(B) To a non-resident,

and if the tax has not been paid thereon nor deducted therefrom under Chapter XVII-B;" (underlining for emphasis)

18. It is at once seen that where the legislature wanted to make payment of tax within a specified time a necessary pre-condition, it had expressly indicated so. The Parliament has expressly enacted that deduction in respect of payments made under sub-clause (i) of clause (a) of Section 40 of the Act would not be available where such payments were made in India to a non-resident in respect of which tax had not been paid "before the expiry of time prescribed under sub Section (i) of Section 200". However, no such condition for depositing the tax paid within a prescribed time was introduced in sub clause (iii) of clause (a) of Section 40 of the Act.

19. It is also relevant to note that sub-clause (i) of clause (a) of Section 40 was further substituted by sub-clauses (i), (ia) and (ib) by virtue of Finance Act (No.2) w.e.f. 1st April, 2005. However, the pre-condition for depositing the tax within the time prescribed under Section (i) of Section 200 was retained in sub-clause (i) and (ia). Thereafter, by virtue of Finance Act (No.2), 2014, sub clause (i) was further amended and the principal condition of depositing tax in respect of payments made in India was amended and instead of the pre-condition of depositing the tax within the time prescribed under Section 200 (i) of the Act, it was now stipulated that the tax be deposited "on or before the due date specified in sub section (i) of Section 139".

20. With effect from 1st April, 2015, sub-clause (i) of clause (a) of Section 40 reads as under:

'40. Notwithstanding anything to the contrary in sections 30 to [38], the following amounts shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession",....

(a) in the case of assessee

[(i) any interest (not being interest on a loan issued for public subscription before the 1st day of April, 1938), royalty, fees for technical services or other sum chargeable under this Act, which is payable,....

(A) outside India; or

(B) in India to a non-resident, not being a company or to a foreign company, on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid [on or before the due date specified in sub-section (1) of section 139]:

[Provided that where in respect of any such sum, tax has been deducted in any subsequent year, or has been deducted during the previous year but paid after the due date specified in sub-section (1) of section 139, such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.]

Explanation. For the purposes of this sub-clause,--

(A) "royalty" shall have the same meaning as in Explanation 2 to clause (vi) of sub-section (1) of section 9;

(B) "fees for technical services" shall have the same meaning as in Explanation 2 to clause (vii) of sub-section (1) of section 9;

It is apparent from the above that the condition to deposit TDS within the prescribed time cannot be read into sub-clause (iii) of clause (a) of Section 40 of the Act as-unlike the

language of item (B) of sub-clause (i) of clause (a) of Section 40-the same has not been specifically enacted.

21. We are also unable to agree with Mr. Chaudhari's contention that no deduction can be claimed by the Assessee as the salaries were not reflected in the profit and loss account. The controversy whether an Assessee can claim deduction on an expense which is not reflected in its profit and loss account for the relevant period has been authoritatively settled by the Supreme Court in its decision in *Kedarnath Jute Mfg. Co. Ltd. v. CIT, (Central)* [\[1971\] 82 ITR 363 \(SC\)](#) wherein the Court held as under: —

"We are wholly unable to appreciate the suggestion that if an assessee under some misapprehension or mistake fails to make an entry in the books of account and although under the law, a deduction must be allowed by the Income Tax Officer, the assessee will lose the right of claiming or will be debarred from being allowed that deduction. Whether the assessee is entitled to a particular deduction or not will depend on the provision of law relating thereto and not on the view which the assessee might take of his rights nor can the existence or absence of entries in the books of account be decisive or conclusive in the matter."

22. In view of the above, the question of law is answered in the negative, that is, in favour of the Assessee and against the Revenue.

23. The appeal is allowed. In the circumstances, the parties are left to bear their own costs.

jjyoti

*In favour of assessee.

†Arising out of order Tribunal in *ANZ Grindlays Bank v. Dy. CIT* [\[2004\] 88 ITD 53 \(Delhi\)](#).

IN THE ITAT DELHI BENCH 'A'

Bharti Airtel Ltd.

v.

Income-tax Officer (TDS), Ward 1 (1), New Delhi

H.S. SIDHU, JUDICIAL MEMBER

AND J. SUDHAKAR REDDY, ACCOUNTANT MEMBER

**IT APPEAL NOS. 3593 TO 3596 AND 4076 TO 4079 DELHI OF 2012
[ASSESSMENT YEARS 2008-09 TO 2011-12]**

MARCH 17, 2016

S.K. Tulsiyan, Sashi Tulsiyan, Ms.Abha Aggarwal and Ms.Manisha Aggarwal, Advs. for the Appellant. Anuj Arora for the Respondent.

ORDER

J. Sudhakar Reddy, Accountant Member - These are the cross appeals against the common order passed by the Ld. CIT(A)-XXIX, New Delhi dated 21.5.2012 in Appeal No. 83 to 86/11-12 for assessment years 2008-09, 2009-10, 2010-11 & 2011-12. As issues arising in these appeals are common, for the sake convenience they were heard together and are being disposed of by this common order.

2. The brief facts of the case are:

2.1 The Assessee M/s Bharti Airtel Ltd. is a Company and is a leading Telecom Service Provider in India. It is also a Global Telecommunication Company having operations in several countries. It is engaged internationally in the business of providing Cellular Telephone Facilities to subscribers. The Department of Telecommunication, Govt. Of India has granted the License to the Assessee Company for operating its services in certain specified Circles.

The facts leading to the assessment are brought out at para no. 4.2 to 4.7 of the Ld. CIT(A)'s order at pages 7 to 9. This is below extracted for ready reference:—

"4.2 Earlier, in respect of domestic part of business of the assessee, DCIT, Circle 49, New Delhi, passed an order under section 201(1)/201(1A) of the Income-tax Act, 1961 for the financial years 1995-96 to 2002-03 on 26-03-2004, holding that the payment made by the assessee to MTNL on account of interconnection charges, port/access charges was 'fees for technical services' and tax was required to be deducted by the appellant u/s. 194J therefrom. Since MTNL had already filed return of income for the aforesaid financial year, declaring relevant amount received from the appellant on

account of interconnection and port/access charges as income and had paid tax thereon, the DCIT, Circle 49, New Delhi did not raise any demand under section 201(1) on the appellant for the tax it had allegedly not deducted, but levied interest U/S 201 (1 A) of the Act for the alleged default in not deducting such taxes for the period of default.

4.3 The appellant filed appeal against the order of DCIT, Circle 49, New Delhi before the CIT-(A), New Delhi. The CIT (A), relying on the decision of Hon'ble Madras High Court in the case of *M/s Skycell Communication Ltd*: 251 ITR 253, deleted the interest levied U/S 201(1A) on the ground that the interconnection/port access charges paid by the appellant to MTNL were not in the nature of "fee for technical services" under section 194J read with Explanation 2 to section 9(1)(vii) of the Act. The Revenue preferred appeal against the order of the CIT (A) before the ITAT, which was dismissed.

4.4 Thereupon, the Revenue filed appeal before the Delhi High Court. The Court while examining the scope of the definition of "fee for technical services" in Explanation 2 to section 9(1)(vii) of the Act, observed that the expression "technical services" takes colour from the expressions "managerial services" and "consultancy services" which necessarily involve a human element. Since the services rendered qua interconnection/port access did not involve any human interface, the same could not, therefore, be regarded as "technical services" as contemplated under Section 194J of the said Act. Accordingly, the Revenue's appeal was dismissed. The decision has been reported in 319 ITR 139. The Revenue assailed the order passed by the Delhi High Court by way of Special Leave Petition (SLP) before the Supreme Court.

4.5 The Supreme Court, vide order dated 12/08/2010, in SLP No. 16452 of 2009 while agreeing in principle with the aforesaid observation of the Delhi High Court regarding involvement / presence of human element in order for 'technical services' to be said to have been rendered in terms of Explanation 2 to section 9(1)(vii) of the Act, set-aside the matter and directed the ACIT(TDS), Gurgaon to decide whether the process of carriage of calls requires manual intervention or not, by examining technical experts from the side of the department, allowing opportunity to the appellant for cross examination.

4.6 In the set aside proceedings, statements of Mr. Ashok Mittal and Mr. Tanay Krishna, from C-DOT, were recorded by the ACIT (TDS), Gurgaon on 29.09.2010. Mr. Tanay Krishna was cross-examined by the representative of the appellant on 04.10.2010.

Mr. Tanay Krishna was also re-examined on 04.10.2010 by the Department. The appellant also submitted evidence by way of opinion, dated 14.12.2010, of Mr. G.S. Grover, Ex-Member, Telecom Commission.

Subsequently, the ACIT (TDS), Gurgaon, vide order dated, 03.01.2011, held that as there was human intervention in installing, monitoring of infrastructure etc., the

services provided by BSNL/ MTNL to the appellant were covered within the meaning of "technical services" and tax ought to have been deducted therefrom U/S 194J of the Act. The said order of passed by ACIT (TDS), Gurgaon is challenged by the assessee in appeal.

4.7 Pursuant to the aforesaid order, the ACIT(TDS), Gurgaon, vide letter dated 8th February, 2011, sent information to the Income-tax Officer, TDS Ward 1(1), International Taxation, New Delhi so as to examine the similar issue involved in international part of business of the assessee. On receipt of the aforesaid letter, the ITO, TDS Ward 1(1), International Taxation, New Delhi, issued show cause notice, dated 31st March, 2011, requiring the appellant to show cause as to why the appellant should not be treated as an assessee in default under section 201 (1) for failure to deduct tax at source U/S 195 of the Act in respect of inter connection charges paid by the appellant to various foreign telecom operators. The assessing officer, vide order dated 12th January, 2012, passed under section 201(1)/201(1A) of the Act, which is impugned in the present appeal, holding therein that interconnect charges paid by the appellant to foreign telecom operators were in the nature of fee for technical services under section 9(1)(vii) and alternatively, royalty for use of process under section 9(1)(vi), on which tax was deductible under section 195 of the Act and therefore the appellant was to be treated as an assessee in default under section 201(1) for failure to withhold tax under section 195 of the Act from the impugned payments."

2.2 The AO held that Inter-connect Usage Charges (hereinafter referred "IUC") paid by the Assessee to the Foreign Telecom Operator (hereinafter referred as "FTO"), in the course of carrying out its business as an International Long Distance (hereinafter referred as "ILD") Service Provider are in the nature of Fee for Technical Services ("FTS") u/s. 9(1)(vii) of the Income Tax Act, 1961 (hereinafter referred as "Act") or in the alternative, in the nature of Royalty u/s. 9(1)(vi) of the Act. Hence, he held that the income from the "IUC" is deemed to accrue to arise in India in the case of "FTO". The AO held that the Assessee Company was required to deduct tax at source from such payments u/s. 195 of the Act and for the failure to do so, the Assessee Company was liable u/s. 201 of the Act.

2.3 The reasons/grounds given by the AO for holding the amount of IUC charges, paid by the Assessee to FTO are in the nature of FTS/ royalty are mentioned in paras 6(h) of the assessment order. This para is extracted below for ready reference:—

- "(i) The assessee company repeatedly submitted that the facility provided by other overseas service providers for international interconnection services are being provided through automatic machinery or equipments automatically but failed to counter the opinion of the experts who have categorically established the human intervention which takes place in areas right from setting up of capacity for interconnect and further in testing, commissioning of interconnect circuit, Interconnect performance standards, interconnect

capacity, network interface, interconnect link architecture, configuration of system, testing, interconnect testing, pilot testing, operation and maintenance of hardware/software, supervision/monitoring the functioning of interconnect network, capacity augmentation and reconfiguration and capacity enhancement, monitoring including network monitoring, maintenance, fault identification, repair and ensuring quality of service as per interconnect agreement of interconnect network system to provide fault free services according to interconnect standards.

- (ii) The whole process for carriage and transfer of calls from the network of one operator to another is not limited to process of carriage of calls though being an automated process undertaken by a series of highly advanced telecom network equipment. The process of interconnection is a composite process involving several aspects which requires constant human intervention to make the process of carriage of calls satisfactory and as per performance standard agreed by the two parties.
- (iii) Regarding interconnection to Gateway, it is worth noting that Mobile Switching Centre (MSC) of two different operators is interconnected using any transport technology which involves wires as well as human interface for setting up. Further, it involves different phases like planning, selection of vendor, supply of hardware and software, installation as per vendor guidelines, call configuration/provisioning of system, exhaustive testing on various modes on network portion, interconnect testing and also requires support/consent of other interconnect operator. All these phases require human interventions which are mostly technical in nature.
- (iv) The explanation of the assessee company/deductor that no intervention is required in the process of carriage of calls, is totally half baked as the assessee company/deductor failed to fully appreciate that such process of carriage of calls is automatic only in case of successful calls. When a call gets connected by one operator to another, per se, it is an automatic connection but, there can be instances where there is a problem in the call connect. There may be problems due to call not reaching the destination or the voice not coming/reaching. Failure of call could be due to many reasons like failure in physical hardware, problem due to software bug, problem due to snapping of optic fiber cables etc. which requires resolution through intervention of teams of technical experts to remedy the situation and hence there is no fully automatic operation of this network. Though the carriage of calls from one network to the other network flows automatically, to make the carriage of calls successful, constant network monitoring is required to attain quality of service at Operation Maintenance Centers (QMC) which operates 24 X 7 X 365 wherein technical experts are monitoring physical equipment as well as the network. The process of monitoring-by such professionals is

effectively required to provide or to avail fault free services at both ends of the OMCs of operators.

- (v) Though the 'carriage of calls' is automatic, the process of 'carriage of calls' shall not take place unless the systems are made operational or maintained or configured by the service provider at OMCs. Technical help is required to detect certain complicated faults at OMCs like hardware faults which may require change of components, cards, etc. and/or software faults for which patches/rectification of software is required. Such an intervention requires highly qualified and trained technical professional having expertise, experience and acumen in that particular area of relevant technology and is not possible by a general technician or semi skilled person.
- (vi) The assessee company/deductor has been considering the issue of call carriage in isolation under process of interconnection which involves many processes, like call connect, call routing and signaling taking place in a network. These processes taken together form interconnection but the assessee company/deductor has failed to counter the opinion of the experts who have categorically established that human, intervention, takes place during carriage of call as the call routing and signaling are predefined as an initial setup or in installation phase and based on this predefined data, which is part of configuration in interconnect system, such phases are selected automatically to call connect and not just in routing. The process of carriage of call is automatic only for successful and fault free calls (A successful, call is which reaches the desired destination and which carries quality voice). The configuration (predefined data is part of configuration of interconnecting of network) and reconfiguration of data in network system and capacity enhancement etc. also essentially require human intervention of highly qualified and trained technical professional having expertise, experience and acumen in that particular area of relevant technology and it is not possible for a general technician or semi skilled person to determine/manage the entire interconnect process.
- (vii) Another contention of the assessee company, that the other mobile service providers monitor/ maintain and repair their own infrastructure. However, for ensuring a seamless service by employing specific set of people to carry out operability and functioning of network, it makes it clear that human intervention is a necessity to provide seamless service .
- (viii) Regarding the situation on exhaustion of allotted capacity and allotment of additional capacity, the capacity enhancement is a time consuming exercise by a group of technically skilled professionals with close coordination of both the parties simultaneously.

- (ix) The contention of the assessee company that every service provider providing any service using its own equipment and infrastructure would always incur such costs to ensure that its equipment and infrastructure is in the best of working condition to ensure provision of services for which it is meant and such act is not undertaken as a service to the recipient of services provided by utilizing the same equipment or infrastructure is not tenable since the assessee company has failed to appreciate the fact that handling of equipment and infrastructure by operators in their own network, is to ensure fault free service and as an obligation for success of interconnect as seen from the clauses of interconnect agreement of interconnect performance standards. This not only takes place on one side but takes place on both the ends in close co-ordination and that is what the experts opined.
- (x) During the process of carriage of calls, the network system of each cellular provider requires monitoring/supervision on several parameters of the network like health, congestion, faults, etc. for which, reconfiguration of system is required to handle such congestion by way of increasing the transport capacity, increasing hardware, modifying the required software, reconfiguring the systems, etc. On all the above areas of intervention, technical expert is persistently required to make the process of carriage of call victorious. Persons involved in these areas cannot be merely a technician but are to be professionally and highly qualified experts having good knowledge of network management, knowledge of hardware & software, knowledge of network configuration, etc. as no service provider does take the risk of leaving the network systems unattended, when the networks are interconnected with each other during the process of carriage of calls, for the simple reason that even a small fault can cascade into large faults. which could finally lead to entire collapse of the systems and fail the process of carriage of calls .
- (xi) The technical experts have clearly stated that the entire process of call processing and capacity augmentation, i.e. additional capacity when capacity gets exhausted, is essentially/necessarily human intervention and cannot be done without the services of humans. The interconnect / access / port facility is regarded as technical services and all payments made on account of interconnect charges/access/port charges falls within the meaning of the technical services. In fact, the combined environment of both men and machinery is needed for providing technical services. Even sophisticated and automated machinery/equipment cannot work without a human interface, as these are regularly required to monitoring of performance and maintenance. A machine or instrument even if automatic cannot become or replace human mind. In fact, there are a number of articles in the interconnect agreement. which itself provide various specifications for quality of services or

performances.

- (xii) The agreement entered between both the operators is for composite services and not just one part of carriage of calls. Carriage of calls is the end result to be achieved through the Interconnection consisting of many processes. It has also been clarified by the C.DOT expert in reference to question No 1.0 during re-examination that even if after initial setup and after making the interconnected network functional, if human intervention in the form of operation and maintenance is taken away, the interconnected network will not function indefinitely and further the purpose of interconnection along with the quality of service will not be achieved (Ans. 11 & 12). Lastly, it is also important to mention here that;—
- The assessee company/deductor itself is deducting TDS on these interconnect payments to domestic mobile service providers with effect from April 2003.
 - There is no difference in flow of calls for an international call or a national call, except the fact that the interconnect operator being national or international. All the processes involved in establishing a call and to make it successful in international flow of traffic to earn revenue, are the same as in the case of domestic calls, as opined by the technical expert vide his second opinion dated 28/12/2011.
 - It was confirmed by the assessee company itself vide letters dated 01/11/11 and 09/11/11 that technically there is no difference between the domestic IUC and international IUC, except that in domestic IUC, the network and the equipment of the other telecom operators are located in India, whereas, in international IUC, the network and the equipment of the other telecom - operators are located outside India."

2.4 The AO alternatively and without prejudice to his finding that, the said payment is payment for FTS u/s. 9(1)(vii) of the Act had held that the payment was 'Royalty' in Clause (iii) of Explanation 2 to Section 9(1)(vi) of the Act.

2.4.1 The AO vide order dated 12.1.2012 raised the demand u/s. 201 as well as 201(IA) to the assessment years 2008-09 to 2011-12 for non-deduction of tax at source u/s. 195 of the Income Tax Act, 1961 (hereinafter referred as "The Act" of 'IUC' payment made to "FTO's". He levied tax on higher rate of 20% (plus Surcharge & Cess) on the gross amount of payment made to the FTO for all the years under consideration by applying the provisions of section 206AA of the Act. Aggrieved the assessee carried the matter in the Appeal before the Ld. First Appellate Authority. The First Appellate Authority upheld the order of the AO to the extent of the finding that the payment of IUC are in the nature of FTS under the Act. He has held as follows:—

"9.7 The whole controversy is whether any human intervention exists at time of picking up of call from ILD gateway of the appellant by ILD gateway of foreign operators and it has to be understood and resolved by examining the statements of the experts, which have been reproduced supra. Scrutiny of the statements reveal following facts:

When a call gets connected from one operator to other, per se it is an automatic connection, but there can be instances when there is problem in call connect which requires human intervention.

Successful and fault free call happens without manual intervention.

Intervention by technical experts is required when there is failure in hardware, problem due to software bug or snapping of fibre optic cables.

Per se processing of a successful call has many aspects like call connect, call routing and signaling. Call connect component cannot be dissected.

Beside these faults, constant network monitoring is required to be done by technical experts to ensure fault free connection. The network system cannot be left un-attended .

Human intervention is required for capacity augmentation.

There is no network system which can work continuously without any kind of human intervention. Machines cannot work on their own. There has to be man - Machine interface.

Above mentioned human interventions cannot be made by semi-skilled personnel or mere technicians. Such persons are highly qualified technical experts having good knowledge of software, network management and configuration.

For a fault free running calls, operation and maintenance has to be at both the ends and if the second operator does not maintain it then the call will fail.

9.8 Now, if we have to just see whether there is any human intervention at the time of interconnect, then the answer is quite obvious that for a successful call, the interconnect is automatic. This has been accepted by the AO also. As already discussed supra, this cannot be the intention/essence of direction of Hon'ble Supreme Court as the interconnect of call takes place in fraction of a second and during that period, no effective human intervention is possible. Therefore, we have to see the process of interconnect of call in a holistic manner. The agreement between the appellant and foreign telecom operators is to provide facility of successful interconnect of call at

port/interconnection location of two net works. The clause 3.1 of agreement, which is standard one for all operators, says,

"Each party shall be responsible to connect to other part's network at one of the other part's network interconnection locations, and the parties shall be responsible to procure, at their own expense, the necessary facilities or equipment required to interconnect to such locations."

9.9 Though, the ultimate purpose of the agreement is to achieve successful carriage of call at the interconnection location, the process of establishing interconnection itself is elaborate one. It involves making the two network systems compatible, configuration & reconfiguration of system, allotment of capacity & capacity augmentation whenever required, re-routing of call in event of overflow, fault finding and repair and over & above, constant monitoring of the network system so as to ensure un-interrupted carriage of call. All these activities are performed by highly qualified professionals and not merely technicians or unskilled workers. All these human interventions are pre-requisite for successful connect of the call. Without such human intervention, the service of successful connection of call cannot be provided. Now, it is undisputed that with advent of latest technology, the call connect process has become software based and substantially automatic. Over a period of time, the automation has increased and correspondingly human intervention has decreased progressively. If the quantum of human intervention involved is the only criterion for determining whether a particular service is in nature of technical service, then what used to be a technical service a few years ago, has ceased to be so now with progressive automation; This however does not mean that the machine has replaced the man. In case under consideration, it is clear from contents of statements that human intervention is essential in areas right from setting up of capacity for interconnect and further in testing, commissioning of interconnect circuit, Interconnect performance standards, interconnect capacity, network interface, configuration of system, testing, interconnect testing, pilot testing, operation and maintenance of hardware/software, supervision/monitoring the functioning of interconnect network, capacity augmentation and reconfiguration and capacity enhancement, constant monitoring & maintenance, fault identification, repair etc. All this is required to ensure quality of service as per interconnect agreement to provide fault free services. Call is not something which can be carried in person by a technical person. It has to pass through a configured network and technical personnel are required to see that net work functions properly. The direction contained in Hon'ble Supreme Court's order can not be construed in such a manner to suggest that technical persons do not have any role in carriage of call from one network to another. In view of these, I agree with the view taken by the AO that payments made by the appellant are in nature of Fee for technical services:

9.10 The definition of fee for technical service is given in Explanation 2 to section 9(1)(vii) of the Act, which is reproduced as under:

"Explanation 2 - For the purposes of this clause, "fees for technical services" means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head "Salaries".

9.11 The definition of FTS as per DTAA is the same as in the Act. Just to take an example, FTS as Indo-UK treaty is given in Article 13(4), which is reproduced as below:

4. For the purposes of paragraph (2) of this Article, and subject to paragraph 5, of this Article, the term "fees for technical services" means payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including the provision of services of technical or other personnel) which :

The definition says that FTS consists of two parts:

- (a) Consideration for the rendering of any managerial, technical or consultancy services.
 - (b) consideration for provision of services of technical or other personnel
- 9.12 The second part of definition talks about technical personnel whereas first part does not mention about technical personnel. It can reasonably be inferred that first part of definition is concerned with technical services provided in any manner, may be mainly through automated machine. In case under consideration, there is practically no human intervention at the time of connect of successful call and this is the position which has been accepted even by the AO. This situation is taken care of by the first part of definition of FTS. There is ample human intervention involved at different stages as discussed supra and this situation falls within purview of second part of definition of FTS.

9.13 Another argument taken by the appellant is that payments made by it are in nature of revenue sharing and hence not FTS. It has been argued that the appellant has entered into agreement with various international telecom operators for the purpose of two way carriage of call internationally. Whatever revenue is charged from the subscribers is shared between network operators depending upon flow of successful calls and therefore no network operator is providing services to other network operator. Therefore, the amount paid to the foreign telecom operator is not qua the service provided by the foreign telecom operator to the appellant, but is a share of revenues calculated on the basis of per call / pulse.

9.14 This contention of the appellant has been duly considered and is found to be fallacious. It is undisputed that as a result of agreement between the appellant and non- resident telecom operator, no joint venture, AOP or partnership comes into

existence. It is also evident from Clause 18 of the agreement which is regarding relationship of the parties. It says that,

"The relationship between the parties shall not be that of partners, and nothing herein contained shall be deemed to constitute a partnership between them, a joint venture, or a merger of their assets or their fiscal or other liabilities or undertakings. Neither party shall have right to bind the other party, except as expressly provided for herein."

9.15 Therefore, agreement does not create a new 'Person' as defined in section 2(31) of the Act. The obligations of the appellant have to be seen in its separate capacity. When a call is carried by the appellant's network from NLD network, the appellant becomes entitled to revenue from NLD network operator. Further, when call from ILD gateway of appellant is taken over by gateway of non-resident operator, the non-resident gets right to receive revenue from the appellant and that payment becomes expenditure in hands of the appellant. The non-resident operator is not entitled to get revenue directly from NLD operator in India. So it is not a situation where revenue from NLD operator comes to a common pool and both appellant and the non-resident operator are entitled to share it according to some formula. The payments made by the appellant to non-resident telecom operators are in nature of expenditure in books of accounts of the appellant and such payments are in nature of FTS as discussed supra. Therefore, this contention of the appellant is rejected.

9.16 The appellant has taken another argument that it makes payment only for a successful call and other activities of foreign operator like maintenance of network system are not remunerated by it. Therefore, other incidental activities where some human intervention is involved, are not in nature of services from perspective of the appellant. This contention of the appellant is misleading. The payment on basis of successful call is only a mode of calculating the payment for provision of service of transmission of call. The service provided by non-resident operator cannot be restricted by adopting a particular mode of making the payment.

9.17 It is also pertinent to note that the appellant is deducting tax on IV C payments made to domestic telecom operators, which clearly indicates that the appellant is conscious of legal provisions applicable. Then, why such deduction is not being made in respect of IUC payments made to foreign telecom operators is not explainable.

9.18 In view of discussion supra, I hold that the IUC payments made by the appellant to the non-resident telecom operators are in nature of FTS both under IT Act, 1961 and under relevant DT AA and hence chargeable to tax in India. Accordingly, the appellant is held to be assessee in default u/s 201 (1) in respect of these payments. This disposes off ground of appeal no. 2,3,4,7,9,10,11,12,13,14,15,16,18. "

3. Ld. CIT(A) held that the IUC payment cannot be pleaded as royalty. The alternative finding of the Assessing was reversed by the Ld. CIT(A). He has held as follows:—

"11.0 Finding:

11.1 The submissions made by the appellant have been carefully considered. The AO has held that the payments made by the appellant amount to royalty U/S 9(1)(vi)(iii) as these are for use of process. The contentions of the appellant are summarized as under:

- The payments are in nature of revenue sharing.
- The appellant has not been given 'use or right to use' of process by foreign operators.
- Proposed amendments in the Act do not override the treaty definition of royalty.
- In any case, the appellant cannot be held to be assessee in default because of retrospective amendment.

11.2 The argument of the appellant that the payments are in nature of revenue sharing _ and hence do not partake character of royalty is fallacious as it has been discussed supra under Issue no. 1. In order to characterize the payments made by the appellant, we have to see the legal provisions and relevant clauses of agreement between the appellant and non-resident telecom operators. The definition of term 'royalty' is provided in Explanation 2 to section 9(1)(vi) of the Act, which is being reproduced as below:—

Explanation 2. -For the purposes of this clause, "royalty" means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains") for—

- (i) the transfer of all or any rights (including the granting of a licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property;
- (ii) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property;
- (iii) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property;
- (iv) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill;

- (iva) the use or right to use any industrial, commercial or scientific equipments but not including the amount referred to in section 44BB;
- (v) the transfer of all or any rights (including the granting of a licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films; or
- (vi) the rendering of any services in connection with the activities referred to in sub- clauses (i) to (iv), (iva) and (v).

The definition of royalty as per Article 13(3) of Indo-UK treaty is as under:

3. For the purposes of this Article, the term "royalties" means:

- (a) payments of any kind received as a consideration for the use of, or the right to use, any copyright of a literary, artistic or scientific work, including cinematograph films or work on films, tape or other means of reproduction for use in connection with radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience; and
- (b) payments of any kind received as consideration for the use of, or the right to use, any industrial, commercial or scientific equipment, other than income derived by an enterprise of a Contracting State from the operation of ships or aircraft in international traffic.

11.3 According to AO, the payments are made for use of process and hence in nature of royalty under clause (iii) of 9(1)(vi) of the Act. In the said clause, the word employed is 'use of'. The factum of 'use of process' has to be established before a payment can be characterized as royalty. The clause 3.1 of agreement, which is standard one for all operators, says, "Each party shall be responsible to connect to other part's network at one of the other part's network interconnection locations, and the parties shall be responsible to procure, at their own expense, the necessary facilities or equipment required to interconnect to such locations. "

11.4 Thus, the essence of the agreement is that each party to the contract shall connect to network of other party at port locations. It is not a case of lease or licence of network of foreign operator in favour of the appellant. Once two networks are interconnected, the flow of call is completed. A foreign operator connects his network with network of the appellant and call coming from appellant's network is taken up by network of foreign operator for further transmission. In this model, only foreign operator is using his network and appellant is not using or is not allowed to use

network of foreign operator. Thus, there is no 'use' on part of the appellant. Whether taking-up of call by network of foreign operator from network of the appellant is a 'process', is another issue to be looked into. The AO has not given a finding to the effect that it constitutes a 'process'. According to Explanation 6, which is proposed to be incorporated in section 9(1)(vi) of the Act by Finance Act 2012, the process shall include transmission by optic fibre or similar technology. Thus, after this amendment, the transmission of call across gateway/interconnect shall be a 'process' under domestic law. However, even if there is a 'process' involved; there is no use of it by the appellant. In discussion supra under Issue no. 1, it has been held that non-resident telecom operator has provided technical services to the appellant. This is possible only when non-resident operator is using his network. Without using his network, nonresident cannot provide services to the appellant. Now, when non-resident is using his network, it cannot be said that the appellant is using the network of non-resident operator. Therefore, two situations are mutually exclusive. Only one of them, either non-resident operator or the appellant is using the network of non-resident while transmission of call through optic fiber. It has already been held that non-resident operator has provided technical services to the appellant as is the case made by the AO, consequently it cannot be said that payments made by the appellant are for 'use of process' and hence in nature of royalty. The appellant has further contended that reliance placed by the AO on decision in case of Verizon Communications Singapore Pvt. Ltd. v. ITO: [2011] 45 SOT 263(Chennai) is misplaced. I have carefully gone through facts of the case law. In that case, the Indian payer company had obtained 'leased lines' on hire basis under a contract from non-resident Verizon Communication. This is a vital fact which makes all the difference. When an Indian Co. takes leased line on hire, then it can be said that it had 'used' it. In present appeal under consideration, the appellant has neither been leased nor been given on hire network of foreign operator, then it cannot be said that the appellant has 'used' the network belonging to foreign operator. Therefore, reliance of AO on the said case law is misplaced.

11.5 It is seen from proposed Explanation 5 & 6 and Memorandum of explanation that meaning of word 'process' has been widened, the 'process' need not be secret and situs of control & possession of right, property or information has been rendered irrelevant. However, all these changes do not affect the definition of royalty as per DTAA. In Article 13 (3)(a) of Indo-UK tax treaty, the word employed is 'use or right to use' in contradistinction to the word 'use' in domestic law. The meaning attached to phrase 'use or right to use' has been explained in various judicial decisions in case of *Mis Yahoo India Pvt Ltd v. DCIT* (ITAT Mumbai), *Standard Chartered Bank v. DDIT*, Mumbai, *ISRO Satellite Centre* [2008 307 ITR 59 AAR] and *Dell International Services (India) P. Ltd.* [2008305 ITR 37 AAR]. All these judicial pronouncements say that in order to satisfy 'use or right to use'; the control and possession of right, property or information should be with payer. Therefore, under DT AA, the restricted meaning of royalty shall continue to operate despite amendments in domestic law.

11.6 The appellant has further argued that even if it is assumed that payments partake the character of royalty after retrospective amendment in the act, the appellant cannot be held to be assessee in default in respect of those payments. I find force in this argument in view of various judicial decisions relied upon by the appellant. The obligation imposed upon the appellant u/s 195 to deduct tax is 'at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier '. Therefore time of credit or actual payment of sum is relevant to see the obligation of the payer. Thus, subsequent amendment though retrospective in effect, cannot create any obligation upon payer which did not exist at time of crediting or actual payment of the sum.

11.7 In view of discussion supra, I have no hesitation to hold that payments made by the appellant are not in nature of royalty under domestic law and relevant DTAA. This disposes off ground of appeal no. 19 which is accordingly allowed."

3.1 On Section 206AA, the Ld. CIT(A) held that this Section is applicable only prospectively.

4. Aggrieved with the finding of the Id. CIT(A), that the payment for 'IUC' is 'FTS', the assessee filed these Appeals. The Revenue has filed the Cross Appeals against the finding of the Ld. CIT(A) that IUC cannot be treated as royalty and also the finding that section 206AA is applicable only prospectively.

5. Ld. Counsel of the Assessee Sh. S.K. Tulsiyan, filed an Application for admission of additional evidence under Rule 29 of the ITAT Rules, 1963 dated 06.11.2013. The additional evidence sought to be produced by the assessee, is an Opinion dated 03.9.2013 of Sh. SH Kapadia, Former Chief Justice of India, on the applicability of withholding tax provisions u/s. 194J read with Section 9(1)(vii) of the Income Tax Act, in the case of the assessee. The Ld. DR, Mr. Anuj Arora, CIT(DR) strongly objected to the admission of this opinion as an evidence on the ground that Shri Kapadia delivered the judgment in the assessee's own case when he was the Chief Justice of the Supreme Court of India setting aside the matter to the Assessing Officer for fresh consideration and adjudication and after retirement, he had given an opinion in the very same case in favour of the assessee, which is impropriety and unethical. He argued that the conduct of Sh. S.H. Kapadia was not ethical, specifically when he was the author of the judgment in the case of the assessee where he had set aside the matter. He referred to the Code of Conduct laid down by the Hon'ble Supreme Court for Judges.

6. As what is sought to be produced is an opinion of Former Chief Justice of India, we hold that this is not additional evidence which could be admitted for the purpose of adjudication of these Appeals. We do not wish to express any opinion as the conduct of the Former Hon'ble Chief Justice of India who delivered the judgment in the case of the assessee company, and had given an opinion on the very same issue after retirement. Hence, this Application is rejected.

7. Ld. Counsel for the assessee Mr. Tulsiyan, submitted as follows:—

- (a) "IUC" paid to the "FTOs" are neither in the nature of "FTS" nor in the nature of "Royalty" both under the Act as well as the Tax Treaties. Both the issues are covered in favour of the Assessee by a number of judgments including the judgment of the Jurisdictional High Court in the assessee's own case. That these issues are no more res-integra.
- (b) Inter-connect Agreements are basically revenue sharing arrangement between the Telecom operators for pooling in their services. The object of these agreement are to provide seamless facility to the subscribers and income accrues to both the networks and both net works have a right to share the revenue generated from successful calls between the inter connected operators.
- (c) IUC have been in the nature of sharing of revenue generated from successful calls. This is business incomes of such operators.
- (d) The operations of the FTOs in the form of carriage and termination of calls over their respective network, are carried out entirely outside India and hence, are not taxable in India, in terms of Explanation 1(a) to Section 9(1)(i) of the Act.
- (e) IUC cannot be deemed to accrue or arise in the hands of the FTOs u/s. 9(1) read with section 5(2) of the Act.
- (f) As income in question is the business income, and as the FTOs do not have any Permanent Establishment in India, the income is not taxable in India even under Article 7 of the Double Taxation Avoidance Act. Hence, the assessee is not required to withhold the tax u/s. 195 of the Act for such payments and consequently, cannot be held liable u/s. 201 of the Act.
- (g) Section 206AA cannot be applied retrospectively and that the beneficial provisions of the DTAA's have to be applied.
- (h) The Ld. CIT(A) was right in admitting additional evidence.

8. Ld. Counsel for the Assessee Sh. Tulsiyan, made elaborate submissions, filed paper books as well as written submissions and relied upon various case laws in support of his contentions. We would be dealing with all these arguments as well as the case law during the course of our finding.

9. Ld. DR, Sh. Anuj Arora, on the other hand, vehemently controverted the submissions of the Ld. Counsel for the assessee. He relied on the order of the AO and submitted that payment in question is FTS. He submitted that the human intervention is one of the issue

which was considered by the Hon'ble Supreme Court of India and an open remand was made to the AO for examining this issue, without due restrictions or conditions. He argued that the Assessee's contention that the AO should have restricted himself only to this aspect is not correct and does not flow from the judgment of the Hon'ble Supreme Court and submitted that the AO could examine many other issues. He further submitted that the judgment of the Hon'ble Supreme Court of India in question, wherein the matter was remanded to the AO, pertaining to a particular assessment year is not yet finalized and that the assessment of many other cases were being finalized based on this Supreme Court Judgment. He argued that the issue before the Hon'ble Supreme Court was relating to Domestic Telephone Operators whereas the case in hand, the AO was examining the payments made to FTOs. He argued that the regulation of the Telecom Regulatory Authority of India (TRAI) do not bind FTOs and hence the decision cited by the Assessee's counsel based on payments to Domestic Telephone Operations, cannot be applied to the facts of the case.

10. Ld. DR further argued that all the agreements the assessee entered with the FTOs were not with the AO. Referring to Page No. 22 of the Ld. CIT(A)'s order as well as Page no. 35, he drew the attention of the Bench to the questions and answers recorded from Sh. Ashok Mittal as well as Sh. Tanai Krishnan on oath. Specifically he drew the attention of the Bench to Question No. 4, 5 and 6 which are at pages 35 & 36 of the CIT(A)'s order and to the answers to question no. 7 & 30 and argued that in this case there is human intervention where there is 'capacity augmentation' and the function of the personnel include testing, supervising and monitoring etc. and supported the findings of the Ld. CIT(A) that there was human intervention. He referred to the cross examination done by the assessee as well as the re-examination done by the AO and the conclusions drawn by the AO and supported the conclusions of the AO as confirmed by the Ld. CIT(A). He further pointed out that the assessee company has itself deducted TDS on this "IUC" from domestic mobile service provider w.e.f. April, 2003 and argued that there is no difference in flow of calls or operations for a national call or an international call and under these circumstances tax should have been deducted on payment made to FTOs also.

11. Ld. DR further argued that services has been provided by the FTOs to the assessee. He vehemently contended that the submissions of the Assessee that services are connected with successful calls only is fallacious. He argued that services are obtained from FTOs even in a case where a call has not materialized and that successful calls are taken into account only for the purpose of billing. He contended that method of billing cannot be equated with type of services obtained by the assessee. He submitted that the operations are described in the composite agreement and it includes host of service. He submitted that the call drop is also considered in these agreements and it is provided that in case of call drop, a penalty would be attracted. He pleaded that the pith and substance of these services should be considered and not the mode of billing and the agreement should be viewed in a holistic

manner. He referred to the definition of FTS u/s. 9(1)(viii) and submitted that it does not exclude lumpsum consideration.

12. On the argument that it is a case of revenue sharing the Ld. DR relied on Page No. 59 of the Ld. CIT(A)'s order vide para no. 9.13 to 9.18 and submitted that the agreements between the assessee and FTOs are not joint venture agreements or partnership concerns and that they are not a 'person' under the Act for being separately assessed. On the issue whether the services can be treated as FTS under the Treaty with certain countries, he drew attention of the Bench to Page No. 95 of the Ld. CIT(A)'s and relied on the same. He further relied upon on certain case laws, which we would be dealing in the course of our finding, as and when required.

13. On the Revenue's Appeals, the Ld. DR submitted that the Ground No. 1 is against the admission of additional evidence by the Ld. CIT(A). He pleaded that there was violation of Rule 46A and submitted that the Ld. CIT(A) should not be admitted the evidence in the form of (i) copy of the agreements with various Overseas Telecom Operator, (ii) Resident Certificate, (iii) no PE Certificate of those non-residents operators and (iv) copies of vouchers regarding the payment made to them. He relied upon the decision of the Delhi ITAT Bench in the case of *JCIT, Circle 17(1) v. Venus Financial Services Ltd.* [2012] 21 Taxman.com 436 (Delhi).

14. The Ground nos. 2 to 6 of the Revenue Appeals are on the issue as to whether the payment for "IUC" to "FTOs" are royalty or not. The Ld. DR basically relied upon the finding of the AO from pages 32 to 40 and submitted that without prejudice to the finding that these payments are for FTS, the AO came to the conclusion that the payments in question should in the alternative be classified as "royalty". Ld. DR further contended that the amendments brought to Section 9(1)(vii) are retrospective and are clarificatory in nature and were only brought in to clarify the unintended interpretation of the Courts of Law. Referring to the Hon'ble Delhi High Court decision on this issue, he submitted that the Hon'ble High Court has not adjudicated the issues post amendment, as the same was not before it. He submitted that the payment is for use of a process and hence covered by Explanation 5 & 6 of Section 9(1)(vi)(b) of the Act. He specifically relied upon the orders of the ITAT, Bangalore Bench in the case of *Vodafone South Ltd. v. DDIT (Int. Taxation)* reported (2015) 53 taxmann.com 441 (Bangalore-Trib.) and argued that the issue in question is squarely covered in favor of the Revenue by this decision. He further relied upon the decision of the ITAT, Mumbai Bench in the case of *Viacom 18 Media (P) Ltd. v. ADIT (International Taxation)*, Mumbai Tribunal reported in (2014) 44 taxmann.com 1 wherein it was held that, the payment of Fees for use of Satellite Transponder Service by assessee to one US Company was taxable as royalty under Article 12 of the DTAA.

15. In reply thereto, Ld. Counsel of the assessee distinguished the case laws relied upon by the Ld. DR and distinguished each and every case law on facts as well as on law. He submitted that the proposition of law laid down by the Jurisdictional High Court on the very

same issue are in favor of the Assessee and hence the orders even if they were in favour of the Revenue from other jurisdiction cannot bind the Tribunal. He further made detailed submissions to the effect that the ITAT should not follow the decision of the Bangalore Bench of the ITAT in the case of *Vodafone South Ltd. v. DDIT (Int. Taxation)* (*supra*) and the decision of the Mumbai, ITAT in the case of *Viacom 18 Media Pvt. Ltd.* etc. We will deal with these arguments in detail in our findings.

FINDING:—

16. Rival contention heard. On a careful consideration of the facts and circumstances of the case and on a perusal of the papers on record and the orders of the authorities below as well as the case law cited, we hold as follows:—

17. The Ld. CIT(A) has classified the issues as follows:—

- I. Whether the assessee is liable to be treated as assessee in default u/s. 201(1).
- II. Whether payments made by the assessee are taxable as Fee for Technical Services (hereinafter referred as FTS).
- III. Whether the payment made by the assessee are taxable in India as royalty u/s. 9(1)(vi) of the Act.
- IV. Whether the payment made by the assessee can be deemed to accrue or arise in India u/s. 9(1)(vi)(b)/ 9(1)(vii)(b) of the Act.
- V. Whether "make available" clause under DTAA is satisfied.
- VI. Whether there is no FTS clause in the relevant DTAA, where the payment are taxable in India in the absence of the FTS.
- VII. Whether section 206AA of the Act is applicable with retrospectively.

18. The Assessee filed these Appeal on the issues which were adjudicated against it by the Ld. CIT(A) and the Revenue has filed the Appeals on the issue which were adjudicated in favour of the Assessee by the Ld. CIT(A).

ASSESSEE'S APPEALS

19. The grounds in the assessee's appeal are summarized as follows:—

- (i) Whether the assessee is liable to be treated as the assessee in default u/s. 201(1).
- (ii) Whether inter-connected agreements between the assessee and the FTOs

are in the nature of revenue sharing arrangements.

- (iii) Whether the payment made by the assessee to Foreign Telecom Operators under inter-connection agreements are taxable in India as FTS.
- (iv) Whether payment made by the assessee to FTOs, can be deemed to accrue or arise in India u/s. 9(1)(vi) & 9(1)(vii) of the Act.
- (v) Whether beneficial rate provided under DTAA would override the provisions of section 206AA.

20. We summarize the grounds in the Revenue's Appeals as follows:—

- (i) Whether the payment made by the Assessee to FTOs are taxable as royalty for the use of process under section 9(1)(vii) of the Act and relevant DTAA's.
- (ii) Whether the assessee can be treated as "assessee in default" u/s. 201 of the Act in respect of the liability imposed by virtue of retrospective amendment to law.
- (iii) Whether "make available" clause under relevant DTAA are satisfied.
- (iv) Whether section 206AA of the Act is applicable retrospectively.
- (v) Whether the Ld. CIT (A) acted in violation of the provision of Rule 46A in admitting additional evidence by the assessee.

20.1 We now frame the following issues for our adjudication:—

ISSUE NO. 1

WHETHER THE PAYMENT OF IUC BY ASSESSEE TO FTOS ARE TAXABLE AS FEE FOR TECHNICAL SERVICES U/S. 9(1)(VII) OF THE ACT.

ISSUE NO. 2

WHETHER THE PAYMENT TO FTOS FOR 'IUC'S ARE IN THE NATURE OF ROYALTY UNDER SECTION 9(1)(VI) OF THE ACT.

ISSUE NO. 3

WHETHER THE ASSESSEE IS LIABLE TO BE TREATED AS ASSESSEE IN DEFAULT U/S. 201 OF THE I.T. ACT.

ISSUE NO. 4

WHETHER THE PAYMENT MADE BY THE ASSESSEE TO THE FTO CAN BE DEEMED TO ACCRUE OR ARISE IN INDIA.

ISSUE NO. 5

WHETHER BENEFICIAL RATE PROVIDED UNDER DTAA OVERRIDE THE PROVISIONS OF SECTION 206AA AND WHETHER SECTION 206AA OF THE ACT IS APPLICABLE RETROSPECTEVELY.

ISSUE NO. 6

Whether the Id. CIT (A) acted in violation of the provisions of Rule 46A in admitting the additional evidence filed by the assessee.

ISSUE NO. 7

Whether the payment is revenue sharing or not.

21. Before we adjudicate each of the issue, it would be relevant to discuss as to what is the Inter-connection, Inter-Connection Usage charges (IUC), International Long Standing Distance Services (ILD) etc.

22. The Id. CIT (A)'s in this impugned order at para no. 8.1 to 8.4 at pages 16 to 19 has explained the meaning of the aforesaid technical terms. For the sake of convenience, the same are reproduced hereunder:—

"8.1 The appellant is carrying on the business of providing telecommunication services to its subscribers. In order to provide international connectivity to its subscribers, the appellant has been granted license to provide International Long Distance services (ILD) [License Agreement No.10-Q7/2002-BS-I(ILD-02) dated 14th March 2002]. Clause 2.2 (a) of the said License is reproduced below [refer page 36 of letter dated 28.03.2012]:

"2.2(a) The ILD Service is basically a network carriage service (also called Bearer), providing International connectivity to the Network operated by foreign carriers. The ILD service provider is permitted full flexibility to offer all types of bearer services from an integrated platform. ILD service providers will provide bearer services so that end-to-end tele-services such as voice, data, fax, video and multi-media etc. can be provided by Access Providers to the customers.

.... ILD service providers would be permitted to offer international bandwidth to other operators. ILD service provider shall not access the subscribers directly which should be through NLD service provider or the Access Provider. Resellers are not permitted."

Clause 1 of the "DEFINITIONS AND INTERPRETATIONS' of the said license defines Access Providers as follows:

"ACCESS PROVIDERS" means Basic, Cellular, and cable service providers who have a direct access with the subscribers.

8.2 Thus, ILD business is nothing but provision of connectivity to the subscriber for international portion of a call, which may or may not originate domestically. The local

connectivity [within India] is provided by Access Providers and National Long Distance (NLD) operators, and the international leg of the connectivity is provided by the ILD operator in conjunction with a foreign telecom operator(s), who provide the last mile connectivity. The following are three illustrations of carriage of calls provided by the ILD operator:

(a) Carriage of calls from India to outside India:

To give an example, if a cellular subscriber is located in Delhi and seeks to make a call to New York, through his cell phone, the call will be routed as follows:

image

In the above diagram, the call moves from Aurangabad mobility circle to the NLD gateway (say at Nagpur), travels on NLD network till ILD gateway (say Mumbai) from where it is transported to international operator(s) outside India.

In order to provide seamless services to its subscribers, the appellant enters into agreement with overseas network operators, to connect the call over their network. Therefore, call traffic originating from India is carried first by the Access Provider, then by the NLD operator, then by the ILD operator and finally by the foreign telecom operator, and/or last mile service provider. The factual position, therefore, is that the entire chains of operator(s) pool their network/infrastructure to provide integrated and seamless connectivity service to the subscriber(s). The Access Provider, due to practical/legal considerations, enters into contract to provide seamless end to end connectivity to the subscriber, and earns revenue from the subscriber. The entire revenue paid by the subscriber to the Access Provider and collected by the Access Provider is shared with the NLD operators (where the NLD operator is different from the Access Provider) and with ILD operator, who in turn shares the revenue with the foreign telecom operator(s).

(b) Carrying calls from outside and terminating such calls in India:

The call in this case originates from outside India. The call may originate from, say, a subscriber of AT & T, USA. The call will travel automatically on the network of AT & T, USA and will be handed over at the Point of Presence (POP)/landing station in New York of the appellant. From such landing station, the call is carried to the landing station of the appellant, in say, Mumbai, where it is handed over to the network of NLD service provider in India for further carriage/transportation to its destination. It is also possible that the network of the NLD service provider may transfer the call to the Access Provider, (if the two are different), who may transport it to the customer. As can be observed from the above, the role of ILD operator is to transport the call from outside India till the first landing station in India. As submitted earlier, the ILD operator is not allowed to transport calls within India.

(c) Carrying calls from a telecom service provider in one country outside India to another telecom service provider and its subscriber in a third country (Hubbing'):

To illustrate, the subscriber of a US telecom service provider, in New York wants to make a call to Singapore. The call will originate at the local network of the US telecom subscriber which telecom network will carry the calls for interconnect to the landing station of the appellant in New York. Here the call is transported to the ILD network. The call will then be automatically carried on the network of the ILD operator to Singapore and then transported to the local operator in Singapore. The ILD operator will earn income from the US telecom service provider but will have to pay the IUC/access charges to the local Singaporean telecom service provider.

8.3 It may be noted that the appellant is not authorized, under the ILD license, to carry call traffic from one place to another within India which can be carried only by a NLD license holder. In this regard, the relevant clause of the NLD license is given below:

"2.2(a) The NLD Service refers to the carriage of switched bearer telecommunications service over a long distance and NLD Service Licensee will have a right to carry inter circle traffic excluding intra-circle traffic except where such carriage is with mutual agreement with originating service provider.

(b) The LICENCEE can also make mutually agreed arrangements with Basic Service Providers for picking up, carriage and delivery of the traffic from different legs between long Distance Charging Center (LDCE) and Short Distance Charging Centers (SDCCs).

(c) In the case of Cellular Mobile Telephone Service traffic, the inter-circle traffic shall be handed/taken over at the Point of Presence (POP) situated in LDCA at the location of level I TAX in originating/terminating service area. For West Bengal, Himachal Pradesh and Jammu & Kashmir such locations shall be Asansol, Shimla & Jammu respectively.

(d) NLD service licensee shall be required to make own suitable arrangements/agreements for leased lines with the Access Providers for last mile. Further, NLD Service Providers can access the subscribers directly only for provision of leased Circuits/Close User Groups (CUGs). leased circuit is defined as virtual private network (VPN) using circuit or packet switched (IP Protocol) technology apart from point to point non-switched physical connections/transmission bandwidth. Public network is not to be connected with leased circuits/CUGs. It is clarified that NLD service licensee can provide bandwidth to other telecom service licensee also."

8.4 It will thus be appreciated that the entire services are provided by the appellant as an ILD operator, outside India. From the ILD gateway of the appellant in India, the call is carried to the gateway of the appellant outside India and if the appellant has no gateway outside India, the call is carried on the telecom network of the foreign operator(s). The call from the gateway outside India is transported to the customer destination by the local foreign telecom operator(s)." (Emphasis Ours)

23. A perusal of the above extracted paras leads to the following conclusions:

The Assessee, as part of its ILD Telecom Services business, is responsible for providing services to its subscribers in respect of calls originated/terminated outside India. Thus, for the provisions of ILD services, the Assessee is required to obtain the services of FTOs for provision of Carriage Connectivity Services over the last leg by the communication channel i.e. the lack of communication channel where the assessee does not have a Licence/capacity to provide connectivity services. Thus, the ILD business is the provisions of connectivity to the subscribers for international portion of the call, which may or may not originate domestically. The local connectivity within India is provided by the Access Providers and the National Long Distance Operators (NLD operators) and the International connectivity by the ILD Operators interconnection with FTO, who provide the last mile connectivity. An international call has to be routed through NLD/ILD using the International Gate way. For termination of the international calls in India, ILD have commercial arrangements with foreign carriers who deliver the Traffic using the international connectivity and calls are delivered to the Indian ILD Operator. The assessee entered into an agreement with Overseas Network Corporate to connect the call over the network. This is done to provide seamless connectivity services to the subscribers. The Access Provider provide seamless end to end connectivity to the subscribers and the entire revenue arise out of such services is paid by the subscribers to the Access Provider. If the NLD Operator is different from Access Provider, then the NLD Operator Bills the Access Provider for his part of service rendered. The ILD Operator is in turn billed by the FTO in the form of Inter-connected Usage Charges (IUC).

24. The basic issue before us is whether such Interconnected Charges Billed by the FTOs and paid by the Assessee are in the nature of Fee of Technical Services (FTS) or in the nature of Royalty. We would first take up the adjudication of these two issues and then we would be reverting to other issues.

25. ISSUE NO. 1

WHETHER THE PAYMENT OF IUC BY ASSESSEE TO FTOS ARE TAXABLE AS FEE FOR TECHNICAL SERVICES U/S. 9(1)(VII) OF THE ACT. (As the Section 9(1)(vii) has already been extracted in the earlier paragraphs, we do not repeat the same.)

26. The Hon'ble Delhi High Court on this issue held as follows in the assessee's own case i.e. *CIT v. Bharti Cellular Ltd.* (2009) 319 ITR 139 (Delhi):—

"The expression 'fees for technical services' as appearing in s. 194J has the same meaning as given to the expression in Explan. 2 to s. 9(1)(vii). In the said Explanation. the expression 'fees for technical services' means any consideration. for rendering any (managerial, technical or consultancy services'. The word (technical' is preceded by the word (managerial' and succeeded by the word 'consultancy'. Since the expression (technical services' is in doubt and is unclear, the rule of *noscitur a sociis* is clearly

applicable. This would mean that the word 'technical' would take colour from the words 'managerial' and 'consultancy', between which it is sandwiched. A managerial service would be one which pertains to or has the characteristic of a manager. It is obvious that the expression 'manager' and consequently 'managerial service' has a definite human element attached to it. To put it bluntly, a machine cannot be a manager. The service of consultancy also necessarily entails human intervention. The consultant, who provides consultancy service, has to be a human being. A machine cannot be regarded as a consultant. From the above discussion, it is apparent that both the words 'managerial' and 'consultancy' involve a human element. And, both, managerial service and consultancy service, are provided by humans. Consequently, applying the rule of *noscitur a sociis*, the word 'technical' as appearing in Explan. 2 to s. 9(1)(vii) would also have to be construed as involving a human element. But, the facility provided by MTNL/other companies for interconnect/port access is one which is provided automatically by machines. It is independently provided by the use of technology and that too, sophisticated technology, but that does not mean that MTNL/other companies which provide such facilities are rendering any technical services as contemplated in Explan. 2 to s. 9(1)(vii). This is so because the expression 'technical services' takes colour from the expressions 'managerial services' and 'consultancy services' which necessarily involve a human element or, what is nowadays fashionably called, human interface. In the facts of the present appeals, the services rendered qua interconnection port access do not involve any human interface and, therefore, the same cannot be regarded as 'technical services' as contemplated under s. 194J. The interconnect/port access facility is only a facility to use the gateway and the network of MTNL/other companies. MTNL or other companies do not provide any assistance or aid or help to the respondents/assesseees in managing, operating, setting up their infrastructure and networks. No doubt, the facility of interconnection and port access provided by MTNL/other companies is 'technical' in the sense that it involves sophisticated technology. The facility may even be construed as a 'service' in the broader sense such as a 'communication service'. But, while interpreting the expression 'technical service', the individual meanings of the words 'technical' and 'service' have to be shed. And only the meaning of the whole expression 'technical services' has to be seen. Moreover, the expression 'technical service' would have reference to only technical service rendered by a human. It would not include any service provided by machines or robots.

Thus, the interconnect charges/port access charges cannot be regarded as fees for technical services." [Emphasis Supplied]

27. The judgment of the Hon'ble Delhi High Court in the aforesaid case may thus be summarized as under:

The rule of *noscitur a sociis* is clearly applicable and the word 'technical'

would take colour from the words 'managerial' and 'consultancy', between which it is sandwiched.

Both managerial service and consultancy service are provided by humans.

Consequently, applying the rule of *noscitur a sociis*, the word 'technical' as appearing in Expln. 2 to s. 9(1)(vii) would also have to be construed as involving a human element

The expression 'technical service' would have reference to only technical service rendered by a human.

MTNL or other companies do not provide any assistance to the assessee in managing, operating, setting up their infrastructure and networks.

No doubt, such a facility is 'technical' in the sense that it involves sophisticated technology and may even be construed as 'communication service' but while interpreting the entire expression 'technical service', the individual meanings of the words 'technical' and 'service' have to be shed and only the meaning of the whole-expression 'technical services' has to be seen.

The services rendered qua interconnection/port access do not involve any human interface and, therefore, the same cannot be regarded as 'technical services' as contemplated under s. 194J."

28. The phraseology of Fees for Technical Services covers only such technical services provided for Fees. There should be a direct co-relation between the Services which are on technical nature and the consideration received in lieu of rendering the services. The services can be said to be of technical nature is the special skills and knowledge relating to technical field which required for the provisions of such services. These are required to be rendered by humans. The services provided by machines and robust do not fall within the ambit of technical services as provided u/s. 9(1)(vii) of the Act.

29. On appeal by the Revenue, the Hon'ble Supreme Court in the case reported as *CIT v. Bharti Cellular Ltd.* (2011) 330 ITR 239 upheld the proposition of law laid down by the Hon'ble Delhi High Court. The Hon'ble Supreme Court has held as under:—

"The question basically involved in the lead case is: whether TDS was deductible by M/s. Bharti Cellular Limited when it paid interconnect charges/access/port charges to BSNL? For that purpose, we are required to examine the meaning of the words "fees for technical services" under Section 194J read with clause (b) of the Explanation to Section 194J of the Income Tax Act, 1961, ['Act', for short] which, inter alia, states that "fees for technical services" shall have the same meaning as contained in Explanation 2 to clause (vii) of Section 9(1) of the Act. Right from 1979 various judgments of the High Courts and Tribunals have taken the view that the words "technical services" have got

to be read in the narrower sense by applying the rule of *Noscitur a sociis*, particularly, because the words "technical services" in Section 9(1)(vii) read with Explanation 2 comes in between the words "managerial and consultancy services".

The problem which arises in these cases is that there is no expert evidence from the side of the Department to show how human intervention takes place, particularly, during the process when calls take place, let us say, from Delhi to Nainital and vice versa. If, let us say, BSNL has no network in Nainital whereas it has a network in Delhi, the Interconnect Agreement enables M/s. Bharti Cellular Limited to access the network of BSNL in Nainital and the same situation can arise vice versa in a given case. During the traffic of such calls whether there is any manual intervention, is one of the points which requires expert evidence. Similarly, on what basis is the "capacity" of each service provider fixed when Interconnect Agreements are arrived at? For example, we are informed that each service provider is allotted a certain "capacity". On what basis such "capacity" is allotted and what happens if a situation arises where a service provider's "allotted capacity" gets exhausted and it wants, on an urgent basis, "additional capacity"? Whether at that stage, any human intervention is involved is required to be examined, which again needs a technical data. We are only highlighting these facts to emphasise that these types of matters cannot be decided without any technical assistance available on record. There is one more aspect that requires to be gone into. It is the contention of Respondent No.1 herein that Interconnect Agreement between, let us say, M/s. Bharti Cellular Limited and BSNL in these cases is based on obligations and counter obligations, which is called a "revenue sharing contract". According to Respondent No.1, Section 194J of the Act is not attracted in the case of "revenue sharing contract". According to Respondent No.1, in such contracts there is only sharing of revenue and, therefore, payments by revenue sharing cannot constitute "fees" under Section 194J of the Act. This submission is not accepted by the Department. We leave it there because this submission has not been examined by the Tribunal. In short, the above aspects need reconsideration by the Assessing Officer. We make it clear that the assessee(s) is not at fault in these cases for the simple reason that the question of human intervention was never raised by the Department before the CIT. It was not raised even before the Tribunal; it is not raised even in these civil appeals. However, keeping in mind the larger interest and the ramification of the issues, which is likely to recur, particularly, in matters of contracts between Indian Companies and Multinational Corporations, we are of the view that the cases herein are required to be remitted to the Assessing Officer (TDS).

Accordingly, we are directing the Assessing Officer (TDS) in each of these cases to examine a technical expert from the side of the Department and to decide the matter within a period of four months. Such expert(s) will be examined (including cross-examined) within a period of four weeks from the date of receipt of the order of this Court. Liberty is also given to Respondent No.1 to examine its expert and to adduce any

other evidence. Before concluding, we are directing CBDT to issue directions to all its officers, that in such cases, the Department need not proceed only by the contracts placed before the officers." (Emphasis Ours)

29.1 Thus in our view the proposition of law laid down in the judgment of the Hon'ble Delhi High Court have attained finality. The Hon'ble Supreme Court held that the issue as to whether there is involvement/presence of human element or not was a factual and technical matter and required to be examined. The other proposition have been accepted by the Hon'ble Supreme Court. As the Hon'ble Supreme Court was of the opinion that this factual aspect of human intervention was not examined by the AO, the matter was remanded to the AO for factual examination only. The AO in pursuance of the directions of the Hon'ble Supreme Court examined witness on oath and also gave the assessee the opportunity to cross examine them. He also re-examined the expert witness. Our decision will be based on the evidence so collected by the AO on this aspect of human intervention in the services rendered. It held that the word "technical services" have got to be read in the narrower sense by applying the rule of *noscitur a sociis*, particularly, because the words "technical services" in Section 9(1)(vii) r/w Expln. 2 comes in between the words "managerial and consultancy services". Hence, there should be involvement/presence of human element for coming to a conclusion that "technical services" can be said to have been rendered in terms of Explanation 2 to Section 9(1)(vii) of the Act. In our view the Hon'ble Supreme Court of India has approved the proposition laid down by the Hon'ble High Court, that this is a service and that it would be FTS as defined u/s. 9(1)(vii) if there is human interference in such communication service. Hence the issue to be considered is narrow and based on evidence collected by the Revenue post the Hon'ble Supreme Court judgment. All other issues are no more res-integra.

29.2 This aspect as to whether a human element is involved in such interconnect services or not, has been examined by different Benches of the Tribunal based on the evidence collected by the AO in the above stated set-aside proceedings. The facts that are on record are the same as the facts and evidence which have been examined by various Coordinate Benches of the Tribunal. These include the statement of experts recorded by the Assessing Officer and the cross examination done by the Representative of the Company. For the sake of brevity, we do not extract the statement and cross examination etc. of the various experts, as these were considered in detail by the Coordinate Benches and it was held as follows:

29.3 The Kolkata Bench of the Tribunal in the case of *Vodafone East Ltd. v. Addl. CIT* in ITA No. 243/Kol/2014, vide order dated 15.9.2015 held as follows:—

"From the aforesaid statement recorded from technical experts pursuant to the directions of the Supreme Court in *CIT v. Bharti Cellular Ltd.* (330 ITR 239) which has been heavily relied upon by the Learned CITA, we find that human intervention is required only for installation setting up/repairing/servicing/maintenance/capacity

augmentation of the network. But after completing this process, mere interconnection between the operators while roaming, is done automatically and does not require human intervention and accordingly cannot be construed as technical services. It is common knowledge that when one of the subscribers in the assessee's circle travels to the jurisdiction of another circle, the call gets connected automatically without any human intervention and it is for this, the roaming charges is paid by the assessee to the Visiting Operator for providing this service. Hence we have no hesitation to hold that the provision of roaming services do not require any human intervention and accordingly we hold that the payment of roaming charges does not fall under the ambit of TDS provisions u/s 194J of the Act."

30. The Jaipur Bench of the Tribunal in the case of *Bharti Hexacom Ltd. v. ITO (TDS)* in ITA 656/JP/2010 dated 12.6.2015 held as follows :

"11. We have heard the rival contentions of both the parties and perused the material available on the record. After going through the order of the Assessing Officer, Id CIT (A); submissions of the assessee as well as going through the process of providing roaming services; examination of technical experts by the ACIT TDS, New Delhi in the case of Bharti Cellular Ltd.; thereafter cross examination made by M/s Bharti Cellular Ltd.; also opinion of Hon'ble the then Chief Justice of India Mr. S.H. Kapadia dated 03/09/2013 and also various judgments given by the ITAT Ahmadabad Bench in the case of Canara Bank on MICR and Pune Bench decision on Data Link Services. We find that for installation/setting up/repairing/servicing/maintenance capacity augmentation are require human intervention but after completing this process mere interconnection between the operators is automatic and does not require any human intervention. The term Inter Connecting User Charges (IUC) also signifies charges for connecting two entities. The Coordinate Bench also considered the Hon'ble Supreme Court decision in the case of Bharti Cellular Ltd. in the case of i-GATE Computer System Ltd. and held that Data Link transfer does not require any human intervention and charges received or paid on account of this is not fees for technical services as envisaged in Section 194J read with Section 9(1)(vii) read with Explanation-2 of the Act. In case before us, the assessee has paid roaming charges i.e. IUC charges to various operators at Rs. 10,18,92,350/-. Respectfully following above judicial precedents, we hold that these charges are not fees for rendering any technical services as envisaged in Section 194J of the Act. Therefore, we reverse the order of the Id CIT (A) and assessee's appeal is allowed on this ground also."

31. The AO as well as the Ld. CIT (A) has recorded that there is no human intervention when the call is successfully completed. It is also not disputed that there is no difference in the technology, system and methodology used by Telecom Companies in providing inter-connection of domestic calls or of international calls. So what decision is applicable for use of local calls also applies to "IUC" of international calls. Thus the view taken on the

deductibility of TDS on IUC charges paid for local inter connectivity service would on all fours apply to charges paid for "IUC" for international inter connectivity.

32. The Chennai Bench of the ITAT in the case of *M/s Dishnet Wireless Ltd. v. DCIT* in ITA No. 320 to 329/Mad/2014 vide order dated 20.7.2015 on the aspect of human intervention held as follows:—

"25. Now coming to roaming charges, the contention of the assessee is that human intervention is not required for providing roaming facility, therefore, it cannot be considered to be a technical service. We have gone through the judgment of Apex Court in *Bharti Cellular Limited (supra)*. The Apex Court after examining the provisions of Section 9(l)(vii) of the Act, found that whenever there was a human intervention, it has to be considered as technical service. In the light to the above judgment of the Apex Court, the Department obtained an expert opinion from Sub-Divisional Engineer of BSNL. The Sub-Divisional Engineer clarified that human intervention is required for establishing the physical connectivity between two operators for doing necessary system configurations. After necessary configuration for providing roaming services, human intervention is not required. Once human intervention is not required as found by the Apex Court, the service provided by the other service provider cannot be considered to be a technical Service. It is common knowledge that, when one of the subscribers in the assessee's circle travels to the jurisdiction of another circle, the call gets connected automatically without any human intervention. It is due to configuration of software system in the respective service provider's place. In fact, the Sub-Divisional Engineer of BSNL has explained as follows in response to

Question No. 23:—

"Regarding roaming services as explained to question no. 21. Regarding interconnectivity, initial human intervention is required for establishing the physical connectivity and also for doing the required configuration. Once it is working fine, no intervention is required. In case of any faults human intervention is required for taking necessary corrective actions." In view of the above, once configuration was made, no human intervention is required for connecting roaming calls. The subscriber can make and receive calls, access and receive data and other services without human intervention. Like any other machinery, whenever the system breakdown, to set right the same, human intervention is required. However, for connecting roaming call, no human intervention is required except initial configuration in system. This Tribunal is of the considered opinion that human intervention is necessary for routine maintenance of the system and machinery. However, no human intervention is required for connecting the roaming calls. Therefore, as held by the Apex Court in *Bharti Cellular Limited (supra)*, the roaming connections are provided without any human intervention and therefore, no technical service is availed by the assessee. Therefore, TDS is not required to be made in respect of roaming charges paid to other service providers."

33. All the Benches of the Tribunal are unanimous in their view on this issue. We see no reason whatsoever to deviate from these views. Hence consistent with the view taken in the above referred orders, we hold that the payment in question cannot be characterized as Fee for Technical Services u/s. 9(1)(vii) of the Act. There is no manual or human intervention during the process of transportation of calls between two networks. This is done automatically. Human intervention is required only for installation of the network and installation of other necessary equipments/infrastructure. Human intervention is also necessary for maintaining, repairing and monitoring each operator or individual network, so that they remain in a robust condition to provide faultless services to the customers. Human intervention is also required in case where the network capacity has to be enhanced by the telecom operators. Such human intervention cannot be said to be for inter-connection of a call.

34. Where routing of every call has been decided, the exhaustive standard of capacity of the transporter network will automatically re-route through another channel through another operator. Human intervention in setting up enhanced capacity has no connection or relation with the traffic of call. Thus it is clear that in the process of actual calls, no manual intervention is required. The finding of the revenue authorities that interconnection is a composite process, involving several processes which require human intervention is erroneous. The test laid down by the Hon'ble Supreme Court of India in its order when the case was remanded to the AO is to find out as to whether "during traffic of calls, is there was any manual intervention?". There is no reference to the issues of set up, installation or operation maintenance or repair of network as explained by the Ld. CIT (A). These decisions of the various Benches of the ITAT, when read with the judgment of the Hon'ble Delhi High Court as well as the Hon'ble Supreme Court, would settle this matter in favour of the assessee. But as a number of other decisions have been relied upon, we examine the same.

35. The Hon'ble Madras High Court in the case of *Skycell Communications Ltd. v. DCIT* (2001) 251 ITR 53 (Mad.) has held that call charges received from telecom operators from firms and companies subscribing to cellular mobile services provided by them do not come within the definition of technical services u/s. 194J read with section 9(1)(vii) Expln. 2, as it is a mere collection of Fee for use of standard facility provided to all those willing to pay for it. Applying the proposition laid down in this case law to the facts of this case, we have to hold that inter connection facility and the service of the FTO in picking up, carrying and successful termination of the call over their respective network is a standard facility and the FTO in question does not render any technical services to the assessee under interconnect agreement.

36. The Hon'ble High Court of Delhi in the case of *CIT v. Estel Communications (P) Ltd.* [2008] 217 CTR (Del) 102 held as follows:—

"Tribunal considered the agreement that had been entered into by the assessee with T and came to the conclusion that there was no privity of contract between the

customers of the assessee and T. In fact, the assessee was merely paying for an internet bandwidth to T and then selling it to its customers. The use of internet facility may require sophisticated equipment but that does not mean that technical services were rendered by T to the assessee. It was a simple case of purchase of internet bandwidth by the assessee from T. Under the circumstances, the Tribunal came to the conclusion that there were no technical services provided by T to the assessee and, therefore, the provisions of s. 9(l)(vii) did not apply. Tribunal has rightly dismissed the appeal after taking into consideration the agreement between the assessee and T and the nature of services provided by T to the assessee. It was a simple case of payment for the provision of a bandwidth. No technical services were rendered by T to the assessee. On a consideration of the material on record, no substantial question arises in the matter."

37. In the case of *ACIT v. Hughes Software Systems Ltd.* [2013] 35 CCH 416 Del. Trib, the Tribunal has held as under:—

"Deduction. of tax at source-Fees for technical services-Assessee was engaged in business of software development of products and providing software services in India and overseas-Assessee was treated as "assessee in default" u/s 201(1) on account of non-deduction of TDS u/s 194J from payment made for use of tele-communication services i.e telephone charges, link charges and band width charges as 'fee for technical services' u/s 9(1)(vii)-CIT(A) reversed findings of AO-Held, payments were made to MTNL & BSNL etc. for providing space for transmission of data for carriage of voice and for availing service of inter-communication, port access for which no human intervention was necessary-Payment cannot be characterized as "fee for technical services"-Thus, assessee cannot be held to be in default -for non- deduction of tax at source from payment of telecommunication. charges in terms of section 194J-Revenue's ground dismissed.

38. The Bangalore ITAT in the case of *Wipro Ltd. v. ITO* [2003] 80 TTJ (Bang) 191 held as follows:—

"Income deemed to accrue or arise in India-Fees for technical services/royalty-Payment for transmission of data and software through uplink and down link services-Assessee engaged, inter alia, in the business of development of software providing on line software services through customer based circuits with the help of VSNL and foreign telecom companies outside India-As per the agreements with such telecom companies assessee is to use the standard facility having standard pricing patterns-There is nothing to show that assessee was provided with any technology or technical services-Therefore, the amounts paid by assessee-company to non-resident telecom companies for downlinking and transmitting of data to the assessee's customers located outside India cannot be considered as 'fees for technical services' under s. 9(l)(vii), moreso when similar services offered by VSNL is not regarded as technical services-Further, no process has been made available to the assessee-Hence, there is no question of

applicability of s. 9(l)(vi) too-So long as the amount paid is not taxable under the Act, the clause in the DTAA cannot bring the charge-Hence, there was no liability to deduct tax under s. 195"

39. In view of the above discussions, respectfully following the binding judgment of the Hon'ble Supreme Court of India, we have no hesitation in upholding the submissions of the Ld. Counsel of the Assessee that, the payment in question cannot be considered as "Fee for Technical Services" in terms of section 9(1)(vii) read with Expln. 2 of the Act.

40. The second aspect of the issue are before us, is without prejudice to the finding under the Domestic Law, whether the payment to FTOs for "IUC" is fee for technical services under the DTAA, wherever 'make available clause' is found in these agreements. In view of our finding that the payment is not fee for technical services under the Act, it would be an academic exercise to examine whether the payment in question would be fee for technical services under DTAA's. Suffice to say wherever treaties contain "making available" clause, then in terms of the judgment of the Hon'ble Karnataka High Court in the case of *CIT & Ors. v. De Beers India Minerals Pvt. Ltd.* [2012] 346 ITR 0467; the payment cannot be treated as FTS under the DTAA as there is no imparting as contemplated in the Treaties. Similar are the propositions on the issue of "make available" in the decisions in the case of *Mahindra & Mahindra Ltd. v. DCIT* 313 ITR 263; *Ramond Limited v. DCIT* 86 ITD 791; *Cable and Wireless Networks India P. Ltd.* [2009] 315 ITR 72.

41. The next aspect of this issue, which is raised as Ground No. 8 in the Department's Appeal is that, when the treaties do not contain FTS clause, what is the impact on taxability. Wherever FTS clause is not available in the treaty with a country, then the income in question would be assessable as business income and it can be brought to tax in India, only if the FTO has the permanent establishment in India and if the earning of income is attributable to activities or functions performed by such permanent establishment. This view is supported by the decision of the Coordinate Bench.

42. The Delhi Bench of the Tribunal in the case of *ACIT v. Paradigm Geophysical Pty. Ltd.* 122 ITD 155 (2010) held as follows:—

"What art. 7(7) seems to convey is that where the business profits of the non-resident include items of income for which specific or separate provisions have been made in other articles of the treaty, then those provisions would apply to those items. Per contra, if it is found that those provisions are not applicable to those items of income, then the logical result would be that those items of income will remain in art. 7 and will not go out of the same. Such items of income which do not fall under any other provision of the double tax treaty, would continue to be viewed as business profits covered by art. 7. The position canvassed by the counsel for the assessee seems to be more logical than the view canvassed on behalf of the Department. Fees for technical services are essentially business profits since the rendering of such services is the business of the non-resident. In order to take out an item of income from the business

profits, it is necessary under art. 7(7) that there should be some other provision in the treaty dealing specifically with the item of income sought to be taken out from the business profits. If there is no other provision in the treaty or if the provision made in the treaty is not found applicable or to cover the item of income sought to be taken out from the business profits, for whatever reason, then it follows that the particular item of income should continue to remain under art. 7. In light of the above discussion, the amount received by the assessee company from RIL under the contract did not represent consideration for any technical services rendered to RIL which made available technical knowledge, experience, skill, etc. or consisted of the development and transfer of any technical plan or design within the meaning of art. 12(3)(g) of the Indo Australian Treaty. The consideration will continue to be viewed as business profits under art. 7 of the treaty and since the assessee had no PE in India the business profits cannot be taxed in India."

43. Similarly, the Hon'ble Bombay High Court in the case of *CIT v. Siemens Aktiengesellschaft* [2009] 310 ITR 320 (Bom)

"Double taxation relief Agreement between India' and' Federal Republic of Germany- Royalty vis-a-vis industrial and commercial profits-Even though s. 9 would apply, provisions of DTAA, if more beneficial, would prevail- Assessee having no PE in India, amount of royalty, sought to be assessed as industrial or commercial profit, is not assessable to tax in India-If the consideration received by the assessee for grant of the patents and license is regarded as royalty as the grant admittedly took place outside India; the question of applying deeming provisions of Explanation to s. 9 inserted by the Finance Act, 2007 would not arise and further, assessee having no PE in India, such income would not be taxable in India as industrial and commercial profits in terms of art. III of Indo-German DTAA-Income from activities covered by arts. V to XII by virtue of art. 111(3) are specifically excluded from the expression 'industrial or commercial profits' in art. III as they are to be taxed in the manner provided under arts. V to XII- Therefore, income other than of the nature provided in arts. V to XII, if relatable to industrial or commercial profits would fall under art. III, not chargeable to tax in the absence of PE-This view is further fortified by the fact that art. III of the 1960 DTAA has been substituted by DTAA of 1995 and a new art. VIIIA has been inserted explaining the expression 'royalties '"

44. In view of the above reasons, we hold that wherever under the DTAA's. Make available clause is found, then as there is no imparting, the payment in question is not 'FTS' under the Treaty and when there is no 'FTS' clause in the treaties, the payment falls under Article 7 of the Treaty and is business income.

45. ISSUE NO. 2

WHETHER THE PAYMENT TO FTOS FOR 'IUC'S ARE IN THE NATURE OF ROYALTY UNDER SECTION 9(1)(VI) OF THE ACT.

46. The specific charge of the AO is that taking up a call by the FTO from the assessee is a use of 'process' and hence the payment for the same is "Royalty" in terms of Clause (iii) of Explanation 2 to Section 9(1)(iv) of the Act.

47. We analyse the finding of the Ld. CIT (A) on this issue.

- (a) Section 9(1)(vi)(iii) employs the word "use of". The factum of "use of process" has to be established before the payment can be characterized as royalty. A perusal of the agreements between the parties demonstrate that it is not a case of lease or licence of network of foreign operator in favour of the assessee. The foreign operator connects his network to that of the assessee for further transmission. Hence, in this model, only the foreign operator is using his network and the assessee is not using or is not allowed to use network of foreign operator. Therefore, the definition of royalty is not attracted.
- (b) The AO has not given a finding as to whether taking up a call by the "FTO" from the Assessee is a "process". The definition of the term "process" rather the meaning of word "process" has been expanded by insertion of Explanation 6 to Section 9(1)(vi) of the Income Tax Act, introduced by the Finance Act, 2012 to include transmission by optic fibre or similar technology. Thus, after the amendment, transmission of call across gateway shall be a process under the Domestic Law. Even it is considered a process, as there is no use of it by the assessee, the definition of royalty is not attracted.
- (c) The FTO provides technical services to the assessee by using its network. When the FTO is using its network, it cannot be said that assessee is using the network of the Non-Resident Operator. Hence, both the situations are mutually exclusive. As the assessee is not using the network of the FTO, the payment made is not for "use of process", hence, not in the nature of royalty.
- (d) The AO's reliance on the judgment of the Chennai Bench of the Tribunal in the case of *Verizon Communications Singapore Pte. Ltd. v. ITO* [2011] 45 SOT 263 (Chennai) is misplaced, as in that case the Indian Company obtained 'Leased Lines' on hire/lease basis under the contract. The facts are different.
- (e) Explanation 5 & 6 incorporated in Section 9(1)(vi) by the Finance Act, 2012 do not affect the definition of royalty, as per DTAA. The Indo UK Tax Treaty, employs the word "use or right to use" in contra distinction to the word 'use' in domestic law. As per various judicial pronouncements, in order to satisfy the word "use or right to use", the control and possession of right, property or information should be with the payer. Thus under the DTAA royalty has a much restricted meaning.

- (f) Without prejudice to the above findings, even if the payments partake the character of royalty after retrospective amendment in the Act, the assessee cannot be held to be an assessee in default in respect of those payments made prior to the amendment, as brought out in the Finance Act, 2012.
- (g) The obligation imposed upon the assessee u/s. 195 to deduct tax specifies that it should be at the time of credited of such income to the account or at the time of payment thereof whichever is earlier and both these events had taken place much prior to the amendment brought in by the Finance Act.

48. We uphold the finding of the 1st Appellate Authority for the following reasons.

The AO has taken a contradictory stand that the payments in question may be treated as "royalty" for "use of process" in terms of Section 9(1)(vi) of the Act, if in case the Appellate Authorities hold that the payment to FTOs are in the nature of "Fee for Technical Services". As the AO has held that the payment in question is royalty, as it is for the "use of process", as per clause (iii) to Explanation 2 to Section 9(1)(iv) of the Act, we restrict our finding to this issue only. The term "Process" occurs under clause (i), (ii) and (iii) to Explanation 2 to Section 9(vi). It reads as under:—

"Explanation 2. -For the purposes of this clause, "royalty" means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains") for—

- (i) the transfer of all or any rights (including the granting of a licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property;
- (ii) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property;
- (iii) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property; (emphasis ours)

49. By the Finance Act, 2012, Explanation 5 & 6 are added with retrospective effect from 1.6.1976 which reads as under:—

"Explanation 5 – For the removal of doubts, it is hereby clarified that the royalty includes and has always included consideration in respect of any right, property or information, whether or not —

- (a) The possession or control of such right, property or information is with the payer;
- (b) Such right, property or information is used directly by the payer;

(c) The location of such right, property or information is in India.

Explanation 6.- For the removal of doubts, it is hereby clarified that the expression "process" includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret."

50. Before we deal the issue as to whether the payment is question for use of "process", we feel it relevant to extract certain clauses of the agreements (a) Agreement between Bharti Airtel Ltd. and Sunrise Communications AG, which reads as under:—

"1. Object of the Agreement

1.1 Each Party agrees to provide the other Party with connecting, transit and termination services (hereinafter referred to as "the Services") allowing the conveyance of international and/or national calls on a non-exclusive basis as defined in the Service Description(s) associated with this Agreement.

1.2 This Agreement shall not be construed to constitute a partnership or agency relationship between the Parties. The parties are entering into this agreement on a principal to principal basis. Each Party acts in its own name and operates for its own benefit and risk while performing its obligations under this Agreement.

1.3 Neither of the Parties hereto shall have any rights in the equipments or in the network of the other Party (eg. liens or pledges). Each Party is and remains responsible for its network and for the provision of services relating to it, unless specifically stated otherwise in this Agreement. "

3. Definition of Services

The Parties shall connect, and keep connected, for the duration of this agreement, their systems at Points of Interconnection (POI) in order to convey calls to and from those systems and to provide voice Services to each other in accordance with this Agreement and as specified in the Schedules hereto.

5. Technical Standards and Interconnection

5.1. **

**

**

5.2 Each Party shall at its own cost, unless otherwise agreed, be responsible for providing, installing, testing, making operational and maintaining all equipment on its side of each Point of Interconnection (POI) as defined in the TFD.

5.3. **

**

**

7. Equipment

7.1 Each Party shall at its own cost, unless otherwise agreed by both Parties, be responsible for providing, installing, testing, making operational and maintaining all equipment on its side of each Point of Interconnection.

7.2. **

**

**

9. Charges

9.1 Each Party shall notify the other in writing of its 'per minute' rates for the Service(s) on a regular basis, as defined in the Service. Description(s) (see Schedule 1). All rates shall be stated in DOLLAR (\$). Each Party shall invoice the other Party for the Service(s) provided based on actual call duration and number of calls (where applicable), which will be calculated in the relevant Service Descriptions.

(b). Agreement between Bharti Airtel Ltd. (Bharti) and Airtel Tanzania Ltd. (Airtel) (copy enclosed at pages 39 to 74 of the PB):

WHEREAS Bharti and Airtel are providers of international telecommunications services and WHEREAS, Bharti desires to procure certain telecommunications services provided by AIRTEL and AIRTEL desires to procure certain telecommunications services provided by Bharti; and WHEREAS, Parties, which are already providing carrier-to-carrier traffic, is now interested in creating a non-exclusive carrier-to-carrier relationship with Bharti; and

WHEREAS, the Parties have agreed to enter into this Agreement to set out the arrangement between the parties in respect of the exchange of international telecommunication services as also the settlement rates in respect of the Service(s) listed in relevant Annexures attached.

3. OPERATIONAL MATTERS

3.1 Each Party shall be responsible to connect to the other Party's network at one of the other Party's network interconnection locations, and the Parties shall be responsible to procure, at their own expense, the necessary facilities or equipment required to interconnect to such locations.

3.2. & 3.3. **

**

**

3.4 The Parties shall coordinate the management of their respective system facilities, with each Party being responsible for providing and operating, at its own expense, its respective network facilities. The Parties also shall interface on a 24 hours/7 days a week basis to assist each other with the isolation and repair of any facility fault in their respective networks."

"ANNEX 1 - [BHARTI VOICE TERMINATION SERVICES,

THIS ANNEX to International Telecommunication Services is subject to the terms and conditions of the RECIPROCAL TELECOMMUNICATIONS SERVICES AGREEMENT entered into between AIRTEL TANZANIA LIMITED ('AIRTEL') and BHARTI AIRTEL LTD. ('Bharti') effective as of SERVICES Bharti will terminate international telecommunications traffic (IDD type), which AIRTEL has delivered to one of Bharti's interconnection locations to those Destinations as agreed from time to time."

"ANNEX 3 [AIRTEL TANZANIA LIMITED, VOICE TERMINATION SERVICES,

THIS ANNEX for domestic and International Telecommunication Services is subject to the terms and conditions of the RECIPROCAL TELECOMMUNICATIONS SERVICES AGREEMENT entered into between AIRTEL TANZANIA LIMITED ('AIRTEL') and BHARTI AIRTEL LTD. ('Bharti') effective as of SERVICES AIRTEL will terminate international telecommunications traffic (IDD Type), which Bharti has delivered to one of AIRTEL'S interconnection locations to those international Destinations."

51. A perusal of these agreements demonstrate that, each party under the agreement remains responsible for its own network and for the provision of services related to it. The Telecom Operator provide connecting, transit and termination services to each other on a reciprocal basis and neither of the parties shall have any rights in the equipments or in the network of other parties. The charges under the agreement are also levied for the services provided under the agreement, based on the actual call duration and number of calls successfully delivered to the other parties. The agreement are not for renting, hiring, letting or leasing out of any of the network elements or resources to the other parties or for rendering telecommunication services on a reciprocal basis. The assessee merely delivers the call that originates on its network to one of the inter connection locations of the FTO and FTO carries and terminates the call on its network. The Assessee is nowhere concerned with the route, equipment, process or network elements used by the FTO in the course of rendering such services.

52. The term "process" used under Explanation 2 to section 9(1)(vi) in the definition of 'royalty' does not imply any 'process' which is publicly available. The term "process" occurring under clauses (i), (ii) and (iii) of Expl 2 to section 9(1)(vi) means a "process" which is an item of intellectual property. Clause (iii) of the said Explanation reads as follows:

"(iii) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property"

Clauses (i) & (ii) of the said explanation also use the same coinage of terms. The words which surround the word 'process' in clauses (i) to (iii) of Explanation 2 to section 9(1)(vi) refer to various species of intellectual properties such as patent, invention, model, design, formula, trade mark etc. Thus the word "process" must also refer to a specie of intellectual property applying the rule of ejusdem generis or noscitur a sociis as held in the case of *CIT v. Bharti Cellular Ltd.* [2011] 330 ITR 239]. The expression 'similar

property' used at the end of the list further fortifies the stand that the terms 'patent, invention, model, design, secret formula or process or trade mark' are to be understood as belonging to the same class of properties viz. intellectual property.

'Intellectual property' as understood in common parlance means: Knowledge, creative ideas, or expressions of human mind that have commercial value and are protectable under copyright, patent, service mark, trademark, or trade secret laws from imitation, infringement, and dilution. Intellectual property includes brand names, discoveries, formulas, inventions, knowledge, registered designs, software, and works of artistic, literary, or musical nature. It is one of the most readily tradable properties in the digital marketplace." [as per definition provided in BusinessDictionary.com]

53. The term "process" is therefore to be understood as an item of intellectual property resulting from the discovery, specialized knowledge, creative ideas, or expressions of human mind having a commercial value and not widely available in public domain. It is therefore an intangible asset, the exclusive right over which normally rests with its developer/creator or with the person to whom such asset has been exclusively transferred.

In order to receive a 'royalty' in respect of allowing the usage or right to use any property including an intellectual property, the owner thereof must have an exclusive right over such property. As far as intellectual properties (IPs) are concerned, these have significance for the purpose of 'royalty' only till the time the ownership (as differentiated from the right to use) of such property vests exclusively with a single person and such person by virtue of its exclusive ownership allows the usage or right to use such IP to another person/persons for a consideration in the form of 'royalty'. Payment made for anything which is widely available in the open market to all those willing to pay, cannot constitute 'royalty' and is essentially in the nature of business income.

The Hon'ble High Court of Madras in the case of *CIT v. Nayveli Lignite Corporation Ltd.* (2000) 243 ITR 0459 held that "the term (royalty' normally connotes the payment made to a person who has exclusive right over a thing for allowing another to make use of that thing which may be either physical or intellectual property or thing. The exclusivity of the right in relation to the thing for which royalty is paid should be with the grantor of that right. Mere passing of information concerning the design of machine which is tailor-made to meet the requirement of a buyer does not by itself amount to transfer of any right of exclusive user, so as to render the payment made therefor being regarded as royalty".

The Hon'ble High Court of Calcutta in the case of *N.V. Philips Gloeilampenfabrieken Eindhoven v. CIT* (1988) 172 ITR 0521 held as under:

"From the dictionary meaning of the term 'royalty', it appears that the said term connotes payments periodic or at a time for user by one person of certain exclusive rights belonging to another person. The examples of such exclusive rights are rights in the nature of a patent, mineral rights or right in respect of publications. It is possible

that a person who invests may not take out a patent for his invention but unless some other inventor independently and by his own efforts come to duplicate the invention the original invention remains exclusive to the investor and it is conceivable that such an inventor might exploit his invention permitting some other person to have the user thereof against payment. Similarly, it is possible for a person carrying out operations of manufacture and production of a particular product to acquire specialised knowledge in respect of such manufacture and production which is not generally available. A person having such specialised knowledge can claim exclusive right to the same as long as he chooses not to make such specialised knowledge public. It is also conceivable that such a person can exploit and utilise such specialised knowledge in the same way as a person holding a patent or owning a mineral right or having the copyright of a publication to allow a limited user of such specialised knowledge to others in confidence against payment. There is no reason why payment for the user of such specialised knowledge, though not protected by a patent, should not be treated as royalty or in the nature of royalty.-Handley Page vs. Butterfield. 19 Tax Cases 322 relied on."

Thus, the term 'royalty' connotes exclusivity and the exclusive right in relation to the thing (be it physical or intellectual property) for which royalty is paid should be with the grantor of that right. In case of an intellectual property, it is generally associated with some discovery, invention, creation, specialised knowledge etc. emanating from human mind and is payable to the inventor / creator for allowing the usage of his invention or creation and having an exclusive right over it. The Hon'ble Calcutta High Court in the case of *NV Philips Gloeilampenfabrieken Eindhoven v. CIT (Supra)* held that a person having some specialised knowledge can claim exclusive right to the same as long as he chooses not to make such specialised knowledge public. Such a person can exploit and utilise such specialised knowledge in the same way as a person holding a patent or owning a mineral right or having the copyright of a publication to allow a limited use of such specialised knowledge to others in confidence against payment in which case it is termed as royalty. However, once such specialised knowledge becomes public; such person loses the exclusivity in respect of such special knowledge and hence, loses the right to receive any royalty in respect of the same. Thus, for a payment to be classified as royalty, 'exclusivity' of the subject matter is of crucial relevance.

54. The Dictionary meaning of the term 'process' (as defined in Business Dictionary.com) is as under:—

"Sequence of interdependent and linked procedures which, at every stage consume one or more resources (employee time, energy, machines, money) to convert inputs (data, material, parts, etc.) into outputs. These outputs then serve as inputs for the next stage until a known goal or end result is reached."

As Cambridge Dictionaries Online, defines "process" to mean a series of actions that you take in order to achieve a result.

54.1 Hence, the term 'process' implies a sequence of interdependent and linked procedures or actions consuming resources to convert inputs into outputs. Therefore, 'process' when viewed as an asset is an intangible asset and does not have physical existence. Various tangible equipments and resources may be employed in executing a process but 'process' per se, just like a formula or design, is intangible. The term 'process' as contemplated by the definition is thus referable to 'know-how' and intellectual property. There is a clear distinction between a 'process' and the physical equipments and resources deployed in the execution of a 'process'. While the former is an intangible asset, the latter is tangible and has a physical existence. The right to receive a royalty in respect of a process would only be with the person having exclusive right over such 'process' and 'process' being in the nature of intellectual property, the grantor of such right would normally be the inventor or creator of such process or person enjoying exclusive ownership of such process. The owner of the 'process' might grant the 'use' or 'right to sue' to different persons at the same time, but the exclusivity of the ownership should be with the grantor. The royalty is paid for the "use of" the 'process' as an item of IP by the manufacturing company in contradistinction to the equipments or resources deployed in the execution of such 'process'. The payer must therefore use the IP on its own and bear the risk of its exploitation. If the IP is used by the owner himself and he bears the risk of exploitation or liabilities for the use, then as the owner makes own entrepreneurial use of the IP the income would fall under the scope of "Business Income" and not "royalty". A 'process' which is widely known and deployed by everyone in the field and for which the owner does not have exclusive rights cannot be a "process" contemplated in this Section 991)(vi) Explanation (iii).

54.2 In the case of telecom industry, all the telecom operators have similar infrastructure and telecom networks in place, for rendition of telecommunication services. The process embedded in the networks of all telecom operators is the same. The equipments, resources etc. employed in the execution of the process may be different in physical terms i.e. in terms of ownership and physical presence, but the process embedded in the execution of a telecom infrastructure is the same and commonly available with all the telecom operators. The 'royalty' in respect of use of a 'process' would imply that the grantor of the right has an exclusive right over such 'process' and allows the 'use' thereof to the grantee in return for a 'royalty'. It is necessary that guarantee must 'use' the 'process' on its own and bear the risk of exploitation. The 'process' of running the networks in the case of all the telecom operators is essentially the same and they do not have any exclusive right over such 'process' so as to be in a position to charge a 'royalty'. For allowing the use of such process, the term 'use' in context of royalty connotes use by the grantee and not by the grantor. A 'process' which has been in public domain for some time and is widely used by everyone in the field cannot constitute an item of intellectual property for the purpose of charge of 'royalty'. Any compensation or consideration, if at all received for allowing the use of any such 'process' which is publically available and not exclusively owned by the grantor constitutes business income and not royalty.

55. We now consider the interpretation of the term "process" after insertion of Explanation 6 to Section 9(1)(vi) by the Finance Act, 2012 with retrospective effect from 1.6.1976. As per this Explanation, the "expression 'process' includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret." However, the Explanation does not do away with the requirement of successful exclusivity of the right in respect of such process being with the person claiming 'royalty' for granting its usage to a third party. None of the FTOs have any exclusive ownership or rights in respect of such process, and hence in our view the payment in question cannot be considered as royalty. The telecom operator merely render Telecommunications Services to the subscribers, as well as interconnecting telecom operators with the aid of their network and the process embedded therein. This is a standard facility which is used by the FTO itself. Thus the insertion of Explanation 6 to Section 9(1)(vi) does not alter the decision taken by us on this issue.

56. As far as the insertion of Explanation 5 to Section 9(1)(vi) is concerned, we hold that this Explanation comes into play only in case of Royalty falling within the ambit of Section 2 of Section 9(1)(vi). When a process is widely available in the public domain and is not exclusively owned by anyone the it cannot constitute an item of intellectual property for the purpose of charge of 'Royalty' under clauses (i), (ii) and (iii) of Explanation 2 to Section 9(1)(vi). Hence, the criteria of possession, control, location indirect use etc., as explained by Explanation 5 has no effect in the case in hand.

57. The arguments of the Ld. DR that Explanation 5 is attracted since the assessee company is indirectly using such equipment and process through the services provided by the FTO, in our view is devoid of merits. There is difference between the services rendering agreements and royalty agreements. If the arguments of the DR is accepted it would result in absurdity. For example:—

- (i) A person hiring a taxi will be paying a royalty for indirectly using the process of running of the engines of the taxi.
- (ii) A person using a cable connection will be termed to be paying royalty in the form of cable charges for indirectly using the process of running of the systems of the cable operators.
- (iii) A telephone subscriber using or making a call would be held as indirectly using the process of the service of telecom.

58. The Hon'ble Delhi High Court in the case of *CIT v. Bharati Cellular Ltd.* reported in 319 ITR 139 has given a finding that the facility in question provided to the assessee is a "service" and in a broader sense a "communication service". The facility of inter connection is held as providing service which is "technical" in the sense that involved sophisticated technology. Thus the factual finding of the Jurisdictional High Court in this very facts and

circumstances is that "technical services" is being provided by the FTO's to the assessee but that such "Technical Service" is not FTS as defined u/s. 9(1)(vii) of the Act as there is no human intervention. This finding that it is a "service" has not been upheld by the Hon'ble Supreme Court of India only the factual issue as to whether there was human intervention was set aside to AO. Under such circumstances, the question of taking a contrary view that it is not a "technical services", but a case where the FTO had granted the assessee a right to use a process and the payment is for 'royalty' cannot be countenanced. Applying the binding decision of the Hon'ble Jurisdictional High Court we have to hold that the payment cannot be termed as covered by Explanation 2 read with Section 9(1)(vi) of the Act. On this ground alone the order of the First Appellate Authority has to be upheld. The charge that the payment in question is FTS u/s. 9(1)(vii) excludes the possibility of the payment being royalty under section 9(1)(vi) of the Act. Both these sections deal with different set of facts situation which cannot co-exist.

59.1 Even under the DTAA, as held by the Ld. First Appellate Authority we are of the view that the payment in question cannot be termed as royalty.

59.2 The assessee company has entered into interconnect agreements with various foreign telecom operators who are residents of countries like Australia, Canada, France, Israel, Netherlands, Portuguese Republic, Singapore, Spain, Sweden, United Kingdom, United States of America, Bangladesh, Indonesia, Mauritius, Nepal, Philippines, Saudi Arabia, Sri Lanka, Thailand, UAE etc. India has Double Taxation Avoidance Agreements with all the aforesaid countries.

59.3 The definition of 'royalties' (simply referred to as 'royalty' under the Income-tax Act, 1961) is mostly contained in Articles 12 & 13 of the DTAA's between India and the aforesaid countries. The definitions of 'royalties' contained in the Treaties with the aforesaid countries are almost *pari materia* insofar as the royalty is for 'use of process' is concerned. We quote from Article 13(3) of Indo-UK treaty defining the term 'royalties' hereunder:

"3. For the purpose of this Article, the term (royalties' means:

- (a) payments of any kind received as a consideration for the use of, or the right to use, any copyright of a literary, artistic or scientific work, including cinematography films or work on films, tape or other means of reproduction for use in connection with radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience; and (b) payments of any kind received as consideration for the use of, or the right to use, any industrial, commercial or scientific equipment, other than income derived by an enterprise of a Contracting State from the operation of ships or aircraft in international traffic.

(Emphasis ours)

59.4 Further, as per Article 12(3) of the Indo-US treaty, the term 'royalties' has been defined as under:

"3. The term "royalties" as used in this Article means:

- (a) payments of any kind received as a consideration for the use of, or the right to use, any copyright of - a literary, artistic, or scientific work, including.- cinematography films or work on film, tape or other means of reproduction for use in connection with radio or television broadcasting, any patent, trademark, design or model, plan,' secret formula or process, or for information concerning industrial, commercial or scientific experience, including gains derived from the alienation of any such right or property which are contingent on the productivity, use, or disposition thereof; and
- (b) payments of any kind received as consideration for the use of, or the right to use, any industrial, commercial or scientific equipment, other than payments derived by an enterprise described in paragraph 1 of Article 8 (Shipping and Air Transport) from activities described in paragraph 2(c) or 3 of Article 8."

(Emphasis ours)

The definition of 'royalties' under Indo-Canada treaty is the same as above.

59.5 Similarly, Article 13(3) of the Indo-France Treaty defines 'royalties' as under:

"3. The term "royalties" as used in this article means payments of any kind received as consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, or films or tapes used for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, of for information concerning industrial, commercial or scientific experience."

(Emphasis ours)

The definition of royalties under Indo-Netherlands Treaty is the same as above.

59.6 The term 'royalties', has been similarly defined in all other treaties. On a perusal of the definition of 'royalties' provided in various treaties, it is clear that, all the treaties use the expression 'secret formula or process' is separated by a comma before and after the expression. This implies that" formula/ process is a part of the same group and the adjective 'secret' governs both. Thus, under the treaties, in order to constitute royalty for use of or the right to use of a process, the process has to be 'secret'. In the case of telecom industry, however, telecommunication services as already observed by us are rendered through standard facilities and no 'secret process' is involved.

60. A perusal of the wording of these Treaties show that only payments received as consideration for the "use of", or "the right to use" is necessary for the payment to be

termed as Royalty. This is much narrower to the definition of royalty under the Act. As held by the Ld. CIT(A) there is no 'use of' or 'right to use' of any process in the facts and circumstances of the case on hand and hence, even under the DTAA's, the payment in question cannot be termed as royalty.

60.1 The Hon'ble High Court of Delhi in the case of *Asia Satellite Telecommunications Co. Ltd. v. Director of Income Tax* (2011) 332 340 considered this issue and held as follows:—

"The taxpayer, a Hong Kong based company, was engaged in the business of satellite communications and broadcasting facilities. This business: was carried out through the medium of satellites, owned and leased, which are placed in geostationary orbits. These satellites did not use Indian orbital slots. They also did not get placed over the Indian sky space on any occasion. The assessee entered into agreements with TV Channels & communication companies so that they are able to utilize its transponder capacity for data transmission. They could plink their signals on the transponder through their own earth stations. Such earth stations are located outside India. On receipt of the signals, the transponder amplifies the signal and sends it to the target area. The area so covered, called the footprint area, included the territory of India. The assessee held that its income was not chargeable to tax in India because it does not have any permanent establishment in India. In particular, it was argued that there was no office or customers in India. The Delhi Tribunal in the said case held that despite the fact that the assessee could have business connection in India, none of its operations were carried out in India. In addition, the payment made by the customers was not for use of the equipments so that there was no equipment royalty angle in this case. However, the Hon'ble Tribunal also held that in the facts of the case, the customers were making payment to the non-resident for use of a process. It was observed that to constitute royalty, the process need not be a secret process. The income of the non-resident was ruled to be 'process royalty.' The Court held, (i) that under the agreement with television channels, the role attributed to the assessee was as follows: (i) programmes were uplinked by the television channels (admittedly not from India); (ii) after receipt of the programmes at the satellite (at locations not situated in Indian airspace), these were amplified through complicated process; and (iii) the programmes so amplified were relayed in the footprint area including India where the cable operators caught the waves and passed them over to the Indian population. The first two steps were not carried out in India. Merely because the footprint area included India and the programmers by ultimate consumers/viewers watched the programmes in India, even when they were uplinked and relayed outside, India, that would not mean that the assessee was carrying out its business 'Operations in India. The expressions "operations" and "carried out in India" occurring in Explanation I(a) to section 9(1)(i) signify that it was necessary' to establish that any part of the assessee's operations were carried out in India. No machinery or computer was installed by the assessee in India through which the programmes reached India. The process of

amplifying and relaying the programmes was performed' in the satellite which was not situated in Indian airspace. Even the tracking, telemetry and control operations to be performed outside India in Hong Kong. There was no contract or agreement between the assessee either with the cable operators or viewers for reception of signals in India. Thus, section 9(1)(i) was not attracted.

(ii) 'That the process of transmission of television programmes started with television channels (customers of the assessee) uplinking the signals containing the television programmes ; thereafter the satellite received the signals and after amplifying 'and changing their frequency relayed it down in India and other countries where the cable operators caught the signals and distributed them to the public. Any person who had a dish antenna, could also catch the signals relayed from these satellites: 'The role of the assessee was that of receiving the signals, amplifying them and after changing the frequency relaying them on the earth. For this service, the television channels made payment to the assessee. The assessee was the operator of the satellites and was in control of the satellite. It had not leased out the equipment to the customers. The assessee had merely given access to a broadband width available in a transponder which can be utilized for the purpose of transmitting the signals of the customer. A satellite is not a mere carrier, nor is the transponder something which is distinct and separable from the satellite as such. The transponder in fact cannot function without the continuous support of various systems and components of the satellite. Consequently, it is entirely wrong to assume that a transponder is a self-contained operating unit, the control and constructive possession of which is or can be handed over by the satellite operator to its customers. The terms "lease of transponder capacity", "lessor", "lessee" and "rental" used in the agreement would not be the determinative factors. There was no use of "process" by the television channels. Moreover, no such purported use had taken place in India. The telecast companies/customers were situated outside India and so was the assessee. The agreements under which the services were provided by the assessee to its customers were executed abroad. The transponder was in orbit. Merely because it had its footprint on various continents that would not that the process had taken place in India.

Isro Satellite Centre [ISAC], in re [2008] 307 ITR 59 (AAR), *Ishikawajima-Harima Heavy Industries Ltd. v. DIT* [2007] 288 ITR 408 (SC) and *Lakshmi Audio Visual Inc. v. Asst. CCT* [2001] 124 STC 426 (KARN) Applied.

(iii) That the money received from the cable operators by the operators was treated as income by these telecast operators which had in India and they had offered and paid tax. Thus, the income generated in India had been duly subjected to tax in India. The payment made by the tele cast operators situated abroad to the assessee which was also a nonresident did not represent income by way of royalty as defined in Explanation section 9(1)(vi) of the Act. Article 12 of the model double taxation avoidance

agreement framed by the Organisation of Economic Co-operation and Development contains a definition of "royalty" which is in all respects virtually the same as the definition of "royalty" contained in (iii) of Explanation 2 to section 9(1)(vi) of the Act. The commentary by the OECD can be relied upon.

(iv) That the Tribunal rightly admitted the additional ground question of applicability of section 9(1)(vii) on the ground that it was legal and did not require consideration of any fresh facts, as all necessary for adjudication whether the amount received was chargeable to tax section 9(1)(vii) were available on record. However, no arguments been advanced by the Department on this ground, it had to be presumed that the case was not sought to be covered under this provision."

61. In the case of *DCIT v. PanAmSat International Systems Inc.* (2006) 103 TTJ 861 (Del) the Tribunal has held as under:—

"There is a "process" involved in the activity carried on by the assessee. There is a comma after the words "secret formula or process" in art. 12.3(a) of Indo-US DTAA which indicates that both the words "formula" and "process" are qualified by the word "secret". The requirement thus under the treaty is that both the formula and the process, for which the payment is made, should be a secret formula or a secret process in order that the consideration may be characterised as royalty. Normally punctuation by itself cannot control the interpretation of a statutory provision. However, the punctuation-the use of the comma-coupled with the setting and words surrounding the words under consideration, indicates that under the treaty even the process should be a secret process so that the payment therefore, if any, may be assessed in India as royalty. The words which surround the words "secret formula or process", in art. 12.3(a) of the treaty refer to various species of intellectual properties such as patent, trade mark, design or model, plan, etc. Thus the words "secret formula or process" must also refer to a specie of intellectual property applying the rule of ejusdem generis or noscitur a sociis.-*Asia Satellite Telecommunication Co. Ltd. v. Dy. CIT* (2003) 78 TTJ (Del) 489 : (2003) 85 ITD 478 (Del) distinguished. (Para 19)

So far as the transponder technology is concerned there appears to be no "secret technology", known only to a few. There is evidence to show that the technology is even available in the form of published literature/book from which a person interested in it can obtain knowledge relating thereto. There is no evidence led from the side of the Department to show that the transponder technology is secret, known only to a few, and is either protected by law or is capable of being protected by law. Since there is nothing secret about the process involved in the operation of a transponder, the payment for the use of the process- assuming it to be so-does not amount to royalty" (Para 20) The argument that the consideration has been received by the assessee for letting the broadcasters use the patent relating to the transponder/satellite goes farther than the assessment order and therefore cannot be accepted. Even on merits

the argument is not acceptable since the patent relating to the transponder/satellite is not with the assessee but is with the manufacturer of the same. There is no clause in the purchase agreement to show that the patent relating to the transponder/satellite was also transferred to the assessee by the manufacturer. If the patent did not ensure to the assessee, how the assessee could have, even in the wildest of imaginations, let the broadcasters use the same for consideration. The argument sought to be made is factually not borne out. There is not on iota of evidence to show that the assessee had any patent to the satellite or transponder which it allowed the broadcasters to use for a consideration." (Para 21)

62. In the case of *Cable & Wireless Networks India (P) Ltd.* in re (2009) 315 ITR 0072, the AAR held as under:—

"Cable & Wireless Networks India (P) Ltd.; In Re (2009) 315 ITR 0072: Held that "Payment made by applicant to the UK company for providing international leg of the services in transmitting voice/data to places outside India using its international infrastructure and equipments is neither royalty nor fees for technical services; payment is in the nature of business profits and in the absence of PE of UK company in India, same is not taxable in India."

Further, at paras 8.1 to 8.3, the Hon'ble AAR held as under:

"No material has been placed to show that C&W UK uses any secret process in the transmission of the international leg of the service, or that the applicant pays towards the use or right to use that secret process. It is well settled that telecom services are standard services. The arrangement between the applicant and C& W UK is for rendition of service and the applicant pays for the same. It is for C & W UK to see how it will provide that service. The applicant is not concerned with the same. The Revenue has thus failed to show how the payments made by the applicant will be royalty income in the hands of C&W UK."-*Dell International Services India (P) Ltd., In re* (2008) 218 CTR (AAR) 209 : (2008) 10 DTR (AAR) 249 : (2008) 305 ITR 37 (AAR) followed."

62.1 Applying the proposition laid down in the case laws to the facts of the case, we have to hold that the payment in question is not 'Royalty' as contemplated under the DTAAs.

62.2 Now the question is whether there would be any change in this position subsequent to the retrospective amendments brought out by the Finance Act, 2002 w.e.f. 1.6.1976 by adding Explanation 5 & 6 to Section 9(1)(vi) of the Act. The answer is no as changes in domestic law cannot be read into the Treaties as long as there is no change in the working of the Treaties.

63. The Hon'ble High court of Delhi in the case of *DIT vs. Nokia Networks* (2013) 358 ITR 259 has held as under:—

"S. 9 has been amended vide Finance Act, 2012 and Explanations have been inserted with retrospective effect from 1-6-1976. The revenue argued that the amendments are only clarificatory in nature and submitted that the question of "copyrighted article" or actual copyright does not arise in the context of software both in the DTAA and in the Income Tax Act since the right to use simpliciter of a software program itself is a part of the copyright in the software irrespective of whether or not a further right to make copies is granted. The decision of the Delhi Bench of the ITAT has dealt with this aspect in its judgment in *Gracemac Co. v. ADIT* 134 TTJ (Delhi) 257 pointing out that even software bought off the shelf, does not constitute a "copyrighted article". It was categorically held in *CIT v. Siemens Aktiengesellschaft*, 310 ITR 320 (Bom) that the amendments cannot be read into the treaty and on 'the wording of the treaty, it was already held that a copyrighted article does not fall within the purview of Royalty."

Gracemac Co. v. ADIT 134 TTJ (Delhi) 257, *CIT v. Siemens Aktiengesellschaft*, 310 ITR 320 (Bom.), *DIT v. Ericsson*, 343 ITR 370, relied on."

64. Recently, the Hon'ble Delhi High Court in the case of *DIT v. New Skies Satellite BV & Ors.* In ITA No. 473/2012 & Ors. Vide judgment dated 8.2.2016 has held as under:—

"39. It is now essential to decide the second question i.e. whether the assessee in the present case will obtain any relief from the provisions of the DTAA. Under Article 12 of the Double Tax Avoidance Agreements, the general rule states that whereas the State of Residence shall have the primary right to tax royalties, the Source State shall concurrently have the right to tax the income, to the extent of 15% of the total income. Before the amendment brought about by the Finance Act of 2012, the definition of royalty under the Act and the DTAA were treated as *pari materia*. The definitions are reproduced below:

Article 12(3), Indo Thai Double Tax Avoidance Agreement: "3. The term "royalties" as used in this article means payments of any kind received as a consideration for the alienation or the use of, or the right to use, any copyright of literary, artistic or scientific work (including cinematograph films, phonographic records and films or tapes for radio or television broadcasting), any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience."

Article 12(4), Indo Netherlands Double Tax Avoidance Agreement ITA 473/2012, 474/2012, 500/2012 & 244/2014 Page 31 "4. The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience."

Section 9(1)(vi), Explanation 2, Income Tax Act, 1961 "(iii) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property"

40. In *Asia Satellite Telecommunication* the Court, while interpreting the definition of royalty under the Act, placed reliance on the definition in the OECD Model Convention. Similar cases, before the Tax Tribunals through the nation, even while disagreeing on the ultimate import of the definition of the word royalty in the context of data transmission services, systematically and without exception, have treated the two definitions as *pari materia*. This Court cannot take a different view, nor is inclined to disagree with this approach for it is imperative that definitions that are similarly worded be interpreted similarly in order to avoid incongruity between the two. This is, of course, unless law mandates that they be treated differently. The Finance Act of 2012 has now, as observed earlier, introduced Explanations 4, 5, and 6 to the Section 9(1)(vi). The question is therefore, whether in an attempt to interpret the two definitions uniformly, i.e. the domestic definition and the treaty definition, the amendments will have to be read into the treaty as well. In essence, will the interpretation given to the DTAAs fluctuate with successive Finance Act amendments, whether retrospective or prospective?

The Revenue argues that it must, while the Assessee argues to the contrary. This Court is inclined to uphold the contention of the latter.

41. This Court is of the view that no amendment to the Act, whether retrospective or prospective can be read in a manner so as to extend in operation to the terms of an international treaty. In other words, a clarificatory or declaratory amendment, much less one which may seek to overcome an unwelcome judicial interpretation of law, cannot be allowed to have the same retroactive effect on an international instrument effected between two sovereign states prior to such amendment. In the context of international law, while not every attempt to subvert the obligations under the treaty is a breach, it is nevertheless a failure to give effect to the intended trajectory of the treaty. Employing interpretive amendments in domestic law as a means to imply contoured effects in the enforcement of treaties is one such attempt, which falls just short of a breach, but is nevertheless, in the opinion of this Court, indefensible."

64.1 After considering the Vienna Convention on the Law of Treaties, 1969 (VCLT) and the judgments of the Hon'ble Supreme Court of Canada and other precedents, the Hon'ble High Court further has held as under:—

"60. Consequently, since we have held that the Finance Act, 2012 will not affect Article 12 of the DTAAs, it would follow that the first determinative interpretation given to the word "royalty" in *Asia Satellite*⁵⁹, when the definitions were in fact *pari materia* (in the absence of any contoured explanations), will continue to hold the field for the purpose of assessment years preceding the Finance Act, 2012 and in all cases which involve a Double Tax Avoidance Agreement, unless the said DTAAs are amended jointly by both

parties to incorporate income from data transmission services as partaking of the nature of royalty, or amend the definition in a manner so 59 supra note 1 ITA 473/2012, 474/2012, 500/2012 & 244/2014 Page 50 that such income automatically becomes royalty. It is reiterated that the Court has not returned a finding on whether the amendment is in fact retrospective and applicable to cases preceding the Finance Act of 2012 where there exists no Double Tax Avoidance Agreement."

65. Thus, respectfully following the jurisdictional High Court decision as well as the judgments of the other Courts, we agree with the submission of the Ld. Counsel for the assessee that the amendments to the Finance Acts cannot be read into the DTAA's.

66. Ld. DR relied upon the decision of the Bangalore Bench of the ITAT in the case of Vodafone South vs. DCIT (Supra) wherein it was held that there is liability for deduction of tax at source on "IUC" payments as these payments were held to be payments, for use of process and hence payment for royalty. We have perused this decision of the ITAT. The proposition laid down therein are contrary to the propositions laid down by the Hon'ble Jurisdictional High Court in the case of *DIT v. New Skies Satellite BV & Ors. (Supra)* as well as *Asia Satellite Telecommunications Co. Ltd. v. Director of Income Tax (Supra)* and in the case of the assessee itself as well as in the case of *DIT v. Nokia Networks (Supra)* and other judgments referred in our decision. Even the Hon'ble Supreme Court has held that such payments are only for service rendered. Moreover, the agreements entered into by M/s Vodafone South India with the FTOs, are not before us. As per the terms of the agreement before us, the assessee had to pay the Inter Connectivity Usage charges to the FTOs, for services provided by them and not for the 'use of' or 'the right to use' of the process in their telecom network. In the case in hand, the Assessee never used or had acquired the right to use the process of the FTOs. This decision of the ITAT, Bangalore Bench as already stated, is contrary to the proposition laid down in judgment of the Jurisdictional High Court in the case of the assessee itself where it is held that the payment was for service and this necessarily excludes the possibility of the payment being held as that which is made for Royalty, as both are contradictory position. This decision has been affirmed by the Hon'ble Supreme Court. Thus, we follow the binding decision of the Jurisdictional High Court in the matter and uphold the finding of the Ld. CIT(A).

67. Similarly, the reliance placed by the Ld. DR on the judgment of the Hon'ble Madras High court in the case of *Verizon Communications Singapore Pte. Ltd. v. ITO (International Taxation)* reported in (2014) 361 ITR 0575 is also misplaced for the following reasons:—

- (a) M/s Verizon Communications received International Private Leased Circuit charges from customers for providing point to point dedicated private line to communicate between offices that are geographically dispersed throughout the world, the said case the bandwidth capacity was dedicated for the use of the Indian customer irrespective of actual usage. In the case of the present assessee, no such point to point dedicated private line was made available

by the FTOs.

- (b) In the case of Verizon Communications the customer has dedicated active internet connection at a particular speed, so that the contracted bandwidth is provided and the equipment at the customer end is also delivered by VCPL. In the case of the assessee no equipment is given by the FTO to the assessee. The assessee merely delivers a call using its own network, to the interconnection location of the FTOs which picks up the call and further transmit and terminates at the desired destination by using its own network.
- (c) In the case of Verizon Communication the customer has a significant economic interest in the VCPL's equipment to the extent of the bandwidth hired by the customer. The bandwidth capacity is given to the customer on a dedicated basis for a entire contract period. The Assessee has no such interest.

68. Ld. DR further relied upon the decision of ITAT, Mumbai in the case of *Viacom 18 Media (P) Ltd. v. ADIT (International Taxation)*, (2014) 44 taxmann.com 1 (Mumbai Tribunal). This decision is also contrary to the proposition of law laid down by the Hon'ble Jurisdictional High Court in the assessee's own case. The ITAT has held that M/s Viacom 18 Media Pvt. Ltd. was engaged in the broadcasting of its various programmes on TV channels including marketing and advertising airtime. The Mumbai Bench also held that the judgment of the Hon'ble Jurisdictional High court in the case of *Asia Satellite Communications Co. Ltd. v. DIT (Supra)* is not applicable to the facts of Viacom 18 (Supra) case. It is not so in the case on hand. In any event the interpretation given by the Mumbai ITAT is divergent from the law laid down by the Jurisdictional High court in the case of *Asia Satellite Communication Co. Ltd. (Supra)* and hence we cannot follow the same.

69. Thus, we uphold the order of the Ld. First Appellate Authority that the payment made for FTO for interconnection charges does not fall within the ambit of the definition of 'Royalty' under section 9(1)(vi) of the Act or under the definition of 'Royalty' under the Treaties.

70. Now we take up the other issues.

Issue No. 3

Whether the assessee is liable to be treated as assessee in default u/s. 201 of the I.T. Act.

71. Under Section 195, any person, who is responsible for making a payment to a person who is a non-resident, of any sum, which is chargeable to Tax under the Act, is required to deduct the tax thereon at the rates in force. The Hon'ble Supreme Court of India in the case of *GE Technology Central (P) Ltd. v. CIT* (2010) 327 ITR 456 (SC) held that the payer becomes an assessee in default, only when he fails in his statutory obligations under section 195(1) of the Act. If the payment does not contain an element of income, the payer cannot be made

liable to deduct tax u/s. 195 of the Act and he cannot be declared to be an "assessee in default".

72. We have held that the payment in question for "IUC" to FTOs is neither FTS nor royalty either under the Act or under the Treaties. We have in subsequent paragraphs given reasons as to why the income in question arising from the payment cannot be deemed to accrue or arise in India. Thus the assessee cannot be declared as "assessee in default" as it has not failed in its statutory obligations to deduct tax at source u/s. 195 of the Act. Assessee cannot be held the Assessee in default under section 201 of the I.T. Act. Hence, this issue is decided in favour of the Assessee.

Issue No. 4

Whether the payment made by the assessee to the "FTO" can be deemed to accrue or arise in India.

73. The undisputed fact is that none of the operations of the FTOs are in India. The call is delivered outside India and is carried and terminated outside India. Under these circumstances, the question is whether the FTO is liable to pay tax on the income derived by it, on the ground that, the income is received or is deemed to have been received in India or on the ground that, the income accrues or arises in India or is deemed to accrue or arise in India, during the relevant year. On facts, it is clear that Section 5(2)(a) is not applicable, as the payments were neither received nor deemed to have been received by the 'FTOs' in India. The first part of Section 5(1)(2)(b) is also not applicable. Hence, we have to test the receipts, as per the deeming provisions contained in the I.T. Act i.e. whether the receipt in question can be deemed to accrue or arise in India, u/s. 9, read with section 5(2)(b) of the Act.

74. The payment in question does not accrue or arise to the 'FTOs', through or from any property of the 'FTOs' in India or from any asset or source of income of the 'FTOs' in India or through the transfer of any capital asset of the 'FTOs' in India. The entire business operations are carried out outside India by the FTOs. Under these circumstances, the proposition of law laid down in the judgment of the Hon'ble Jurisdictional High Court in the case of *Asia Satellite Communication Company Ltd. (Supra)* applies in this case. Hence, no income is deemed to accrue or arise to the FTO's in India.

75. Even if it is assumed that the payments accrued or arise to the FTOs either directly or indirectly through or from any business connection in India since the business operations of the FTOs are carried out entirely outside India, no part of such income can be said to be reasonably attributable to the business connection of the FTOs if in India.'

76. The Mumbai Bench of the ITAT in the case of *JCTI v. Siemens Aktiengesellschaft* (2010) 133 TTJ 0563 has held as under:—

"Expln. I(a) to s. 9(1) provides that for the purposes of this clause, in the case of a business of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise. In India shall be only such part of the income as is reasonably attributable to the operations carried out in India. From this Explanation, it is further amply clear that even if there is a business connection of the nonresident in India, then also only that part of the income shall be deemed to accrue or arise in India which is relatable to the operations carried out in India. So even if it is presumed for a moment, that there was any business connection of the assessee in India, still in the absence of any operations carried on by the assessee in India in this regard, there cannot be any question of bringing the case within the ambit of s. 9(1). It is pertinent to mention that the assessee categorically stated before the AO that the local activity with reference to installation was carried out by S Ltd. in their independent capacity. It has further been claimed that income from such services has been duly offered for taxation by the Indian company, which has not been disputed by the Departmental Representative. Therefore, no part of the income as relatable to the sale of equipment by the assessee can be said to have deemed to accrue or arise to the assessee in India within the meaning of s. 9."

77. The Hon'ble High Court in the case of *CIT v. Goodyear Tyre & Rubber Co.* (1989) 184 ITR 369 (Del.) held that even though the non-resident had a business connection in India, if no operations were carried out in India, the income cannot be subject to tax in India. Hence, the payment cannot be brought within the ambit of Section 9(1) r.w.s. 5(2) of the Act.

78. Even under the DTAA, the payments being in the nature of business income of the FTOs, Article '7' of the relevant DTAA's governs the same. There is no dispute that the FTOs do not have any Permanent Establishment in India. Under such circumstances, under Article 7 of the Treaty the income cannot be brought to tax in India. Hence, the payment of "IUC" to the FTOS cannot be deemed to accrue or arise in India under any of the clause of Section 9(1) read with Section 5(2) of the Act. Therefore this issue is decided in favour of the assessee.

Issue No. 5

Whether beneficial rate provided under DTAA override the provisions of section 206aa and whether section 206AA of the act is applicable retrospectively.

79. This issue of retrospective applicability is covered in favour of the Assessee and against the Revenue by the decision of the ITAT, Pune Bench in the case of *DDIT (IT-II), Pune v. Serum Institute of India Ltd.* (2015) 56 taxmann.com 1. Hence, respectfully following the order of the Coordinate Bench, we hold that Section 206AA cannot be applied retrospectively.

80. Recently the Bangalore 'B' Bench of the Tribunal in the case of *M/s Wipro Ltd. v. ITO (Int. Taxation)* in ITA NO. 1544 to 1547/Bang./2013 (AY 2011-12) has held as under:—

"Where the tax has been deducted on the strength of the beneficial provisions of section OT Ms, the provisions of section 206AA of the Act cannot be invoked by the Assessing Officer to insist on the tax deduction @ 20%, having regard to the overriding nature of the provisions of section 90(2) of the Act. Section 206AA of the Act does not override the provisions of section 90(2) of the Act and in the payments made to non-residents, the assessee correctly applied the rate of tax prescribed under the OT Ms and not as per section 206AA of the Act because the provisions of the DTAA was more beneficial.

(ii) The explanation below sub-section-1 of Section 200A of the IT Act, which clarifies that in respect of deduction of tax at source where such rate is not in accordance with provisions of this Act can be considered as an incorrect claim apparent from the statement. However, in the case in hand, it is not a simple case of deduction of tax at source by applying the rate only as per the provisions of Act, when the benefit of DTAA is available to the recipient of the amount in question. Therefore, the question of applying the rate of 20% as provided u/s 206AA of the IT Act is an issue which requires a long drawn reasoning and finding. Hence, we are of the considered opinion, that applying the rate of 20% without considering the provisions of DTAA and consequent adjustment while framing the intimation u/s 200A is beyond the scope of the said provision. Thus, the AO has travelled beyond the jurisdiction of making the adjustment as per the provisions of Section 200A of the IT Act, 1961."

81. Respectfully, following the Coordinate Bench decision we hold that the beneficial rate provided in the DTAA override the provisions of Section 206AA of the Act. Thus this issue is resolved in favour of the Assessee.

Issue No. 6

Whether the Id. CIT(A) acted in violation of the provisions of Rule 46A in admitting the additional evidence filed by the assessee

82. After hearing rival submissions, we find that the Assessee was not allowed sufficient time by the AO to file the requisite details. It is not in dispute that the details and documents produced are voluminous. The Assessee submitted before the Ld. CIT(A) that the time given by the AO to furnish all the information and details pertaining to many past years, and that the assessee required time to collect the same from third parties who were located overseas and that such an exercise was time consuming. The Assessee has requested the AO specifically on 5.1.2012 to allow more time to compile the details. The AO without giving any further opportunity, within 7 days of such a request passed the impugned order. Under the circumstances, we find no infirmity in the order of the Id. CIT(A) admitting additional evidence under Rule 46A as these go into the root of the matter. The First Appellate Authority also recorded that these additional evidence are crucial for deciding the primary issues that were raised in the Appeal.

83. The Ld. DR in support of his contention that the Ld. CIT(A) should not have admitted additional evidence relied upon on the following decisions.

- Order of the ITAT, 'D' Bench, Delhi in the case of *ITO v. Life Line Biotech Ltd.* reported (2014) 52 taxmann.com 27 (Delhi - Trib.)
- Order of the ITAT, 'H' Bench, Delhi in the case of *JCIT v. Venus Financial Services Ltd.* reported in (2012) 21 taxmann.com 436 (Delhi)

84. The Assessee also relied upon the decision of the Jurisdictional High Court in the case of *CIT v. Virgin Securities & Credits (P) Ltd.* 332 ITR 396.

85. We have perused these decisions. These are distinguished on facts. When the Ld. DR has not disputed the finding of the Ld. CIT(A) that sufficient time was not granted to the assessee to file the requisite details. He has also not disputed the finding that these documents are crucial for adjudicating this aspect. These were not the facts in these cases cited by the Ld. DR.

86. In the decision of the Hon'ble Delhi High Court in the case of *CIT v. Virgin Securities & Credits (P) Ltd.* (*Supra*) reported in 332 ITR 396 at Para 8 held as follows:—

"8 The aforesaid contention appears to be devoid of any merit. It is a matter of record that before admitting the additional evidence; the Commission of Income-tax (Appeals) had obtained a remand report from the Assessing Officer. While submitting his report, the Assessing Officer had not object, to the admission of the additional evidence, but had merely reiterated contentions in the assessment orders. It is only after considering remand report, the Commissioner of Income-tax (Appeals) had admitted the additional evidence. It cannot be disputed that this additional evidence was crucial to the disposal of the appeal and had a direct bearing On the quantum of claim made by the assessee. The plea of the asses was taken before the Assessing Officer remains the same. The Assessing Officer had taken adverse note because of non-production of certain documents to support the plea and it was in these circumstances, the additional evidence was submitted before the Commissioner of Income- (Appeals). It cannot be said nor is it the case of the Revenue that additional evidence is not permissible at all before the first appellate authority. On contrary, rule, 46A of the Rules permits the Commissioner of Income-(Appeals) to admit additional evidence if he finds that the same is crucial for disposal of the appeal. In the facts of this case, therefore, we are of the opinion that on this aspect, no substantial question of law arises."

87. The Jurisdictional High Court in the case of *CIT v. Text Hundred India (P) Ltd.* at Para 13 held as follows:

"13. The aforesaid case law clearly lays down a neat principle of law that the discretion lies with the Tribunal to admit additional evidence in the interest of justice once the Tribunal affirms the opinion that doing so would be necessary for proper adjudication

of the matter. This can be done even when application is filed by one of the parties to the appeal and it need not to be a suo motu action of the Tribunal. The aforesaid rule is made enabling the Tribunal to admit the additional evidence in its discretion if the Tribunal holds the view that such additional evidence would be necessary to do substantial justice in the matter. It is well-settled that the procedure is handmaid of justice and justice should not be allowed to be choked only because of some inadvertent error or omission on the part of one of the parties to lead evidence at the appropriate stage. Once it is found that the party intending to lead evidence before the Tribunal for the first time was prevented by sufficient cause to lead such an evidence and that this evidence would have material bearing on the issue which needs to be decided by the Tribunal and ends of justice demand admission of such evidence. The Tribunal can pass an order to that effect."

88. Applying the proposition laid down in the decisions to the facts of the case, we uphold the order of the Ld. CIT(A).

Issue No. 7

89. On the issue whether the payment is revenue sharing or not. Though detailed arguments have been advanced by both the parties on this issue, we do not adjudicate the same as in our opinion this requires further details and documents which are not on record. Hence we leave this question open.

90. In the result, all the Appeals of the Assessee are allowed and all the Revenue's Appeals are dismissed.

■ ■

IN THE ITAT DELHI BENCH 'B'

Cargill financial Services Asia Pte. Ltd, In Liquidation

v.

Assistant Director of Income-tax, Circle (1), International Taxation, New Delhi

**S.V. MEHROTRA, ACCOUNTANT MEMBER
AND MS. SUCHITRA KAMBLE, JUDICIAL MEMBER**

**IT APPEAL NOS. 5006 & 5260 (DELHI) OF 2011
[ASSESSMENT YEARS 2003-04 & 2008-09]**

MARCH 15, 2016

Rohan Khare, A. Srivastava and D. Chopra, Advocates for the Appellant. Anuj Arora for the Respondent.

ORDER

S.V. Mehrotra, Accountant Member - These are assessee's appeals against separate orders passed by the Id. CIT(A), relating to A.Yrs. 2003-04 & 2008-09. Since common issues are involved for adjudication, both the appeals were heard together and are being disposed of by a consolidated order for the sake of convenience.

2. The main issue in the present appeals is whether the amounts received by assessee from its Indian associated enterprises were in the form of interest or discounting charges. Brief facts are that the assessee ("CFSA"), is a company incorporated in Singapore and is a tax resident of Singapore. Accordingly, the assessee could opt to be governed by the provisions of the Income-tax Act or the India-Singapore Treaty, which ever was more beneficial to assessee. Assessee had entered into an agreement with Cargill India Pvt. Ltd. ("CIPL"), the assessee's associate, for the rendering of certain administrative and support services relating to treasury and financial activities, whereby CIPL was charged towards the cost of the services (on actual usage basis), as per the method provided in the said agreement, on a cost plus 5% mark up.

3. During the course of assessment proceedings the AO show caused the assessee as to why the amounts paid by Cargill India to it should not be considered as interest as per sec. 2(28A) of the Act and para 4 of Article 11 of the tax treaty between India and Singapore and not discounting charges as claimed by assessee. The assessee in its reply pointed out that it was engaged in the business to subscribe, buy, underwrite or otherwise acquire, own, hold, sell or exchange securities or investments of any kind including negotiable instruments, commercial paper etc. Accordingly, as a part of its business, it draws, makes, accepts, endorses, discounts, executes and issues promissory notes, bill of exchange etc. It was

further pointed out that CIPL incorporated under the Indian Companies Act, was, inter alia, engaged in the business of import and export of agricultural commodities and processed foods. On few occasions CFSA had purchased bill of exchange/ demand promissory note from CIPL. The assessee in detail explained its modus operandi which has been reproduced in the assessment order and also the need for discounting bills of exchange. The AO examined the assessee's contentions and concluded as under:—

"5. In this case, as explained by the assessee, CIPL draws bill of exchange on the buyer. CIPL gets these bills of exchange discounted with CFSA (assessee), which remits the balance amount of bill of exchange (net of discount) to CIPL. On the maturity date the buyer pays the full amount of the bill of exchange to CFSA. As mentioned in the bill of exchange discounting, the pricing of the discounting is based on the Libor plus margin. The transaction from the perspective of the assessee is explained as below:

- It purchases the bill of exchange, for which discounting agreement is entered- and this mentions the face value, the date of acceptance of the bill and maturity date.
- The discounting agreement also has a mention of the pricing of the product and tenor of the bill.
- The discounting agreement has a mention of the face amount, discount amount and the net proceeds payable by the assessee.
- On the date of purchase of the bill of exchange, the assessee pays to CIPL the net proceeds after charging the discount on the face value.
- On the date of maturity it receives the face value from the buyer/ obligor of the bill.
- To summarize the transaction is a simple lending of money and receipt of the money advanced alongwith the interest on the maturity date. The face value of the product consists 'of the net proceeds paid at the time of buying and the discount value.
- This transaction can be compared with a transaction that involves a loan equal to the net amount given by the assessee and repayment of this loan along with interest to CFSA, after the sale proceeds are received. Therefore, prima facie, the discount is nothing but the interest only. The money advanced by the assessee is used for the purpose of business carried on by CIPL/ CGTIPL.

4. The AO, after considering detailed submissions and after examining the definition of "interest" in section 2(28A) of the Income-tax Act and also various circulars, held that the discounting charges were in the nature of interest and, therefore, taxable in India. He,

accordingly, taxed sum of Rs. 8,02,68,762/- @ 15% (in A.Y. 2003-04) and Rs. 558,084,042/- @ 15% (in A.Y. 2008-09) as per DTAA.

5. The assessee filed objections before Id. DRP, which vide its order dated 9.8.2011 concluded that the whole transaction was a colourable device by the assessee company to earn interest from India without payment of tax. Id. DRP in para 7 to 7.3 (A.Y. 2003-04) has observed as under:

7. A perusal of the whole transaction leads to certain unanswered questions.

- (i) What is the expertise of Cargill India, 'which is not available with Cargill International, Geneva for the purchase of Argentine Soyabean from the international market?
- (ii) When the supplier of goods as it appears is also a group company, why the transaction was routed through Cargill India?
- (iii) Whether at anytime goods were inspected by Cargill India or Cargill International, Switzerland, the ultimate buyer?
- (iv) What are the terms of payment between the Indian company and the seller and why the same terms were not kept between Cargill India and the so called purchaser Cargill International Geneva .
- (v) There is no description of quality of goods in the invoice. The goods are purchased and sold without any quality specification and inspection of goods.
- (vi) What was the need of the Indian company for funds for which it approached the assessee for discounting.
- (vii) No comparative studies of the market has been submitted by the assessee where the Indian company approached for discounting of bills.
- (viii) No reason has been given as to why the bills were not discounted by the Indian company in the Indian market from any bank or financial institutions or any other company engaged in similar business.
- (ix) Where was the money invested by the Indian company after receiving it from the assessee?
- (x) Who is in possession of original bill landing and other export documents?
- (xi) What is the basis of information and expertise with Indian company to identify goods without inspection on high seas and negotiate and sell the same?

- (xii) No document has been submitted correspondence between the Indian International, Geneva.
- (xiii) No details are furnished as to how the debt has been recovered by the assessee from Cargill International Geneva?
- (xiv) No copies of final accounts of the assessee have been furnished before the AO or before this Panel to show the treatment of this transaction in their books of account.

7.1 In fact, the whole transaction is a colorful device by the assessee company to earn interest from India without payment of taxes. As the assessee cannot simply deposit funds in India to earn higher rate of interest than in other countries where its funds are lying idle it has entered into these transactions. The assessee company pays money to the Indian company, which invests it in India and the assessee gets a fixed predetermined interest rate. The payment of interest together with the principal by the Indian company to the assessee is routed through another group company, which is called the buyer of goods. It is important to note that promissory notes are given by the non-resident buyer prior to the raising of invoice by the Indian company. The transaction can be explained by an example:

7.2 The assessee pays '90 to the Indian company and takes a promissory note of '100 to be received by it from another group company after one year. The Indian company invests '90 in Indian market and claims '10 as expenditure (interest payment). The non-resident buyer, who allegedly purchased the goods from the Indian company makes the payment to the assessee of '100 instead of making payment to the Indian company. The Indian company pays the cost of goods to the other company from whom the so called goods were purchased by the Indian company. In this way the Indian company remits back the entire money i.e. principal plus interest to the assessee through various group companies, who are so called seller and buyers of goods.

7.3 The term discounting instead of interest has been used by the assessee to avoid payment of taxes on interest income and also to avoid the violation of other regulatory laws like RBI, FEMA etc. The term discount is a misnomer for interest. The mere fact that the assessee has taken advantage of its wide group network to route the transactions will not change the true nature of the transaction. The mere fact that the assessee received its interest from another group company other than Cargill India makes no difference to the transaction. The Indian company while recording the above transaction terms this payment as interest and claims deduction, whereas the same amount is termed as discount by the assessee resulting into no tax payment by the entire group in India.

Similar observations were made for A.Y. 2008-09.

6. Accordingly, the AO passed the assessment order dated 23.9.2011, assessing the interest income at Rs. 8,02,68,762/- taxable @ 15% for A.Y. 2003-04 and assessment order dated 5.9.2011 for A.Y. 2008-09 assessing the interest income at Rs. 558,084,042/- taxable @ 15%.

7. Being aggrieved, the assessee is in appeal before us and has taken following grounds of appeal (A.Y. 2003-04):—

Based on the facts and circumstances of the case, the Appellant respectfully submits:

1. That the learned Assistant Director of Income Tax, Circle- 1 (1), International Taxation, New Delhi (hereinafter referred to as 'Learned AO') and Hon'ble Dispute Resolution Panel ('the DRP') have erred on the facts and in circumstances of the case and in law in initiating re-assessment proceedings based on mere change of opinion as there were no material facts on record giving rise to any valid reasons to believe that any income has escaped assessment. Accordingly, initiation of the re-assessment proceedings for A Y 2003-04 are bad in law.

2. Without prejudice to above, the Learned AO and Hon'ble DRP have erred in facts and in law in making the addition of discounting charges amounting to Rs 80,268,762 on the following grounds:

2.1 That on the facts and circumstances of the case and in law, the learned AO erred in characterizing the discounting charges to be in the nature of interest as per the definition of 'interest' under section 2(28A) of the Act and Article 11 of the Double Taxation Avoidance Agreement between India and Singapore ('the treaty').

2.2 That on the facts and circumstances of the case and in law, the learned A - erred in misinterpreting / misconstruing the transaction of without recourse discounting of Promissory Notes ('PN') / Bills of Exchange ('BE') as a loan by the appellant to Cargill India Private Limited ('CIPL') by relying upon the irrelevant and un-contextual facts.

2.3 That on the facts and circumstances of the case and in law, the Learned AO and Hon'ble DRP has erred in not following the circulars issued by CBDT holding that discounting charges are not in the nature of interest, on the basis that the circulars are issued under section 194A of the Act and are applicable to only residents.

2.4 That on the facts and circumstances of the case and in law, the learned AO has erred in treating the discounting charges as taxable in India without appreciating the fact that the same is in the nature of business income and cannot be brought to tax in the absence of any Permanent Establishment ('PE') in India as per provisions of Article 5 of the treaty .

2.5 That on the facts and circumstances of the case and in law, the learned AO erred in not following the principle of judicial discipline by completely ignoring the favorable order of Hon'ble Delhi ITAT passed in the appellant's own case based on same set of facts for AY 2004-05 and AY 2005-06 and the order passed by the Hon'ble Delhi High

Court in case of Cargill Global Trading India Pvt Ltd for A Y 2004-05 and A Y 2005-06 holding that such discounting charges paid to the appellant are not in the nature of interest and thus, are not taxable in India in the absence of a PE in India of the appellant.

2.6 Without prejudice to the contention that discounting charges are not in the nature of interest, the learned AO erred in holding that payment of interest is by CIPL to the assessee and therefore provision of section 9(l)(v)(c) are not applicable.

3. That the learned AO has erred in facts and in law in levying interest amounting to Rs. 12,431,624 under section 234B of the Act by completely ignoring the fact that no advance tax was payable by the appellant.

4. The learned AO has erred on the facts and the circumstances of the case and in law by initiating penalty proceedings u/s 271(l)(c) against the appellant for furnishing inaccurate particulars or for failure to disclose true particulars of income.

The above grounds are independent and without prejudice to each other.

The Appellant craves leave to add, alter, supplement, amend, vary, withdraw or otherwise modify the ground mentioned herein above at or before the time of hearing.

8. At the outset Id. counsel for the assessee submitted that the issue is squarely covered by the Tribunal's consolidated order dated 19.8.2011 in assessee's own case for AYs 2004-05 and 2005-06 rendered in ITA nos. 579/Del/2010 and 580/Del/2010 and also by the decision of Tribunal in the case of Cargill TSF Asia Pte Ltd. for A.Ys. 2005-06, 2006-07 and 2007-08 vide ITA nos. 581/Del/2010, ITA no. 3880 & 3057/Del/2010. He referred to para 7 of the order in assessee's own case, wherein it has been held as under:

6. We have duly considered the rival contentions and gone through the record carefully. In the case of Cargil Global Trading India (P) Ltd., the IT AT has made the following observations:

"8. We have considered the rival submissions. In the instant case, the facts lie in a narrow compass inasmuch as that once the goods are exported out of India by the assessee company the assessee draw a bill of exchange on the buyer and therefore discounts the aforesaid bill of exchange to CFSA. Therefore, as a result of discount of the bill of exchange. by the assessee company, it receives immediately discounted value of the bill of exchange i.e. face value less discount to the appellant. The short issue is what is the nature of this discount? According to the assessee, the aforesaid discount is not in the nature of interest and hence is not disallowable under section 40(a)(i) of the Act whereas the Assessing Officer has held that this sum is in the nature of interest under section 2(28A) of the Act. Section 2(28A) of the Act provides as under:—

"Interest" means interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilized."

It will be, evident from the above that interest payable in any manner in respect of any moneys borrowed or debt incurred and includes any service fee or other charges in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilized. It is thus seen that interest means either sum payable in respect of any money borrowed or debt incurred. In the instant case, it is not a case of debt incurred or moneys borrowed. In fact, here is a case where the assessee has merely discounted the sale consideration receivable on sale of goods. It is not a case where any money has been borrowed or debt has been incurred. It is also not a case where any service fee or either charge has been paid in respect of money borrowed or debt incurred or in respect of any credit facility which has not been utilized. It is not a case where section 2(28A) of the Act can be invoked.

9. The word "Interest" is differently defined under Interest Tax Act. As per section 2(7) of Interest Tax Act, "interest" means interest on loans and advances made in India and includes>-(a) commitment charges on unutilized portion of any credit sanctioned for being availed of in India and (b) discount on promissory notes and bills of exchange drawn or made in India. Thus where the legislature was conscious of the fact that even the discount of bills of exchange is to be included within the definition of interest, the same was basically so' provided for. However, under the scheme of Income-tax Act the word "Interest" defined under section 2(28A) does not include the discounting charges on discounting of bills of exchange. Though the circular no. 65 was rendered in relation to deduction of tax under section 194A, in respect of payment to a resident, the same will be relevant even for the purpose of considering whether the discount should be treated as interest or not. The CBDT has opined that where the supplier of goods makes over the usance bill/hundi to his bank which discounts the same and credits the net amount to the supplier's account straight away without waiting for realization of the bill on due date, the property in the usance bill/ hundi passes on to the bank and the eventual collection on due date is a receipt by the bank on its own behalf and not on behalf of the supplier. For such cases of immediate discounting the net payment made by the bank to the supplier is in the nature of a price paid for the bill. Such payment cannot technically be held as including any interest and therefore, no tax need be deducted at source from such payment by the bank. The decision relied by the Assessing Officer in the case of *Vijay Ship Breaking Corp.* (supra) has been reversed by the Hon'ble Supreme Court as reported in the case of *Vijay Ship Breaking Corporation v. CIT* 219. CTR 63-9; The Hon'ble Supreme court held that usance interest payable outside India by an undertaking engaged in the business of ship breaking is exempt from payment of Income-tax by virtue of Explanation 2 added to section 10(15)(iv)(c)

with retrospective effect from 1.4.1962 and hence the assessee was. not liable to deduct tax at source under section 195 of the Act. The discounting charges are not in" the nature of interest paid by the assessee. Rather after deducting discount the assessee received net amount of the bill of exchange accepted by the purchaser. CFSA not having any permanent establishment in India, is not liable, to tax in respect or such discount earned by it and hence the assessee is not under obligation to deduct tax. at source under section 195 of the Act. Accordingly, the same amount cannot be disallowed by invoking section 40(a)(i) of the Act."

"7. This finding of the ITAT in the case of *Cargil Clobal Trading (P) Ltd.* has been upheld by the Hon'ble High Court in ITA Nos. 331 and 204 of 2011. Learned CIT(Appeals) has also followed this order of the ITAT. We find that the issue in dispute is squarely covered by the above conclusion of the ITAT. Assessing Officer is not justified in considering the discounting charges akin to expression "interest" employed in sec. 2(28A) of the Income-tax Act, 1961. Apart from this one aspect, ITAT has examined it from other angle also. Taking into consideration the detailed order of the Learned CIT(Appeals), impugned in the appeals in the light of Hon'ble Delhi High Court's decision, we are of the view that no 'interference is called for. Hence, both the appeals are dismissed".

9. He further pointed out that the Tribunal's order in the case of *Cargil Global Trading (P) Ltd.*, has been upheld by the Hon'ble Delhi High Court in 335 ITR 94, wherein in para 5 to 7, Hon'ble High Court has observed as under:

"5. We may notice at this stage that the respondent-assessee is in the export business. On the exports made by the assessee to its best buyers outside India, the assessee draws bills of exchange on those buyers located outside India. These bills of exchange are discounted by the assessee from CFSA who on discounting the bills immediately remits the discounted amount to the assessee. Thereafter, it is the obligation/headache of CFSA to realise the amounts from those buyers to whom the goods are exported and bills are drawn by the assessee. It is the said discounted charges which were claimed by the assessee as expenses under section 37(1) of the Act. The discounting facilities offered by CFSA to the assessee after charging its aforesaid discounted commission are not questioned by the Revenue. The only objection was that on this amount remitted by the assessee to CFSA, the assessee was to deduct tax at source (TDS) under section 195 of the Act and since it was not done, invoking the provisions of section 40(a)(i) of the Act, the expenditure was disallowed.

6. As pointed out above, according to the Assessing Officer, the aforesaid discounted charges by the assessee to CFSA were treated as interest within the meaning of section 2(28A) of the Act.

7. We may also point out at this stage that CFSA is a company incorporated in Singapore and a tax resident of Singapore. CFSA, inter alia, underwrite or otherwise

acquire, own, hold, sell or exchange securities or investments of any kind including negotiable instruments, commercial paper, etc. Accordingly, as a part of its aforesaid business, it draws, makes, accepts, endorses, discounts, executes and issues promissory notes, bill of exchange, etc. Further, CFSA does not have a permanent establishment (PE) in terms of articles 5 of the India Singapore Treaty ("the Treaty" or the "DTAA")."

10. Ld. A/R further pointed out that in the case of assessee, Hon'ble Delhi High Court, following the decision in the case of *Cargil Clobal Trading (P) Ltd.*, dismissed the appeals filed by revenue vide order dated 24.4.2012 in ITA nos. 269/2012 and 272/2012, observing as under:—

"These appeals have to be dismissed in view of the decision dated 1ih February, 2011 in ITA No.331/2011 *Commissioner of Income Tax v. Cargill Global Trading Pvt. Ltd.* [2011] 335 ITR 94 (Del.). Cargill Global Trading Pvt. Ltd. was the payer and the Assessing Officer had held that they were liable to deduct tax at source on the bill discounting which was treated and considered as interest paid. The High Court has not agree with the Revenue and has held that bill discount cannot be equated and treated as interest paid and therefore the tax at source was not liable to be deducted.

The present appeals are directed against recipient Cargill Financial Services Asia Pvt Ltd. who had entered into the transaction/agreement with Cargill Global Trading Pvt. Ltd. The issue being identical and squarely covered by the decision of this Court in the case of *Cargill Global Trading Pvt. Ltd. (supra)*, no substantial question of law arises and the appeals are dismissed."

11. He further pointed out that the SLP filed against the Hon'ble Delhi High Court's decision has been dismissed by the Hon'ble Supreme Court in the case of *Cargil Global Trading (P) Ltd.* He, therefore, submitted that the issue is squarely covered by the aforementioned decisions.

12. Ld. DR, however, submitted that the facts have not correctly been appreciated by Tribunal in earlier years and, therefore, the issue requires reconsideration. He has filed detailed written submissions, which are reproduced hereunder:

"SUBMISSIONS OF REVENUE ON SPECIFIC ASPECTS

1. The Revenue emphatically relies on the assessment orders of the relevant assessment years as well as directions of the DRP.
2. Without prejudice to these, following additional submissions are made.
3. These submissions below are ONLY on specific aspects. On balance aspects, oral submissions during the hearing, the Assessment Order as well as specific portions, favourable to Revenue, of DRP's orders are relied upon.

4. It is Revenue's humble submission and contention that the Hon'ble Tribunal could differ from its earlier decision, in view of decision of the Hon'ble Supreme Court in the case of *Union of India v. Raghubir Singh* [1989] 178 ITR 548 and that this is a fit case to do so. This aspect is detailed below.

CARGILL TSF ASIA PTE L TO, SINGAPORE I AY 2008-09

5. The Ld. AR has relied, inter alia, on the orders of the Hon'ble ITAT in the assessee's own case in AYs 2005-06, 2006-07, 2007-08 (combined order dated 19.08.2011) which have also been confirmed by the Hon'ble HC, Delhi (combined order dated 19.11.2012). The copies of these orders have also been provided by Ld. AR in paper book and / or during the hearing.
6. It may kindly be seen from the said combined orders of the Hon'ble ITAT and Hon'ble HC that these have addressed the main issue whether or not the discounting charges earned by the assessee by discounting bills of exchange and promissory notes amounted to interest as defined u/s 2(28A) of the Income Tax Act. The Hon'ble courts have held that the said receipts are not in the nature of interest as defined u/s 2(28A).
7. It is also seen from the said combined order of the Hon'ble ITAT that it has based its entire order and findings on the Hon'ble ITAT's order dated 19.08.2011 in the case of a related concern, namely Cargil Financial Services P. Ltd (CFSPL). At Para 6, page 5 of the order dated 19.08.2011, the Hon'ble ITAT notes that "There is no disparity of facts between both the assessees." Accordingly it has quoted extensively from the said order dated 19.08.2011 in the case of CFSPL starting at page 5 of its combined order till page 13 of its order.
8. Further, it is seen from the said ITAT order in the case of CFSPL (provided by Ld. AR) that, this order in turn relies on the order of ITAT in case of another related concern Cargil Global Trading India (P) Ltd. (CGTIPL).
9. While relying and quoting extensively from the order of the related concerns (CFSPL & CGTIPL), certain crucial facts (discussed below) remained to be considered and adjudicated by the Hon'ble ITAT.
10. Accordingly, the AO notes in the present AY 2008-09 at page 15, para 7.8 of the assessment order that certain vital facts remained to be considered/ presented to the Hon'ble Tribunal in the earlier years especially "role of Cargill Inc., role of buyer Cargill Intl. SA, RBI Circulars, FEMA provisions etc. were not presented before the Ld. ITAT which are very material for the case".
11. To put the issues in perspective, the Ld. DRP notes at Para 7 of its order/

directions:

"In fact, the whole transaction is a colorable device by the assessee company to earn interest from India without payment of taxes. As the assessee cannot simply deposit funds in India to earn higher rate of interest than in other countries where its funds are lying idle it has entered into these transactions. The assessee company pays money to the Indian Company, which invests it in India and the assessee gets a fixed predetermined interest rate. The payment of interest together with the principal by the Indian company to the assessee is routed through another group company, which is called the buyer of goods. It is important to note that promissory notes are given by the non-resident buyer prior to raising of invoice by the Indian company".

12. The thrust of Revenue's present submission, is that none of the above referred orders of Hon'ble ITAT (i.e., earlier orders of ITAT in the case of the assessee itself, or its orders in the cases of CFSPL & CGTIPL which have been relied and quoted by the ITAT in the case of the assessee) have considered and adjudicated the entire set of facts and circumstances. This has been very briefly highlighted above (at para 9,10,11) and has been detailed below. Thus, the Hon'ble ITAT and Hon'ble High Court have addressed only the legal issue as summarised at Para 6 above without addressing the facts and circumstances that lead to the unmistakable conclusion that the assessee, along with its related concerns, have put through colourable transactions for benefiting from the higher interest rates in India and avoiding payment of taxes. The scheme of transactions put through by the group is mainly to give color of bill discounting to interest earning activity in hands of the NR assessee while at the same time minimizing the tax liability in the hands to the supporting group Indian concern.
13. For sake of clarity and brevity, the said facts and circumstances that have not been considered or adjudicated by the Hon'ble ITAT in its earlier orders, as culled out from the Ld. DRP's directions, are as under:

<i>Para/page of Ld. DRP's order</i>	<i>Issue</i>	<i>Remarks, if any</i>
Page 4, para 3	At the outset, DRP has put on record the non-cooperation of the assessee. The DRP had asked the assessee to place on record the entire transactions, along with complete supporting documents, for one month. The assessee chose to submit selected documents and not the complete	This further strengthens the Revenue's contention that the assessee, along with its group companies, are using colourable transactions/ devices.

trail.

Page 3-7,
Para 5-6.1

The limited information made available by the assessee or as already available on record has been analysed by Ld. DRP.

Para 6.1 gives the issues/ aspects which are unanswered and effectively questions the very genuineness of whole scheme of transactions used by the assessee along with its group concerns

The findings of the DRP have to be read with the findings of the AO at page 22 of the assessment order (Gross margin of the assessee on sale is 0.05%. In comparison, the charges suffered by the Indian concern are large 5.75%. This ensures that max amount remains tax free in hands of assessee while the supporting Indian concern is able to reduce its tax liability).

Page 7-8

The scheme used by the assessee is explained (with example). The term "discounting" used by the assessee are also put in context (also in the context of other regulations of RBI, FEMA). The DRP emphatically notes the finding that "The Indian company (related/ group concern) while recording the above transaction terms this payment as interest and claims deduction, whereas the same amount is termed as discount by the assessee resulting into no tax payment by the entire group in India."

Page 10-11 Page 9-9.1,
Page 12

Last two para

Page 17

Assessee has placed heavy reliance on discounting being without recourse. This has been analysed in light of RBI regulations and facts of the case and has been found to be of no

Page 9,12	help to the assessee and is also without supporting evidence.
Page 11, Para 9.2-9.3	The "paper transactions" of the assessee have been highlighted along with its non-compliance.
Page 13 Para (iv)&(v),(i)	The definition of "interest" in the Income Tax Act and the DTAA has been put in perspective
Page 14 Para (ii)	
Page 11-12 Para 9.4 -9.6	Assessee's reliance on CBDT circulars is analysed and rejected. Critical observations therein include (i) Assessee has not approached bankers for discounting of so called bills; (ii) PNs of group concerns are not freely transferable by endorsement and delivery; (iii) The case of the assessee is a private arrangement among group concerns and cannot be compared with banking transactions and CDs.

14. The Revenue submissions remain on the same lines as above.

RELIANCE ON judgment in *Raghubir Singh* [1989]178 ITR 548 (SC)

15. It is Revenue's humble submission and contention that the Tribunal could differ from its earlier decision, if such a need arose, in view of decision of the Supreme Court in the case of *Union of India v. Raghubir Singh* [1989] 178 ITR 548. The Supreme Court in the case of *Raghubir Singh (supra)* laid more emphasis on the principle of consistency that it should not differ from its earlier decision merely because a contrary view appears to be preferable.

However, it is also laid down that if the previous decision is plainly erroneous, it would be a duty of the Court to say so and not to perpetuate the mistake. The Court also furnished two illustrations-{i} where relevant statutory provision was not brought to its notice, (ii) if a vital point was not considered. The submissions above emphasize that the matter is covered by the said

point (ii).

CONCLUSION

11. The undersigned is committed to provide any further clarification that the Hon'ble Bench may desire.

13. In the rejoinder Id. counsel has filed detailed submissions, which are also reproduced hereunder:

""Brief facts

While framing assessment for the subject year, the Ld. AO has characterized the discounting charges received by the Appellant on account of discounting of Bills of exchange / demand Promissory Notes (,hereinafter referred to as BE') from Indian group companies namely, Cargill India Private Limited and Cargill Global Trading Private Limited ('hereinafter collectively referred as Indian group companies') as interest under section 2(28A) of the income Tax Act, 1961 ('the Act') and under the DT AA between India and Singapore.

2. Appellant's Contentions

At the outset, the Appellant (being offshore entities Cargill TSF Asia Pte Ltd and Cargill Financial Services Asia Pte Ltd- In Liquidation) would like to highlight that the issue under consideration has already been adjudicated in favor of the Appellant in Appellant's own case vide the following orders:

DIT v Cargill TSF Asia Pte Ltd A Y 2005-06, A Y 2006-07 & A Y 2007-08 (Delhi HC) (ITA No. ITA No. 62112012, ITA No. 63212012 and ITA No. 62412012)

Cargill TSF Asia Pte Ltd A Y 2005-06, A Y 2006-07 & A Y 2007-08 (Delhi IT AT) (IT A No. 5811De1I2010, 3880IDell2010 and 30571De1I2010)

DIT v Cargill Financial Services Asia Pvt Ltd A Y 2004-05 and A Y 2005-06 (Delhi High Court) (ITA 269/2012 and ITA 272/2012)

ADIT v Cargill Financial Services Asia Pte Ltd A Y 2004-05 and A Y 2005-06 (Delhi IT AT) (IT A No. 579IDell20 10 and IT A No. 580IDell20 1 0)

Further, it is pertinent to mention that in the Indian entities case being M/s Cargill Global Trading India Pvt. Ltd. and M/s Cargill India Pvt. Ltd. for the same A Y i.e. A Y 2008-09, the Ld. CIT(A) has held that the discounting charges paid to appellant (Cargill TSF Asia Pte Ltd) are not in the nature of interest and thus, no disallowance U/S 40(a)(i) was warranted.

This order has been accepted by the Department and no further appeal was preferred.

The facts and the issue involved in the above mentioned assessment years are identical to the facts and issue involved in the years in question i.e. whether discounting charges is akin to interest income as defined u/s 2(28A) of the Act, taxable as per the provisions of the Act as well as the DT AA between India and Singapore (Reference in this regard may be made to the grounds of appeal raised). The Learned Department Representative ('Ld. DR') has raised concerns that crucial facts pertaining to the cases involved have not been considered by the Hon'ble ITAT while adjudicating the orders in earlier years. The Appellant here would like to submit its rebuttal on the specific concerns raised by the Ld. DR:

Contention No.1: The AO in notes in the present AY 2008-09 at page 15, para 7.8 of the assessment order that certain vital facts remained to be considered/ presented to the Hon'ble Tribunal in the earlier years especially "role of Cargill Inc., role of buyer Cargill Intl. SA, RBI Circulars, FEMA provisions etc. were not presented before the Ld. ITAT which are very material to the case".

Referring to the AO's order points to the fact that the ITAT order referred in the above allegation is that of Cargill Global Trading India Private Limited (CGTIPL - Indian group company) i.e. IT A NO. 684IDel/2009 for A Y 2004-05. The Appellant most humbly submits that the entire transaction pertaining to the discounting has been duly explained and captured in the CGTIPL ITAT order (Refer Para 4 on Page 2 of Annexure I). It is also submitted that the assessee is a nonresident company which does not have any presence in India. The transaction with Indian company was through proper banking channel wherein all laws and regulations would have been complied with. Neither tax authority nor any other authority has alleged any irregularity in the transaction as per applicable Indian law/regulation.

It is also respectfully submitted that the questions that have been raised by the Learned Department Representative giving a flavour that certain vital facts regarding the role of the parties involved, RBI Circulars and FEMA provisions, which were material were not presented before the ITAT which were material to the case. These comments are obviously to impress upon this Hon'ble Tribunal to disregard the co-ordinate bench's decision which was passed on the identical issue and which was confirmed by the Hon'ble Delhi High Court. It is respectfully submitted that the issue before the Tribunal was the characterization of the receipts in the hands of the non-resident of the assessee and that is precisely what needs to be adjudicated. It is also submitted that making such bold allegations that certain material facts and roles played by the respective enterprises was not presented has no bearing on the issue. This is nothing but a misguided effort on behalf of the revenue to confuse the issue. At this juncture, it is also respectfully submitted that it is a settled proposition of law that the revenue cannot dictate to the taxpayer businessmen as to how to conduct its affairs and the question of commercial expediency cannot be raised by the revenue at this stage or at

any stage prior. Hence, objections raised are of no consequence and deserves to be ignored.

Contention No.2: Para 11 and para 12 of the Ld. DR's submission

The finding of the Hon'ble DRP that the whole transaction is a colorable device merely entered by the Appellant to earn higher rate of interest on funds (which are lying idle abroad) and are give to Indian group companies, under the shelter of the discounting transaction, which in turn invests it in India and earns fixed pre-determined interest rate is merely an allegation and devoid of any material on record to prove the same.

'At the outset, it is submitted that the trade transaction are actual international trade which is even recognized by RBI as Merchanting Trade. There is actual movement of goods from one country to other through Ship, thus, the transaction cannot be termed as sham transaction or colorful transaction. The Appellant is not a party to the buy-sell agreement but it understands that the whole transaction is routed through banking channel and permitted by Indian regulator. The Appellant is in the business of providing financial services including dealing in negotiable instruments like bills of exchange, promissory note etc. It has purchased the PN at a discounted value (on non-recourse basis) which can't be termed as interest in the hands of the assessee as accepted by Hon'ble Delhi High Court as well as Supreme Court while dismissing the SLP. Most of the questions raised by the Hon'ble DRP pertains to the trading leg in which Appellant is not a party, thus, it cannot be asked to provide such detail.

Moreover, the contention put forth by the Ld. DR that "The scheme of transaction put through by the group is mainly to give color of bill discounting to interest earning activity in hands of the NR Appellant while at the same time minimizing the tax liability in the hands to the supporting group Indian concern" is also not acceptable as the Appellant is not claiming that the income is not taxable in its hands. It merely says that the said income is a business income as the Appellant's are engaged in the business of buying and selling of financial instruments and due to the beneficial provisions of the DTAA, the said income is not taxable in India. Moreover, from the angle of the Indian entity as well, the said charges would be tax deductible even if the said transaction had been carried by the Indian group company with an unrelated entity like Indian banks etc. To the best of the knowledge, it has been communicated to the assessee that not only the said transaction was examined by assessing officer of the Indian group company but also by the Transfer Pricing officer wherein the same was duly accepted to be at arm's length price.

It is respectfully reiterated that these reservations in the reply of the D.R. are again dangerously inclining towards questioning the commercial expediency of the transaction. It is also respectfully submitted that this is beyond the powers and scope vested in the assessing officer and as such deserves to be ignored. At this juncture, we would like to highlight the fact that the AOIDRP cannot question the genuineness of

expenditure/ transactions being undertaken by an entity with any party unless there is something on record to prove otherwise. Reliance in this connection is placed on Supreme Court judgment of *SA Builders v CIT* 288 ITR 1 and Delhi High Court judgment of *CIT v Dalmia Cements Pvt Ltd* 254 ITR 377.

Contention No.3: Para 13 of the Ld. DR's submission i.e. Arguments culled out from the DRP's order

Contention on non-cooperation of the assessee in respect of submitting complete trail of documents and limited information available by the assessee: The Appellant had duly submitted all the vital documents pertaining to bill discounting vis a vis invoice raised by Indian group company on offshore buyer of goods, promissory note issued by offshore buyer of goods, discounting agreement between the Appellant and Indian group entity. Moreover, the relevant documents required by the Appellant for undertaking a usual business transaction has been duly submitted by the Appellant during assessment as well as DRP proceedings.

Further, as regards, the contention on the margin of Indian group company is a subject matter of Indian group entity and as per information available, had been examined in the transfer pricing analysis by the TPO in case of Indian group companies and in no way shall impact the said discounting transaction of the Appellant.

The finding that the Indian company records the transaction as payment of interest and the appellant terms the same as discount is incorrect. Both the Indian group companies as well as the Appellant terms the said transaction as discount transaction only. Reference is placed on the TP study of CIPL (extract of which is quoted on Page 14 of the DRP order) that the said transaction is discounting charges. Hence, both the Indian company and the Appellant have shown the said transaction as discounting charges.

Paper transaction have been highlighted along with its non-compliance of the definition of "interest": The legal question as to whether the discounting charges is interest has already been discussed and adjudicated by the Delhi HC that the same is not in the nature of "interest".

CBDT Circulars: The applicability of the CBDT Circulars relied by the Appellant have been duly considered and dealt in detail by the Delhi HC in the order of Cargill Global Trading India Private Limited

Critical observations: The queries raised are from the stand point of Indian group companies and could not have been responded by the Appellant in this case. The Appellant had merely carried on a normal business transaction and has earned business income which by virtue of DTAA is not taxable in India.

A perusal of the questions raised by the Dispute Resolution Panel are clearly indicative of the fact that these questions are not relevant to be raised now as these questions

appear to question the necessity of entering into the transaction which again links to the question on commercial expediency .. As submitted above, the case before the Hon'ble Tribunal is that of a non-resident assessee and the issue which has arisen is the treatment of the receipts in the hands of such non- resident assessee. This issue has no bearing on the questions raised by the DRP and are wholly irrelevant for the determination of the issue by this Tribunal.

Although, the above submission of the assessee addresses this point, but on an illustration to be given, the attention of the Hon'ble Tribunal is invited into the question No. VI which reads as under:

"(vi) What was the need of the Indian company for funds for which it approached the assessee for discounting? "

This in itself would show that the revenue is questioning the commercial expediency of the transaction which it is not permissible. It is thus accordingly prayed that the written submission filed by the revenue are not determinative of any material fact or position of law and deserves to be ignored. As stated above, the issue is squarely covered in favor of the assessee by the decision of the Tribunal, the Hon'ble High Court and the Hon'ble Supreme Court.

Contention No.4: Reliance on judgment in Raghbir Singh [1989] 178 ITR 548 (SC)

Reliance on this judgment has been placed stating that the Hon'ble IT AT can deviate from its earlier decision as the vital points have not been considered. However, the Appellant would like to submit that all the facts of the transaction were duly presented before various authorities and after consideration of necessary facts, the Hon'ble HC and ITAT have adjudicated the matter in favor of the Appellant.

Without prejudice to the above, it is also submitted that in the Appeal filed by the assessee and the grounds raised the question that has been raised is regarding the characterization of the discounting charges and that is the only subject matter of the Appeal and in the absence of any cross objection -

by the revenue, the Tribunal is not permitted to go beyond the subject matter of the appeal.

This position is stated in concrete by the jurisdiction of the High Court in the case of *Marubeni India Pvt. Ltd. v CIT* (328 ITR 306) (Del). The relevant extracts of the judgment are as under:—

"Sec. 254(1) provides that the Tribunal may, after hearing the parties on the appeal, 'pass such orders thereon' as it thinks fit. Thus, on a plain reading of the relevant provision of law, the power to pass such orders as the Tribunal thinks fit can be exercised only in relation to the matters that arise in the appeal and it is not open to the Tribunal to adjudicate on a question which is not in dispute and which does not

form the subject-matter of the appeal. The word 'thereon' is a particularly significant and has been interpreted by many High Courts and Supreme Court to circumscribe the jurisdiction of the Tribunal to the subject-matter of the appeal, which is constituted of the original grounds of appeal and such additional grounds as may be raised by the leave of the Tribunal. The consensus of judicial opinion appears to be that the jurisdiction of the Tribunal is confined to the passing of orders on the subject-matter of the appeal, that is, those orders which are necessary for the disposal of the appeal. The Tribunal cannot give a finding in respect of the assessment of a year which is not the subject-matter of the appeal before it. The Tribunal thus can give a finding that the deduction/income does not belong to the relevant assessment year/years, but though it may incidentally find that the deduction/income relates to another assessment year, it cannot give a finding that the deduction/income belongs to another specified year. There is, however, an exception to the general rule that the jurisdiction of the Tribunal is confined to the subject-matter of appeal. The exception is where an additional ground has been raised with the leave of the Tribunal. In that case, the subject-matter of the appeals constitutes the original grounds of appeal and such additional ground/grounds as may be raised with the leave of the Tribunal. "

14. We have considered the rival submissions and have perused the record of the case. We have extensively reproduced the submissions of both the department and assessee, in order to appreciate the specific objections raised by revenue.

15. Now we proceed to consider the alleged distinguishing features pointed out by Id. DR in his detailed submissions, reproduced above. In order to appreciate the submissions of Id. CIT(DR), we have to first consider the brief background of the case.

16. The assessee is a company incorporated under the laws of Singapore and is tax resident of Singapore. It had entered into an agreement for cost sharing with Indian party for rendering certain services. Besides this, assessee had also discounted the bills of exchange (BE)/ demand promissory notes (PN) of certain Indian group entities i.e. Cargill India Pvt. Ltd. and Cargill Global Trading Pvt. Ltd. The assessee did not offer the income earned by it on discounting the PN of Cargill India Pvt. Ltd. on the ground that the same was in the nature of "business income" and was not taxable in the absence of permanent establishment (PE) of the assessee in India. The Indian group entities CIPL and CGTIPL got discounted the promissory notes issued to them by the buyer of their goods for the assessee. For this purpose the assessee entered into a discounting agreement with Cargill India Pvt. Ltd. for purchase of PN at a discount specifying the details of PN to be discounted face value, discounted value, rate of discount, name of the company who owed PN, date of maturity of PN, bank debts for payments etc. The CIPL endorsed the PN in favour of the assessee on "without recourse" basis. The said endorsement of PN signifies that all risks and rewards of the PN stand transferred to the assessee and in no case the assessee could make the Indian entity liable to make payment to the assessee in case of delay or default on maturity. The assessee makes payment of PN to the Indian entities as per the net present

value. The difference between the face value and net present value of the PN has been considered as discounting charges. Further, the above facts were summarized as under:

"3.1.2.5. The above position may be summarized as under:

- Cargill India approach the assessee for discounting of the PN issued to them by the buyers of goods;
- The Assessee purchases the PN at a discount on 'without recourse' basis and pays the discounted amount to the Cargill India;

The assessee earns income on maturity or subsequent sale of PN which is in the nature of 'business income'

It may be worthwhile to mention here that purchase of PN on a 'without recourse' basis implies that:

- Assessee purchases the PN from the Cargill India
- Assessee pays the consideration based on present value which is less than the face value and the difference is regarded as-discount value.
- Assessee does not have any right against the seller of PN i.e. Cargill India in case of any dispute or default in the encashment of PN on the due date.
- Assessee has the right to collect the money from the entity which owed the PN in its own name.
- Assessee does not recover the amount from the entity which owed the PN on behalf of the Cargill India but recovers the same in its own behalf."

17. In the backdrop of aforementioned facts the income earned by the assessee has been considered as discounting charges in its hands and this issue has been settled by the decision of Hon'ble Delhi High Court in the case of *Cargill Global Trading Pvt. Ltd. (supra)*. Thus, the issue stands settled by Hon'ble Jurisdictional High Court and the SLP filed by the department in the case of Cargill Global Trading India Pvt. Ltd. has been dismissed. The decision of Cargill Global Trading India Pvt. Ltd. has been followed in the case of assessee, as noted earlier.

18. Now the first aspect pointed out by Id. CIT(DR) with reference to para 7.8 at page 15 of assessment order is with reference to role of Cargill Inc. The said para is reproduced hereunder:—

"7.8 As per the last order of the Ld. ITAT in the case of CGTIPL wherein appeal of I CGTIPL has been allowed in I.T.A. No.684/Del/2009 for A.Y. 2004-05 and subsequent years, this income of the assessee is held to be of not of the nature of interest however

that order is passed by the Ld. IT AT wherein complete facts were not presented and specially facts relating to the assessee (Cargill TSF Asia Pte Ltd), role of Cargill Inc., role of buyer Cargill Intl. SA., RBI Circulars, FEMA provisions etc. were not presented before the Ld. IT AT which are very material for the case.

Also, it becomes an undisputed fact that the interest income (discounting charges as per the nomenclature) arises in India, as is also mentioned by the assessee in the notes to return of income filed on 30-09-2008.

Once the interest accrues/arises in India there is no need to go to section 9 of the Income Tax Act, 1961 which provides for 'Income deemed to accrue or arise in India'. Even otherwise, in the present case, the interest is also deemed to accrue or arise in India as:

The interest is paid by a person who is a resident and even also

Interest is payable in respect of any debt incurred, or. moneys borrowed and used, for the purposes of a business or profession earned on In India The amount borne by the CIPL I CGTIPL would be taxable in the hands of the assessee as per provisions of Section 5(2) of the I.T. Act.

Therefore, it is held that the income is taxable in the hands of the assessee as interest income."

19. A bare perusal of the observations of AO makes it very clear that he has not at all referred to any RBI Circular, FEMA provision which had bearing on the facts of the case and how the receipt in the hands of assessee took the colour of interest and not the discounting charges. However, in this regard Id. CIT(DR) has referred to para 9 and 9.1 of Id. DRP's order at page 10 & 11 wherein Id. DRP has, inter alia, observed that the assessee's contention regarding discounting being 'without recourse' is of no help to assessee because the alleged seller of goods, and the alleged foreign buyer of goods i.e. Cargill International Geneva were obliged to honour the terms of payments as per RBI regulations within a stipulated time. Id. DRP has further observed that as per RBI Regulations, every exporter of goods has to get the inward remittance within a stipulated time in India in foreign currency. It is further observed that, accordingly, the foreign buyer has to remit the fund to the Indian customer and the Indian customer was obliged to recover the money due to it in foreign currency from the supplier within the time specified by the RBI.

20. Id. DRP further observed in para 9.1 that assessee had submitted before the AO and also before the Panel that there had been no default in realizing the promissory note so far. Id. DRP further observed that since the transaction was between group company and the Indian company was obliged to recover the money from the buyer of alleged group, there was no risk involved in the transaction. The conclusion drawn by Id. DRP on this basis is that the obligation by the RBI to recover the money in fact changes the nature of the term

'without recourse'. We do not find any substance in the observations of Id. DRP on this basis. The issue before us is whether the discounting charges, received by assessee on maturity of promissory note on realization of proceeds from the buyer, were in the nature of discounting charges or interest. The RBI regulations cannot decide the true nature of receipt in the hands of assessee. Had there been any violation of RBI regulation in the whole transaction, then action would have been initiated against the assessee in accordance with law. The conclusion drawn by Id. DRP is that as per the definition of interest in the Indian Income-tax Act and the DTAA the amount paid by the assessee is a debt to the Indian company and the assessee company has recovered the said debt with interest from the Indian company through another group company. In our opinion, this aspect has received specific consideration of Hon'ble High Court in the case of *Cargill Global Trading Pvt. Ltd. (supra)* and, therefore, this conclusion cannot be accepted. Further, Id. CIT(DR) has referred to para 7 and 7.2 of Id. DRP's order, which has been reproduced by us earlier. In para 7.2, Id. DRP has, inter alia, observed that the Indian company, while regarding the above transaction terms the payment as interest and claims deduction, whereas the same amount is termed as discount by the assessee, resulting into no tax payment by the entire group in India. In the submissions made by assessee,, reproduced earlier, it has been specifically stated at page 5 that both the Indian companies as well as the assessee term the said transaction as discounting transaction only. In this regard Id. counsel has referred to page 14 of the DRP's order wherein Id. DRP notes in para 9.8 as under:

9.8.The assessee also contended that in the TP study of CIPL discounting charges are classified as discounting charges. However, during the proceedings before this Panel the assessee has submitted on 02.06.2011 as follows:

1. Head under which discounting charges are debited in the books of Indian group entities

As per the information provided by the Indian group entities, they have recorded the discounting charges under the head "Financial Expenses" in their profit and loss accounts."

21. We fail to appreciate as to how Id. DRP has drawn the conclusion from the above statement that Indian company is treating this amount as interest. The true nature of transaction cannot alter merely by clubbing the discounting charges under the head 'financial expenses'. Therefore, this plea raised by Id. CIT(DR) on the basis of observation made by Id. DRP for distinguishing these facts in the current year from earlier years is without any basis. As far as Id. CIT(DR)'s submission regarding non-cooperation of assessee on the basis of observations made by Id. DRP in para 7 are concerned, we find that none of the authorities below have pointed out as to which particular information was missing in the entire trail of transaction. In the submissions filed by assessee it is clearly stated that all the relevant information were furnished before lower revenue authorities.

22. Id. CIT(DR) has further referred to the observations of Id. DRP, which were as under:

"Assessee's reliance on CBDT circulars is analysed and rejected. Critical observations therein include (i) Assessee has not approached bankers for discounting of so called bills; (ii) PNs of group concerns are not freely transferable by endorsement and delivery; (iii) The case of the assessee is a private arrangement among group concerns and cannot be compared with banking transactions and CDs"

23. All these observations are primarily aiming at the commercial expediency of the transaction, which aspect has already been considered by the Hon'ble Jurisdictional High Court. As we have elaborately considered all the objections raised by Id. CIT(DR) and do not find any distinguishing feature being brought on record from earlier years, we do not find any reason to take a different view from earlier years. Therefore, the decision of Hon'ble Supreme Court relied on by Id. DR in the case of *Union of India v. Raghubir Singh* 178 ITR 548 (SC) is of little help to the department.

24. In the result, both the appeals, preferred by the assessee, stand allowed.

■ ■

HIGH COURT OF CALCUTTA
Commissioner of Income-tax, Central -I, Kolkata

v.

Binani Cement Ltd.

GIRISH CHANDRA GUPTA AND ASHA ARORA, JJ.

IT APPEAL NO. 7 OF 2004

GA NO. 3094 OF 2012

MARCH 4, 2016

R.N. Bandopadhyay and **Aniket Mitra**, Advs. *for the Appellant*. **J.D. Mistri**, Sr. Adv. **Madhur Agarwal**, **Moloy Dhar** and **Ajoy Kumar Dey**, Advs. *for the Respondent*.

ORDER

Girish Chandra Gupta, J. - This is an appeal u/s. 260A of the Income Tax Act, 1961 (hereinafter referred to as 'the Act') preferred by the Revenue against a judgement and order dated 30th March, 2012 passed by the Income Tax Appellate Tribunal (hereinafter referred to as 'the Tribunal') 'B' Bench, Kolkata in ITA No.239/KOL/2011 pertaining to the assessment year 2006-07.

2. This Court by an order dated 25th March, 2014 had disposed of this appeal by setting aside the impugned order of the Tribunal and remanding the matter back to the assessing officer. The assessee approached the Supreme Court by special leave against the aforesaid order of this Court. By an order dated 26th October, 2015 the Supreme Court has remanded the matter back to this Court on the ground that no substantial questions of law were formulated by this Court while allowing the appeal by the order dated 25th March, 2014.

3. In the circumstances the appeal is once again taken up for hearing.

4. The following substantial questions of law have been proposed by the revenue for consideration in the instant appeal:—

- (i) Whether on the facts and in the circumstances of the case, the Learned Income Tax Appellate Tribunal "B" Bench, Kolkata was justified in quashing the order passed by the Commissioner of Income Tax (Central – I) Kolkata under Section 263 of the Income Tax Act without appreciating the ratio of the judgement delivered by the Delhi High Court in the case of *Commissioner of Income Tax v. Hari Machine Ltd.* reported in [2009] 311 ITR 285 (Del.)?
- (ii) Whether on the facts and in the circumstances of the case, the Learned income Tax Appellate Tribunal "B" Bench, Kolkata erred in law in holding the

loss of an amount of Rs.919.52 lakhs on account of transfer of investment division of the assessee could not be adjusted in Section 115JB of the Act although this loss is booked in the Profit and Loss Account ?

- (iii) Whether on the facts and in the circumstances of the case, the order passed by the Learned Income Tax Appellate Tribunal "B" Bench, Kolkata is perverse, bad in law ?

5. Briefly stated the facts and circumstances of the case are as follows:—

The assessee M/s. Binani Cement Ltd. is an Indian Company engaged in manufacture and sale of clinker and cement. The assessee filed its return of income for the assessment year 2006-07 disclosing total income at nil and book profit under Section 115JB of the Act at Rs.48,62,96,592/-. The same was processed under Section 143(1) of the Act. Subsequently, the scrutiny assessment proceeding was initiated and notice was issued under Section 143(2). The scrutiny assessment was completed under Section 143(3) by an order dated 5th November, 2008 whereby the total income was determined to be 'nil' and book profit u/s.115JB was found to be Rs.47,21,87,057/-. Furthermore, a claim for deduction of Rs.70,48,242/- u/s.35E of the Act was disallowed.

6. The Commissioner of Income Tax (hereinafter referred to as 'the CIT') by an order dated 20th January 2011 u/s.263 of the Act observed that the assessee had debited an amount of Rs. 919.52 lakhs to the Profit and Loss Account in accordance with a scheme of arrangement for the transfer of its investment division to Daisy Commercials Pvt Ltd (hereinafter referred to as 'DCPL').

7. The said scheme of arrangement is explained by note number 8 of Schedule 15 (titled 'Significant accounting policies and notes on accounts') of the Balance Sheet and Profit and Loss Account for the year ended 31st March 2006, which reads as follows:—

"The Scheme of Arrangement between the Company and Daisy Commercials Private Limited (DCPL) and their respective shareholders under sections 391 and 394 of the Companies Act, 1956 for transfer of the investment division of the Company, consisting of investments/application money for investments in various unlisted companies aggregating to Rs.2316.16 Lakhs, to DCPL with effect from 1st April, 2005, was approved by the shareholders on 15th July, 2005 and by the Hon'ble High Court at Calcutta by its order dated 17th August, 2005.

Certified copy of the said order was filed with the Registrar of Companies on 6th September, 2005.

In accordance with the terms of the said Scheme, the Company transferred the aforesaid investment division to DCPL on 28th September, 2005 against which DCPL has allotted 1,39,66,434 Equity Shares of Rs.10/- each credited as fully paid-up aggregating to Rs.1396.64 lakhs to the shareholders of the Company based on the option forms

received by DCPL from the shareholders. On allotment of the aforesaid shares by DCPL, 13,66,434 Equity Shares of Rs.10/- each fully paid-up of the Company held by such shareholders stand cancelled and the paid up Share Capital of the Company is accordingly reduced to Rs.20310.13 lakhs divided into 20,31,01,274 Equity Shares of Rs.10 each fully paid-up. The difference of Rs.919.52 lakhs, has been adjusted against the balance in the Profit and Loss Account in accordance with the terms of the Scheme."

8. Therefore according to the sanctioned scheme, the assessee transferred its investment division worth Rs.23.16 crores to DCPL. The shareholders of the assessee company were issued shares of the value of Rs.13.96 crores in DCPL. The assessee reduced its share capital by Rs.13.96 crores. The difference between the investment value of Rs.23.16 crores and the share capital reduction of Rs.13.96 crores, that is, Rs.9.20 crores was debited to the Profit & Loss Account for the year ended March 31, 2006.

9. The CIT by the aforesaid order dated 20th January 2011 u/s.263 of the Act, further observed that the aforesaid amount of Rs 919.52 lakhs was not added back in computing the book profit u/s.115JB of the Act, and as such the assessment order dated 5th November, 2008, u/s.143(3) of the Act was erroneous and prejudicial to the interest of the revenue. Therefore the CIT set aside the order of assessment and directed the assessing officer to decide the issue in accordance with law. The CIT in his order made the following observations:—

"I have gone through the assessment records and the written submissions of the assessee in response to the show-cause notice u/s.263. The facts of debiting Rs.929.52 lakh to the P/L A/c on share capital reduction for disinvestment in shares held as investment as per scheme of arrangement and of not adding back the same for the purpose of computation of book profit for MAT u/s 115JB of the Act, have not been disputed by the assessee.

The relevant facts are available from Notes on A/cs. no.8 of Schedule-15 of the audited accounts of the assessee company. As per the Notes, in accordance with a scheme of arrangement the assessee company transferred the investment division of Daisy Commercials P. Ltd. (DCPL) on 28.09.2005 against which DCPL allotted 1,39,66,434 equity shares of Rs. 10 each credited as fully paid-up aggregating to Rs. 1396.64 lakh to the shareholders of the company based on options forms received by DCPL from shareholders. On allotment of the shares by DCPL, 13,66,434 equity shares of Rs. 10 each held by such shareholders were cancelled and the paid-up share capital of the company was reduced to Rs. 20,310.13 lakh divided into 20,31,01,274 equity shares of Rs. 10 each fully paid-up. The difference of Rs. 919.52 lakh has been adjusted against the balance in P/L A/c. as per terms of the Scheme...

But the contentions raised by the assessee company are not justified or reasonable because of the following:—

- (1) It is apparent from record that the A.O. has not at all considered/examined the issue.
- (2) The contention is not correct since the debit of the amount under consideration is not as per Part- II & III of Schedule – VI of the Companies Act. It is already held by the Delhi High Court in the case of *CIT v. Hari Machine Ltd.* [2009] 311 ITR 285 that such capital reduction is fictitious. On similar facts the Delhi ITAT held that such fictitious loss on capital deduction may a balance sheet adjustment but cannot be an item of P & L A/c and the loss booked in the P & L A/c is required to be added back for computation of book profit u/s.115JB. The Assessee's contention is not tenable because of prejudicial nature of the assessment regarding MAT payable for this year.
- (3) The case decisions relied upon by the assessee are not relevant/applicable since the issues in those cases before the Court/ITAT's were totally different.
- (4) The issue is required to be decided after examining whether the accounts were prepared as per Part-II & III of Schedule-VI of the Companies Act and the case decision as referred to in (2) above.

The basic issue is whether the condition stipulated in subsection (2) of Sec. 115JB that the accounts have to be prepared as per Part-II & III of Schedule-VI of the Companies Act, is satisfied or not. From the facts stated above it is apparent that the loss booked in the P/L A/C. is for share-capital reduction. There is no scope for such accounting as per Part-II & III of Schedule-VI of the Companies Act. Besides, such loss fictitious as held by ITAT, Delhi in quantum appeal in a similar case of debit in the case of *Hari Machines Ltd.* This is evident from the report of the case of *CIT v. Hari Machines Ltd.* in 166 Taxman 84 (2008), which was in respect of penalty u/s 271 (1)(c) but in the facts such finding of ITAT has been discussed. Therefore, such share capital reduction cannot be an item of P/L Ac. As per Part-II III of Schedule-VI of the Companies Act. The decision of the Hon'ble Apex Court in the case of *Apollo Tyres Ltd.* in respect of adjustments only as per explanation-1 is applicable only after the accounts have been prepared as provided in sub-section (2) of Sec. 115JB of the Act. The condition not having been satisfied, the amount was required to be added back in computation of Book profit for MAT u/s 115JB. But it is apparent from the records that the issue has not been examined by the AO at all while passing the assessment order and no such addition has been made

Therefore, it is held that the assessment order u/s.143(3) dated 05.11.2008 passed by the A.O. is erroneous and prejudicial to the interest of the revenue so far as the above mentioned issue is concerned and accordingly, the order is set aside to that extent and the A.O. is directed to decide the issue in accordance with law after giving reasonable opportunity to the assessee."

10. Against the order of the CIT the assessee appealed before the Tribunal. The Tribunal by an order dated 30th March, 2012 while allowing the appeal of the assessee held as follows:—

"We find that irrespective of whether or loss such a loss is deductible in computation of taxable income or not, what we have to really decide is whether or not the Assessing Officer could have made adjustment in respect of this loss, as booked in the profit and loss account, in computation of book profits u/s.-1-15JB. It is, therefore, not material whether the loss in question was allowable deduction in nature. Learned CIT reliance on Hon'ble Delhi High Court's judgement in the case of *Hari Machines Ltd. (supra)* which deals with penalty in respect of quantitative disallowance in computation of income is thus wholly misplaced. We are also of the considered view that the loss in question is a loss on reduction of capital, because the entry in question is not in respect of the reduction of capital is not in the case of the assessee. As far as assessee is concerned; the assessee has been given shares in consideration of its transfer of investments. There is nothing in Schedule VI of the Companies Act which prohibits this loss being booked in the profit and loss account nor could learned Departmental Representative point out the same. Unless it is pointed out that the book profit is not arrived at on the basis of profit and loss account computed in accordance with Part II and III of Schedule VI to the Companies Act, or unless there are no Specific enabling provisions for adjustment in Section. 115JB itself, the book profit as per profit and loss, duly approved by the auditor and duly adopted by the Company, cannot be tinkered with Hon'ble Supreme Court's judgment in the case of *Apollo Tyres Ltd. v. CIT* (255 ITR 273) holds so. As regards note no. 8 in the balance sheet, it is not an objection or qualification by the auditor but it is a part of significant accounting policies and notes on account's. Which is mainly informative in nature. By no stretch of logic, this can be treated as qualification in the auditors report. In view of these discussions, in our considered view, the adjustment directed by the CIT is devoid of legally sustainable merits.

For the reasons set out above, we vacate the impugned revision order. As the assessee has succeeded on merits, we see no need to deal with other peripheral legal issues raised by the assessee."

11. Mr. J. D. Mistri learned Senior Advocate appearing for the assessee made the following submissions:—

- (1) According to the mandate of s.115JB(2)(a) the assessee company had maintained its accounts as per the provisions of Part II and Part III of Schedule VI of the Companies Act 1956. The same was scrutinized and certified by the statutory auditors and was approved by the assessee company in its annual general meeting. As such the assessing officer had no jurisdiction to question the correctness of the accounts. In support of his

submission he relied on the judgement of the Apex Court in the case of *Apollo Tyres Ltd. v. CIT* reported in [2002] 255 ITR 273 wherein the following issue arose for consideration:—

"Can an Assessing Officer while assessing a company for income tax under Section 115-J of the Income Tax Act question the correctness of the profit and loss account prepared by the assessee company and certified by the statutory auditors of the company as having been prepared in accordance with the requirements of Parts II and III of Schedule VI to the Companies Act?"

Answering the aforesaid question in the negative the Apex Court held as follows:

"For deciding this issue, it is necessary for us to examine the object of introducing Section 115-J in the IT Act which can be easily deduced from the Budget speech of the then Hon'ble Finance Minister of India made in Parliament while introducing the said section which is as follows:

"It is only fair and proper that the prosperous should pay at least some tax. The phenomenon of so-called 'zero-tax' highly profitable companies deserves attention. In 1983, a new Section 80-VVA was inserted in the Act so that all profitable companies pay some tax. This does not seem to have helped and is being withdrawn. I now propose to introduce a provision whereby every company will have to pay a 'minimum corporate tax' on the profits declared by it in its own accounts. Under this new provision, a company will pay tax on at least 30% of its book profit. In other words, a domestic widely held company will pay tax of at least 15% of its book profit. This measure will yield a revenue gain of approximately Rs 75 crores."

The above speech shows that the Income Tax Authorities were unable to bring certain companies within the net of income tax because these companies were adjusting their accounts in such a manner as to attract no tax or very little tax. It is with a view to bring such of these companies within the tax net that Section 115-J was introduced in the IT Act with a deeming provision which makes the company liable to pay tax on at least 30% of its book profits as shown in its own account. For the said purpose, Section 115-J makes the income reflected in the companies' books of accounts as the deemed income for the purpose of assessing the tax. If we examine the said provision in the above background, we notice that the use of the words "in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act" was made for the limited purpose of empowering the assessing authority to rely upon the authentic statement of accounts of the company. While so looking into the accounts of the company, an Assessing

Officer under the IT Act has to accept the authenticity of the accounts with reference to the provisions of the Companies Act which obligates the company to maintain its account in a manner provided by the Companies Act and the same to be scrutinised and certified by statutory auditors and will have to be approved by the company in its General Meeting and thereafter to be filed before the Registrar of Companies who has a statutory obligation also to examine and satisfy that the accounts of the company are maintained in accordance with the requirements of the Companies Act. In spite of all these procedures contemplated under the provisions of the Companies Act, we find it difficult to accept the argument of the Revenue that it is still open to the Assessing Officer to rescrutinize this account and satisfy himself that these accounts have been maintained in accordance with the provisions of the Companies Act. In our opinion, reliance placed by the Revenue on sub-section (1-A) of Section 115-J of the IT Act in support of the above contention is misplaced. Sub-section (1-A) of Section 115-J does not empower the Assessing Officer to embark upon a fresh inquiry in regard to the entries made in the books of account of the company. The said sub-section, as a matter of fact, mandates the company to maintain its account in accordance with the requirements of the Companies Act which mandate, according to us, is bodily lifted from the Companies Act into the IT Act for the limited purpose of making the said account so maintained as a basis for computing the company's income for levy of income tax. Beyond that, we do not think that the said sub-section empowers the authority under the Income Tax Act to probe into the accounts accepted by the authorities under the Companies Act. If the statute mandates that income prepared in accordance with the Companies Act shall be deemed income for the purpose of Section 115-J of the Act, then it should be that income which is acceptable to the authorities under the Companies Act. There cannot be two incomes, one for the purpose of the Companies Act and another for the purpose of income tax, both maintained under the same Act. If the legislature intended the Assessing Officer to reassess the company's income, then it would have stated in Section 115-J that "income of the company as accepted by the Assessing Officer". In the absence of the same and on the language of Section 115-J, it will have to be held that the view taken by the Tribunal is correct and the High Court has erred in reversing the said view of the Tribunal.

Therefore, we are of the opinion, the Assessing Officer while computing the income under Section 115-J has only the power of examining whether the books of account are certified by the authorities under the Companies Act as having been properly maintained in accordance with the Companies Act. The Assessing Officer thereafter has the limited power of making increases and reductions as provided for in the Explanation to the said section. To put it differently, the Assessing Officer does not have the jurisdiction to go behind

the net profit shown in the profit and loss account except to the extent provided in the Explanation to Section 115-J."

The views expressed by the Apex Court in *Apollo Tyres (supra)* was quoted with approval by the Apex Court in *Malayala Manorama Co. Ltd. v. CIT* reported in [2008] 300 ITR 251.

- (2) The views expressed in *Apollo Tyres (supra)* was followed by this Court in the case of *CIT v. Ispat Industries Ltd* reported in [2008] 2 DTR (Cal) 133 wherein a Division bench of this Court held as follows:

"Accordingly, it appears that the learned Tribunal correctly held that the AO has to accept the authenticity of the account maintained in accordance with the provisions of the Companies Act in particular Part II and Part III of Sch VI to the said Act which are specifically certified by the auditors and approved by the company in the annual general meeting."

The Bombay High Court also followed the views expressed by the Apex Court in *Apollo Tyres* in the case of *CIT v. Adbhut Trading Company Pvt. Ltd.* reported in [2011] 338 ITR 94 and held as follows:

"According to the Revenue, the assessee has intentionally prepared a wrong profit and loss' account. Once the accounts' including the profit and loss account are certified by the 'authorities under the Companies Act it is not open to the Assessing Officer' to contend that the profit and loss account has not been prepared in accordance with the provisions of the Companies Act, 1956."

- (3) The Registrar of Companies, Statutory auditors and share-holders are the only authorities to check whether accounts are in accordance with Part II and III of Schedule – VI of the Companies Act 1956.
- (4) By an order dated 17th August, 2005 this Court sanctioned the proposed scheme of arrangement between the assessee company and DCPL. The accounting treatment for the proposed arrangement was also laid down in Part II of Schedule A of the scheme of arrangement which reads as follows:—

"8. Accounting:

8.1 The assets and liabilities of the Investment Division shall be transferred to DCPL at their respective values as appearing in BCL's book of account as on the date immediately preceeding the Appointed Date. The said assets and liabilities shall be recorded in the books of accounts of DCPL at the said

values.

8.2 The difference between the book value of the said assets and liabilities of the Investment Division recorded in the books of account of DCPL as reduced by the aggregate face value of the Equity shares issued and allotted by DCPL in terms of clause 7 above shall be credited to General Reserves in the books of account of DCPL

8.3 In the books of account of BCL the difference between the assets and liabilities of the Investment Division as reduced by the Share Capital of BCL which shall stand cancelled in terms of this Scheme shall also be adjusted against the balance in Profit and Loss Account of BCL."

Thus in view of accounting treatment expressly laid down in the scheme of arrangement sanctioned by this Hon'ble Court it was obligatory on the part of the assessee to debit the amount of Rs 919.52 lakhs towards loss on account of the transfer of the Investment Division of the assessee company to the Profit and Loss account.

- (5) The CIT by his order u/s.263 did not disclose any provision of Part II and III of Schedule VI of the Companies Act 1956 which was allegedly contravened. In fact the CIT by his order dated 20th January 2011 made a bald statement by holding as follows:—

"From the facts stated above it is apparent that the loss booked in the P/L A/c is for share-capital reduction. There is no scope for such accounting as per Part-II & III of Schedule-VI of the Companies Act. Besides, such loss fictitious as held by ITAT, Delhi in quantum appeal in a similar case of debit in the case of Hari Machines Ltd. This is evident from the report of the case of *CIT v. Hari Machines Ltd.* in 166 Taxman 84 (2008), which was in respect of penalty u/s 271 (1)(c) but in the facts such finding of ITAT has been discussed. Therefore, such share capital reduction cannot be an item of P/L Ac. As per Part-II & III of Schedule-VI of the Companies Act."

- (6) The CIT by his order u/s.263 wrongly relied on the judgment of *CIT v. Hari Machines Ltd* reported in [2009] 311 ITR 285 which has no manner of application to the facts of the instant case. In *Hari Machines (supra)* the issue was regarding imposition of penalty under Section 271(1)(c) of the Act and it was not a case dealing with Section 115JB. In that case, the assessee had a paid up capital of Rs 25 lakhs however according to the assessee the intrinsic value of the equity shares was Rs 19.5 lakhs odd. Thus the assessee decided to reduce the share capital to Rs 20 lakhs and applied to the Calcutta High Court for permission, which was granted. The assessing officer was of the view that reduction in share capital did not represent a loss

incurred by the assessee and taxed the amount of Rs 5 lakhs allegedly shown as a loss. The CIT(Appeals) as well as the Tribunal upheld the action of the assessing officer. The Tribunal came to a conclusion that the loss shown on account of reduction of share capital was a fictitious loss with the intention of creating a scheme or device to defraud the Revenue. In the meanwhile, the assessing officer initiated penalty proceedings against the assessee under Section 271(1)(c) of the Act. The CIT(A) and the Tribunal cancelled the levy of penalty, which was upheld by the Delhi High Court.

12. In the instant case, the CIT in his order u/s.263 relied on *Hari Machines (supra)* and the observations of the Delhi ITAT recorded therein to reach the conclusion that such capital reduction amounts to fictitious loss. To be precise the CIT held as follows:—

"It is already held by the Delhi High Court in the case of *CIT v. Hari Machine Ltd.* [2009] 311 ITR 85 that such capital reduction is fictitious. On similar facts the Delhi ITAT held that such fictitious loss on capital deduction may a balance sheet adjustment but cannot be an item of P & L A/c and the loss booked in the P & L A/c is required to be added back for computation of book profit u/s.115JB... From the facts stated above it is apparent that the loss booked in the P/L A/c is for share-capital reduction. There is no scope for such accounting as per Part-II & III of Schedule-VI of the Companies Act. Besides, such loss is fictitious as held by ITAT, Delhi in quantum appeal in a similar case of debit in the case of *Hari Machines Ltd.* This is evident from the report of the case of *CIT v. Hari Machines Ltd.* in 166 Taxman 84 (2008), which was in respect of penalty u/s 271 (1)(c) but in the facts such finding of ITAT has been discussed. Therefore, such share capital reduction cannot be an item of P/L Ac. As per Part-II & III of Schedule-VI of the Companies Act."

13. However a close scrutiny of the judgement in *Hari Machines (supra)* reveals that the issue for consideration before the Delhi High Court was only regarding imposition of penalty and not regarding addition to book profit for purpose of section 115JB. In fact the Delhi High Court held that the finding recorded by the Tribunal in the quantum appeal that the loss was fictitious was harsh.

14. The Delhi High Court while upholding the order of deletion of penalty observed as follows:—

"In the present case, there is no allegation that there was any gross or wilful neglect on the part of the assessee to declare the correct income. The question that arises is whether the assessee has committed any kind of fraud.

It is difficult to say, on the facts of the present case, that the assessee had committed any fraud notwithstanding the strong words used by the Tribunal in the quantum matter. The assessee was entitled to determine the intrinsic

value of its shares, which it did. Thereafter, in order to reduce its share capital, the assessee is obliged to proceed in accordance with law and so the assessee approached the Calcutta High Court for reduction of its share capital. After considering the materials on record, the Calcutta High Court permitted the assessee to reduce its share capital in terms of its order dated December 21, 1972.

It is nobody's case that the Calcutta High Court was defrauded by the assessee. That being the position we must proceed on the basis that the decision rendered by the Calcutta High Court was correct and there was no attempt on the part of the assessee to mislead the Calcutta High Court. On the other hand, the Calcutta High Court could have refused to entertain the prayer made by the assessee, if the assessee had tried to mislead the court.

Under these circumstances, we are of the opinion that the Tribunal was correct in upholding the order passed by the Commissioner of Income-tax (Appeals) cancelling the levy of penalty against the assessee and holding that the assessee had not committed any fraud. The question of law referred to us is answered in the affirmative, that is in favour of the assessee and against the Revenue."

- (7) The jurisdiction u/s.263 was wrongly exercised on an erroneous reading of the judgement in *Hari Machines (supra)* which has no manner of application to the facts of this case. The CIT in his order u/s.263 did not disclose any material on the basis of which he could arrive at the conclusion that the assessment order under consideration is "erroneous in so far as it is prejudicial to the interests of the revenue".
- (8) The note number 8 of Schedule 15 (titled 'Significant accounting policies and notes on accounts') of the Balance Sheet and Profit and Loss Account for the year ended 31st March 2006 was not provided by the statutory auditors rather it is a note made by the company. Regarding note number 8 the Tribunal had held as follows:

"As regards note no. 8 in the balance sheet, it is not an objection or qualification by the auditor but it is a part of significant accounting policies and notes on account's which is mainly informative in nature. By no stretch of logic, this can be treated as qualification in the auditors report."
- (9) That revisional jurisdiction u/s.263 of the Act cannot be exercised where two views are possible and the assessing officer has taken one of the possible views. In support of his submissions he relied on a judgement in the case of *Malabar Industrial Company v. CIT* reported in [2000] 243 ITR 83 wherein

their Lordships discussed the scope of s.263 and held as follows:—

"...The Commissioner has to be satisfied of twin conditions, namely, (i) the order of the Assessing Officer sought to be revised is erroneous; and (ii) it is prejudicial to the interests of the Revenue. If one of them is absent — if the order of the Income Tax Officer is erroneous but is not prejudicial to the Revenue or if it is not erroneous but is prejudicial to the Revenue — recourse cannot be had to Section 263(1) of the Act.

There can be no doubt that the provision cannot be invoked to correct each and every type of mistake or error committed by the Assessing Officer; it is only when an order is erroneous that the section will be attracted. An incorrect assumption of facts or an incorrect application of law will satisfy the requirement of the order being erroneous. In the same category fall orders passed without applying the principles of natural justice or without application of mind.

The phrase "prejudicial to the interests of the Revenue" is not an expression of art and is not defined in the Act. Understood in its ordinary meaning it is of wide import and is not confined to loss of tax. The High Court of Calcutta in *Dawjee Dadabhoy & Co. v. S.P. Jain* [(1957) 31 ITR 872 (Cal)] , the High Court of Karnataka in *CIT v. T. Narayana Pai* [(1975) 98 ITR 422 (Kant)] , the High Court of Bombay in *CIT v. Gabriel India Ltd.* [(1993) 203 ITR 108 (Bom)] and the High Court of Gujarat in *CIT v. Minalben S. Parikh* [(1995) 215 ITR 81 (Guj)] treated loss of tax as prejudicial to the interests of the Revenue...

The phrase "prejudicial to the interests of the Revenue" has to be read in conjunction with an erroneous order passed by the Assessing Officer. Every loss of revenue as a consequence of an order of the Assessing Officer cannot be treated as prejudicial to the interests of the Revenue, for example, when an Income Tax Officer adopted one of the courses permissible in law and it has resulted in loss of revenue; or where two views are possible and the Income Tax Officer has taken one view with which the Commissioner does not agree, it cannot be treated as an erroneous order prejudicial to the interests of the Revenue unless the view taken by the Income Tax Officer is unsustainable in law."

15. In view of the authoritative pronouncement of the Apex Court in *Appollo Tyres (supra)* the assessing officer while computing the income under Section 115-JB has only the power of examining whether the books of account are certified by the authorities under the Companies Act as having been properly maintained in accordance with the Companies Act. The Assessing Officer thereafter has the limited power of making increases and reductions as provided for in the Explanation 1 to the section 115JB(2). Thus, the Assessing Officer does not have the jurisdiction to go behind the net profit shown in the profit and loss account

except to the extent provided in the Explanation 1 to Section 115JB. The amount of Rs 919.52 lakhs debited to the Profit and Loss A/c towards the loss on account of the transfer of the Investment Division of the assessee company, cannot be added back for computing the book profit u/s.115JB because the Explanation 1 to s.115JB(2) does not provide for such addition. Hence the assessing officer in the instant case could not have made any addition for the said amount. Thus the view taken by the assessing officer in not making any addition to the book profit for purpose of s.115JB cannot be called erroneous. In fact it was the only possible view that could have been taken. Furthermore the CIT in his order u/s.263 did not hold that the order of the assessing officer was unsustainable. Hence, in view of the mandate in *Malabar Industrial Company Ltd.*, the exercise of revisional jurisdiction under Section 263 was bad as the preconditions for exercise of revisional power did not exist. The views expressed in *Malabar Industrial Company (supra)* were reiterated by the Apex Court in *CIT v. Max India Ltd.* reported in [2007] 295 ITR 282.

16. An erroneous order is one which is not in accordance with the law or which has been passed by the Income-tax Officer without making any enquiry in undue haste. An order can be said to be "prejudicial to the interests of the Revenue" if it is not in accordance with the law and consequently the lawful revenue due to the State is not realised. There must be material available on the record called for by the Commissioner to satisfy him prima facie that the aforesaid two conditions are present. If not, he has no authority to initiate proceedings for revision u/s.263 of the Act. The said provision does not allow the Commissioner to substitute his own view for that of the assessing officer unless the conditions precedent u/s.263 are satisfied. In support of his submission he relied on a judgement of the Bombay High Court in *CIT v. Gabriel India Ltd.* reported in [1993] 203 ITR 108 wherein the court has elaborately discussed the scope of s.263 in the following words:—

"From the aforesaid definitions it is clear that an order cannot be termed as erroneous unless it is not in accordance with law. If an Income-tax Officer acting in accordance with law makes a certain assessment, the same cannot be branded as erroneous by the Commissioner simply because, according to him, the order should have been written more elaborately. This section does not visualise a case of substitution of the judgment of the Commissioner for that of the Income-tax Officer, who passed the order, unless the decision is held to be erroneous. Cases may be visualised where the Income-tax Officer while making an assessment examines the accounts, makes enquiries, applies his mind to the facts and circumstances of the case and determines the income either by accepting the accounts or by making some estimate himself. The Commissioner, on perusal of the records, may be of the opinion that the estimate made by the officer concerned was on the lower side and left to the Commissioner he would have estimated the income at a figure higher than the one determined by the Income-tax Officer. That would not vest the Commissioner with power to re-examine the accounts and determine

the income himself at a higher figure. It is because the Income-tax Officer has exercised the quasi-judicial power vested in him in accordance with law and arrived at a conclusion and such a conclusion cannot be termed to be erroneous simply because the Commissioner does not feel satisfied with the conclusion. It may be said in such a case that in the opinion of the Commissioner the order in question is prejudicial to the interests of the Revenue. But that by itself will not be enough to vest the Commissioner with the power of suo motu revision because the first requirement, viz., that the order is erroneous, is absent. Similarly, if an order is erroneous but not prejudicial to the interests of the Revenue, then also the power of suo motu revision cannot be exercised. Any and every erroneous order cannot be the subject-matter of revision because the second requirement also must be fulfilled. There must be some prima facie material on record to show that tax which was lawfully exigible has not been imposed or that by the application of the relevant statute on an incorrect or incomplete interpretation a lesser tax than what was just has been imposed.

We, therefore, hold that in order to exercise power under subsection (1) of section 263 of the Act there must be material before the Commissioner to consider that the order passed by the Income-tax Officer was erroneous in so far as it is prejudicial to the interests of the Revenue. We have already held what is erroneous. It must be an order which is not in accordance with the law or which has been passed by the Income-tax Officer without making any enquiry in undue haste. We have also held as to what is prejudicial to the interests of the Revenue. An order can be said to be prejudicial to the interests of the Revenue if it is not in accordance with the law in consequence whereof the lawful revenue due to the State has not been realised or cannot be realised. There must be material available on the record called for by the Commissioner to satisfy him prima facie that the aforesaid two requisites are present. If not, he has no authority to initiate proceedings for revision. Exercise of power of suo motu revision under such circumstances will amount to arbitrary exercise of power. It is well-settled that when exercise of statutory power is dependent upon the existence of certain objective facts, the authority before exercising such power must have materials on record to satisfy it in that regard. If the action of the authority is challenged before the court it would be open to the courts to examine whether the relevant objective factors were available from the records called for and examined by such authority... So far as calling for the records and examining the same is concerned, undoubtedly, it is an administrative act, but on examination "to consider" or in other words, to form an opinion that the particular order is erroneous in so far as it is prejudicial to the interests of the Revenue, is a quasi-judicial act because on this consideration or opinion the whole machinery of re-examination and reconsideration of an order of

assessment, which has already been concluded and controversy which has been set at rest, is set again in motion. It is an important decision and the same cannot be based on the whims or caprice of the revising authority. There must be materials available from the records called for by the Commissioner."

- (10) The accountant's certificate under Sub-section 4 of Section 115JB of the Act was not challenged by the CIT in his order u/s.263 of the Act.

17. Mr. Bandopadhyay learned advocate appearing for the revenue contended that the loss could not have been debited to the P/L account. Therefore, it is not in accordance with the provisions of Section 115 JB hence it is erroneous and prejudicial to the Revenue. Therefore, exercise u/s.263 was proper.

18. We have heard at length the arguments advanced at the Bar and carefully perused the record.

19. What is required of us is to examine the legality of exercise of power under Section 263 of the Act by the CIT. It is a fact that the assessee incurred loss of a sum of Rs.9.20 crores by resorting to transfer of its investment division to Daisy Commercials Private Ltd. The loss was debited to the profit and loss account. The assessment was under Section 115JB of the Act. The assessing officer did not question the act of debiting loss arising out of the transfer to the P/L account.

20. The CIT was of the opinion that the loss could not have been debited to the P/L account and the amount was required to be added back for computation of book profit under Section 115JB.

21. The accounting standards laid down by the institute however provide for recognition of the profit or loss arising out of investment in the profit and loss account.

22. Reference in this regard may be made to Clauses 21 and 25 of Accounting Standard 13.

"21. On disposal of an investment, the difference between the carrying amount and the disposal proceeds, net of expenses, is recognised in the profit and loss statement.

25. The following disclosures in financial statements in relation to investments are appropriate:—

- (a) the accounting policies for the determination of carrying amount of investments;
- (b) the amounts included in profit and loss statement for:
 - (i) interest, dividends (showing separately dividends from subsidiary companies), and rentals on investments showing separately such income from long term and current investments. Gross income should be stated, the amount of income tax deducted at

source being included under Advance Taxes Paid;

- (ii) profits and losses on disposal of current investments and changes in carrying amount of such investments;
- (iii) profits and losses on disposal of long term investments and changes in the carrying amount of such investments;
- (c) significant restrictions on the right of ownership, realisability of investments or the remittance of income and proceeds of disposal;
- (d) the aggregate amount of quoted and unquoted investments, giving the aggregate market value of quoted investments;
- (e) other disclosures as specifically required by the relevant statute governing the enterprise."

23. The disclosure made in the financial statements is in pursuance of the requirement of Clause- 25 quoted above and is also in pursuance of Clause 2(b) of Part II of Schedule VI to the Companies Act, 1956 which is not to be construed as any qualification indicating any inaccuracy in the accounts. There was, thus no mistake on the part of the assessee in debiting the loss to the profit and loss account.

24. In the computation of income under Section 115JB there is authoritative pronouncement laid down by the Apex Court in *Apollo Tyres (supra)* which is as follows:—

"Therefore, we are of the opinion, the Assessing Officer while computing the income under Section 115-J has only the power of examining whether the books of account are certified by the authorities under the Companies Act as having been properly maintained in accordance with the Companies Act. The Assessing Officer thereafter has the limited power of making increases and reductions as provided for in the Explanation to the said section. To put it differently, the Assessing Officer does not have the jurisdiction to go behind the net profit shown in the profit and loss account except to the extent provided in the Explanation to Section 115-J."

Once it is realized that the assessee had correctly debited the profit and loss account for the loss arising out of the transfer of investment division, there remains no difficulty in realizing that the CIT proceeded on a wrong premise which was responsible for exercise of jurisdiction under Section 263 which he would not have done if he had realized the correct position as would appear from the following paragraph:-

"Therefore, such share capital reduction cannot be an item of P/L Ac. As per Part-II III of Schedule-VI of the Companies Act. The decision of the Hon'ble Apex Court in the case of *Apollo Tyres Ltd.* in respect of adjustments only as per explanation-1 is applicable only after the accounts have been prepared as provided in sub-section (2) of Sec. 115JB

of the Act. The condition not having been satisfied, the amount was required to be added back in computation of Book profit for MAT u/s 115JB. But it is apparent from the records that the issue has not been examined by the AO at all while passing the assessment order and no such addition has been made."

25. Had it not been a case of section 115JB the capital loss incurred on transfer of investments would have been dealt as follows:

1. Under section 70(2) short term capital loss would be set off against either short term or long term capital gain.
2. Under section 70(3) long term capital loss would be set off against long term capital gain only.
3. Under section 71(3) if the net result of computation under the head "Capital gain" is a loss then such loss cannot be set off against income under any other head.
4. Under section 74(1)(a) short term capital loss would be carried forward to the following assessment year and be set off against either short term or long term capital gain.
5. Under section 74(1)(b) long term capital loss would be carried forward to the following assessment year and be set off against long term capital gain only.

26. In that view of the matter, the only conclusion which can be arrived at is that the order passed by the learned Tribunal is unexceptionable.

27. For the aforesaid reasons the question no. (I) is answered in the affirmative.

28. We can only add that the judgment of the Delhi High Court in the case of *CIT v. Hari Machines Ltd.* had no applicability to the facts and circumstances of the case. Rest of the questions need not be answered.

29. The appeal is therefore, dismissed.

■ ■

SUPREME COURT OF INDIA

Commissioner of Income-tax

v.

Meghalaya Steels Ltd.

KURIAN JOSEPH AND R.F.NARIMAN, JJ.

CIVIL APPEAL NOS. 7622 OF 2014 & OTHERS

MARCH 9, 2016

Mrs. Anil Katiyar, Ms. Sadhna Sandhu, Arijit Prasad, Rupesh Kumar and B.V. Balaram Das, Advs. for the Appellant. Ms. Kavita Jha, K.V. Mohan, Vijay Kumar, Mrs. Rani Chhabra, Rajinder Mathur and Kunal Chatterji, Advs. for the Respondent.

JUDGMENT

R.F. Nariman, J. - Delay condoned in filing the special leave petitions.

2. Leave granted in SLP (C) Nos. 36578/2013, 36579/2013, 36581/2013, 37831/2013, 37833/2013, 37834/2013, SLP(C) No.....CC No.224/2014), SLP(C) No.....CC No.1543/2014), SLP(C) Nos.11094/2014, 11095/2014, 12710/2014, 24620/2014, 11319/2015.

3. This group of appeals arises from the State of Meghalaya and concerns deductions to be made under Sections 80-IB and 80-IC of the Income Tax Act, 1961. Civil Appeal No.7622 of 2014 has been treated as the lead matter in which a judgment of the Gauhati High Court dated 29.5.2013 has been delivered, which has been followed in all the other appeals.

4. Civil Appeal No.7622 of 2014 concerns itself with two income tax appeals filed by the Revenue against the judgment of the Income Tax Appellate Tribunal, ITA No.7/2010 arising out of the applicability of Section 80-IB, and ITA No.16/2011 arising out of the applicability of Section 80-IC. For the purpose of these matters, the facts in ITA No.7/2010 are narrated hereinbelow.

5. The respondent is engaged in the business of manufacture of Steel and Ferro Silicon. On 9.10.2014, the Respondent submitted its return of income for the year 2004-2005 disclosing an income of Rs.2,06,970/- after claiming deduction under Section 80-IB of the Income Tax Act on the profits and gains of business of the respondent's industrial undertaking. The respondent had received the following amounts on account of subsidies:-

Transport subsidy Rs.2,64,94,817.0

-

0

Interest subsidy -	Rs.2,14,569.00
Power subsidy -	Rs.7,00,000.00
Total-	Rs.2,74,09,386.00

6. The Assessing Officer, in the assessment order dated 7.12.2006, held that the amounts received by the assessee as subsidies were revenue receipts and did not qualify for deduction under Section 80-IB(4) of the Act and, accordingly, the respondent's claim for deduction of an amount of Rs.2,74,09,386/- on account of the three subsidies aforementioned were disallowed. The respondent-assessee preferred an appeal before the Commissioner of Income Tax (Appeals), Guwahati, who, vide his order dated 8.3.2007, dismissed the appeal of the respondent. Aggrieved by the aforesaid order, the respondent preferred an appeal before the ITAT which, by its order dated 19.3.2010, allowed the appeal of the respondent. The Revenue carried the matter thereafter to the High Court, under Section 260A of the Act, which resulted in the impugned judgment dated 29.5.2013, which decided the matter against the Revenue. Revenue is therefore before us in appeal against this judgment.

7. Shri Radhakrishnan, learned senior advocate appearing on behalf of the Revenue, argued before us that any amount received by way of subsidy was an amount whose source was the Government and not the business of the assessee. He further argued that there is a world of difference between the expression profits and gains "derived from" any business, and profits "attributable to" any business, and that since the section speaks of profits and gains "derived from" any business, such profits and gains must have a close and direct nexus with the business of the assessee. Subsidies that are allowed to the assessee have no close and direct nexus with the business of the assessee but have a close and direct nexus with grants from the Government. This being the case, according to him, the respondent did not qualify for deductions under Sections 80-IB and 80-IC of the Act. In the course of his lengthy submissions, he made reference to a number of judgments including the judgment reported as *Liberty India v. Commissioner of Income Tax* reported in 2009 (9) SCC 328, which has been followed by the Himachal Pradesh High Court in *Supriya Gill v. CIT* (2010) 193 Taxman 12 (Himachal Pradesh). He submitted that the aforesaid judgment of the Himachal Pradesh High Court has taken a diametrically opposite view to the judgment of the Gauhati High Court, impugned in the present appeals, and deserves to be followed, as it, in turn, has followed Liberty India's judgment and another Supreme Court judgment reported as *CIT v. Sterling Foods*, 237 ITR 579 (1999). He also relied upon Sections 80-A and 80-AB in order to demonstrate the scheme of deductions allowable under Part-VI-A of the Income Tax Act. He also referred us to Sections 56 and 57 (iii) of the Act to buttress his submission that subsidies being in the nature of "income from other sources" could not be allowed to be deducted from profits and gains of business, which fell under a different sub-heading in Section 14 of the Act. According to him, there is one interpretation and one interpretation

alone of Sections 80-IB and 80-IC, which cannot be deviated from with reference to any so-called object of the said sections.

8. Countering these submissions, Shri P. Chidambaram Learned Senior Counsel appearing on behalf of the assessee, referred to the Budget Speech of the Minister of Finance for 1999-2000 to buttress his submission that the idea of giving these subsidies was to give a 10 year tax holiday to those who come from outside Meghalaya to set up industries in that State, which is a backward area. He referred to several judgments, including the judgment reported in *Jai Bhagwan Oil and Flour Mills v. Union of India and Others* (2009) 14 SCC 63 and *Sahney Steel and Press Works Ltd. v. Commissioner of Income Tax, A.P. - I, Hyderabad*, (1997) 7 SCC 764 to buttress his submission that subsidies were given only in order that items which would go into the cost of manufacture of the products made by the respondent should be reduced, as these subsidies were reimbursement for either the entire or partial costs incurred by the respondent towards transporting raw materials to its factory and transporting its finished products to dealers, who then sell the finished products. Further, power subsidy, interest subsidy and insurance subsidy were also reimbursed, either wholly or partially, power being a necessary element of the cost of manufacture of the respondent's products, and insurance subsidy being necessary to defray costs for both manufacture and sale of the said products. Further, interest subsidy would also go towards reducing the interest element relatable to cost, and therefore all four subsidies being directly relatable to cost of manufacture and/or sale would therefore necessarily fall within the language of Sections 80-IB and 80-IC, as they are components of cost of running a business from which profits and gains are derived. He sought to distinguish the judgments cited by Shri Radhakrishnan, in particular the judgment of this Court in *Liberty India*, on the ground that the said judgment did not deal with a subsidy relatable to cost of manufacture but dealt with a DEPB drawback scheme, which related to export of goods and not manufacture of goods, thereby rendering the said decision inapplicable to the facts of the present case. Shri S. Ganesh, learned senior counsel appearing on behalf of some of the respondent-assesseees, reiterated the submissions made by Shri P. Chidambaram and added that as all the subsidies went towards cost of manufacture or sale of the products of the respondent, such subsidies being amounts of cost which were actually incurred by the respondent and thereafter reimbursed by the State, the principle of netting off recognized in several decisions of this Court ought to be applied, and on application of the said principle, it is clear that the subsidy received by the respondent was only to depress cost of manufacture and/or sale and would therefore be "derived from" profits and gains made from the business of the assessee. He also relied upon a judgment of the Calcutta High Court dated 15.1.2015, in *C.I.T. v. Cement Manufacturing Company Limited*, which has followed the Gauhati High Court, and a judgment of the Delhi High Court in *CIT v. Dharampal Premchand Ltd.*, 317 ITR 353.

9. We have heard learned counsel for the parties. Before embarking on a discussion of the relevant case law, we think it is necessary to set out Sections 80-IB and 80-IC insofar as they are relevant for the determination of the present case.

"80-IB Deduction in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings

- (1) Where the gross total income of an assessee includes any profits and gains derived from any business referred to in sub-sections (3) to (11), (11A) and (11B) (such business being hereinafter referred to as the eligible business), there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction from such profits and gains of an amount equal to such percentage and for such number of assessment years as specified in this section.
- (2) This section applies to any industrial undertaking which fulfils all the following conditions, namely:-
 - (i) it is not formed by splitting up, or the reconstruction, of a business already in existence: Provided that this condition shall not apply in respect of an industrial undertaking which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such industrial undertaking as is referred to in section 33B, in the circumstances and within the period specified in that section;
 - (ii) it is not formed by the transfer to a new business of machinery or plant previously used for any purpose;
 - (iii) it manufactures or produces any article or thing, not being any article or thing specified in the list in the Eleventh Schedule, or operates one or more cold storage plant or plants, in any part of India: Provided that the condition in this clause shall, in relation to a small scale industrial undertaking or an industrial undertaking referred to in sub-section (4) shall apply as if the words "not being any article or thing specified in the list in the Eleventh Schedule" had been omitted.

Explanation 1- For the purposes of clause (ii), any machinery or plant which was used outside India by any person other than the assessee shall not be regarded as machinery or plant previously used for any purpose, if the following conditions are fulfilled, namely:-

- (a) such machinery or plant was not, at any time previous to the date of the installation by the assessee, used in India;

- (b) such machinery or plant is imported into India from any country outside India; and
- (c) no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the provisions of this Act in computing the total income of any person for any period prior to the date of the installation of the machinery or plant by the assessee.

Explanation 2- Where in the case of an industrial undertaking, any machinery or plant or any part thereof previously used for any purpose is transferred to a new business and the total value of the machinery or plant or part so transferred does not exceed twenty per cent of the total value of the machinery or plant used in the business, then, for the purposes of clause (ii) of this sub-section, the condition specified therein shall be deemed to have been complied with;

- (iv) in a case where the industrial undertaking manufactures or produces articles or things, the undertaking employs ten or more workers in a manufacturing process carried on with the aid of power, or employs twenty or more workers in a manufacturing process carried on without the aid of power.

(4) The amount of deduction in the case of an industrial undertaking in an industrially backward State specified in the Eighth Schedule shall be hundred per cent of the profits and gains derived from such industrial undertaking for five assessment years beginning with the initial assessment year and thereafter twenty-five per cent (or thirty per cent where the assessee is a company) of the profits and gains derived from such industrial undertaking:

Provided that the total period of deduction does not exceed ten consecutive assessment years (or twelve consecutive assessment years where the assessee is a co-operative society) subject to fulfillment of the condition that it begins to manufacture or produce articles or things or to operate its cold storage plant or plants during the period beginning on the 1st day of April, 1993 and ending on the 31st day of March, 2004: Provided further that in the case of such industries in the North-Eastern Region, as may be notified by the Central Government, the amount of deduction shall be hundred per cent of profits and gains for a period of ten assessment years, and the total period of deduction shall in such a case not exceed ten assessment years.

Provided also that no deduction under this sub-section shall be allowed for the assessment year beginning on the 1st day of April, 2004 or any subsequent year to any undertaking or enterprise referred to in sub-section (2) of section 80-IC. Provided also that in the case of an industrial undertaking in the State of Jammu and Kashmir, the provisions of the first proviso shall have effect as if for the figures, letters and words 31st day of March, 2004, the figures, letters and words 31st day of March, 2012 had been substituted:

Provided also that no deduction under this sub-section shall be allowed to an industrial undertaking in the State of Jammu and Kashmir which is engaged in the manufacture or production of any article or thing specified in Part C of the Thirteenth Schedule."

"80-IC Special provisions in respect of certain undertakings or enterprises in certain special category States

(1) Where the gross total income of an assessee includes any profits and gains derived by an undertaking or an enterprise from any business referred to in sub-section (2), there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction from such profits and gains, as specified in sub-section (3)."

10. There is no dispute between the parties that the businesses referred to in Section 80-IB are businesses which are eligible businesses under both the aforesaid Sections. The parties have only locked horns on the meaning of the expression "any profits and gains derived from any business".

11. The aforesaid provisions were inserted by the Finance Act 1999 with effect from 1.4.2000. The Finance Minister in his budget speech for the year 1999-2000 spoke about industrial development in the North Eastern Region as follows:-

"Mr. Speaker, Sir, I am conscious of the fact that, despite all our announcements, the industrial development in North Eastern Region has not come up to our expectations. To give industrialisation a fillip in this area of the country, I propose a 10 year tax holiday for all industries set up in Growth Centres, Industrial Infrastructure Development Corporations, and for other specified industries, in the North Eastern Region. I would urge the industrial entrepreneurs from this part of the country to seize the opportunity and set up modern, high value added manufacturing units in the region."

12. The reference to the 10 year tax holiday for the industries set up in the North Eastern Region is an obvious reference to the second proviso to sub-section (4) of Section 80-IB set out hereinabove. The speech of a Minister is relevant insofar it gives the background for the introduction of a particular provision in the Income Tax Act. It is not determinative of the construction of the said provision, but gives the reader an idea as to what was in the Minister's mind when he sought to introduce the said provision. As an external aid to construction, this Court has, in *K.P. Varghese v. Income Tax Officer, Ernakulam and Anr.*, (1982) 1 SCR 629, referring to a Minister's speech piloting a Finance Bill, stated as under:-

"Now it is true that the speeches made by the Members of the Legislature on the floor of the House when a Bill for enacting a statutory provision is being debated are inadmissible for the purpose of interpreting the statutory provision but the speech made by the Mover of the Bill explaining the reason for the introduction of the Bill can certainly be referred to for the purpose of ascertaining the mischief sought to be

remedied by the legislation and the object and purpose for which the legislation is enacted. This is in accord with the recent trend in juristic thought not only in Western countries but also in India that interpretation of a statute being an exercise in the ascertainment of meaning, everything which is logically relevant should be admissible. In fact there are at least three decisions of this Court, one in *Loka Shikshana Trust v. Commissioner of Income-Tax* [1975] 101 ITR 234(SC) the other in *Indian Chamber of Commerce v. Commissioner of Income-tax* [1975] 101 ITR 796(SC) and the third in *Additional Commissioner of Income-tax v. Surat Art Silk Cloth Manufacturers Association* [1980] 121 ITR 1(SC) where the speech made by the Finance Minister while introducing the exclusionary clause in Section 2 Clause (15) of the Act was relied upon by the Court for the purpose of ascertaining what was the reason for introducing that clause. The speech made by the Finance Minister while moving the amendment introducing Sub-section (2) clearly states what were the circumstances in which Sub-section (2) came to be passed, what was the mischief for which Section 52 as it then stood did not provide and which was sought to be remedied by the enactment of Sub-section (2) and why the enactment of Sub-section (2) was found necessary. It is apparent from the speech of the Finance Minister that Sub-section(2) was enacted for the purpose of reaching those cases where there was under-statement of consideration in respect of the transfer or to put it differently, the actual consideration received for the transfer was 'considerably more' than that declared or shown by the assessee, but which were not covered by Sub-section (1) because the transferee was not directly or indirectly connected with the assessee. The object and purpose of Sub-section (2), as explicated from the speech of the Finance Minister, was not to strike at honest and bonafide transactions where the consideration for the transfer was correctly disclosed by the assessee but to bring within the net of taxation those transactions where the consideration in respect of the transfer was shown at a lesser figure than that actually received by the assessee, so that they do not escape the charge of tax on capital gains by under-statement of the consideration. This was real object and purpose of the enactment of Sub-section (2) and the interpretation of this sub-section must fall in line with the advancement of that object and purpose. We must therefore accept as the underlying assumption of Sub-section (2) that there is under-statement of consideration in respect of the transfer and Sub-section (2) applies only where the actual consideration received by the assessee is not disclosed and the consideration declared in respect of the transfer is shown at a lesser figure than that actually received."

13. A series of decisions have made a distinction between "profit attributable to" and "profit derived from" a business. In one of the early judgments, namely, *Cambay Electric Supply Industrial Company Limited v. Commissioner of Income Tax, Gujarat II*, (1978) 2 SCC 644, this Court had to construe Section 80-E of the Income Tax Act, which referred to profits and gains attributable to the business of generation or distribution of electricity. This Court held:

"As regards the aspect emerging from the expression "attributable to" occurring in the phrase "profits and gains attributable to the business of" the specified industry (here generation and distribution of electricity) on which the learned Solicitor General relied, it will be pertinent to observe that the Legislature has deliberately used the expression "attributable to" and not the expression "derived from". It cannot be disputed that the expression "attributable to" is certainly wider in import than the expression "derived from". Had the expression "derived from" been used it could have with some force been contended that a balancing charge arising from the sale of old machinery and buildings cannot be regarded as profits and gains derived from the conduct of the business of generation and distribution of electricity. In this connection it may be pointed out that whenever the Legislature wanted to give a restricted meaning in the manner suggested by the learned Solicitor General it has used the expression "derived from", as for instance in s. 80J. In our view since the expression of wider import, namely, "attributable to" has been used, the Legislature intended to cover receipts from sources other than the actual conduct of the business of generation and distribution of electricity." (Para 8)

14. In *Commissioner Of Income Tax, Karnataka v. Sterling Foods, Mangalore*, (1999) 4 SCC 98, this Court had to decide whether income derived by the assessee by sale of import entitlements on export being made, was profit and gain derived from the respondent's industrial undertaking under Section 80HH of the Indian Income Tax Act. This Court referred to the judgment in *Cambay Electric Supply (supra)* and emphasized the difference between the wider expression "attributable to" as contrasted with "derived from". In the course of the judgment, this Court stated that the industrial undertaking itself had to be the source of the profit. The business of the industrial undertaking had directly to yield that profit. Having said this, this Court finally held:-

"We do not think that the source of the import entitlements can be said to be the industrial undertaking of the assessee. The source of the import entitlements can, in the circumstances, only be said to be the Export Promotion Scheme of the Central Govt. whereunder the export entitlements become available. There must be for the application of the words "derived from", a direct nexus between the profits and gains and the industrial undertaking. In the instant case the nexus is not direct but only incidental. The industrial undertaking exports processed sea food. By reason of such export, the Export Promotion Scheme applies. Thereunder, the assessee is entitled to import entitlements, which it can sell. The sale consideration therefrom cannot, in our view, be held to constitute a profit and gain derived from the assessee's industrial undertaking." (Para 13)

15. Similarly, in *Pandian Chemicals Limited v. Commissioner of Income Tax*, 262 ITR 278, this Court dealt with the claim for a deduction under Section 80HH of the Act. The question before the Court was as to whether interest earned on a deposit made with the Electricity Board for the supply of electricity to the appellant's industrial undertaking should be treated

as income derived from the industrial undertaking under Section 80HH. This Court held that although electricity may be required for the purposes of the industrial undertaking, the deposit required for its supply is a step removed from the business of the industrial undertaking. The derivation of profits on the deposit made with the Electricity Board could not be said to flow directly from the industrial undertaking itself. On this basis, the appeal was decided in favour of Revenue.

16. The sheet anchor of Shri Radhakrishnan's submissions is the judgment of this Court in *Liberty India v. Commissioner of Income Tax*, (2009) 9 SCC 328. This was a case referring directly to Section 80-IB in which the question was whether DEPB credit or Duty drawback receipt could be said to be in respect of profits and gains derived from an eligible business. This Court first made the distinction between "attributable to" and "derived from" stating that the latter expression is narrower in connotation as compared to the former. This court further went on to state that by using the expression "derived from" Parliament intended to cover sources not beyond the first degree. This Court went on to hold:-

"34. On an analysis of Sections 80-IA and 80-IB it becomes clear that any industrial undertaking, which becomes eligible on satisfying sub-section(2), would be entitled to deduction under sub-section (1) only to the extent of profits derived from such industrial undertaking after specified date(s). Hence, apart from eligibility, sub-section (1) purports to restrict the quantum of deduction to a specified percentage of profits. This is the importance of the words "derived from industrial undertaking" as against "profits attributable to industrial undertaking".

35. DEPB is an incentive. It is given under Duty Exemption Remission Scheme. Essentially, it is an export incentive. No doubt, the object behind DEPB is to neutralize the incidence of customs duty payment on the import content of export product. This neutralization is provided for by credit to customs duty against export product. Under DEPB, an exporter may apply for credit as percentage of FOB value of exports made in freely convertible currency. Credit is available only against the export product and at rates specified by DGFT for import of raw materials, components etc.. DEPB credit under the Scheme has to be calculated by taking into account the deemed import content of the export product as per basic customs duty and special additional duty payable on such deemed imports.

36. Therefore, in our view, DEPB/Duty Drawback are incentives which flow from the Schemes framed by Central Government or from S. 75 of the Customs Act, 1962, hence, incentives profits are not profits derived from the eligible business under Section 80-IB. They belong to the category of ancillary profits of such Undertakings." (Paras 34,35 and 36)

17. An analysis of all the aforesaid decisions cited on behalf of the Revenue becomes necessary at this stage. In the first decision, that is in *Cambay Electric Supply Industrial Company Limited v. Commissioner of Income Tax, Gujarat II*, this Court held that since an

expression of wider import had been used, namely "attributable to" instead of "derived from", the legislature intended to cover receipts from sources other than the actual conduct of the business of generation and distribution of electricity. In short, a step removed from the business of the industrial undertaking would also be subsumed within the meaning of the expression "attributable to". Since we are directly concerned with the expression "derived from", this judgment is relevant only insofar as it makes a distinction between the expression "derived from", as being something directly from, as opposed to "attributable to", which can be said to include something which is indirect as well.

18. The judgment in *Sterling Foods* lays down a very important test in order to determine whether profits and gains are derived from business or an industrial undertaking. This Court has stated that there should be a direct nexus between such profits and gains and the industrial undertaking or business. Such nexus cannot be only incidental. It therefore found, on the facts before it, that by reason of an export promotion scheme, an assessee was entitled to import entitlements which it could thereafter sell. Obviously, the sale consideration therefrom could not be said to be directly from profits and gains by the industrial undertaking but only attributable to such industrial undertaking inasmuch as such import entitlements did not relate to manufacture or sale of the products of the undertaking, but related only to an event which was post manufacture namely, export. On an application of the aforesaid test to the facts of the present case, it can be said that as all the four subsidies in the present case are revenue receipts which are reimbursed to the assessee for elements of cost relating to manufacture or sale of their products, there can certainly be said to be a direct nexus between profits and gains of the industrial undertaking or business, and reimbursement of such subsidies. However, Shri Radhakrishnan stressed the fact that the immediate source of the subsidies was the fact that the Government gave them and that, therefore, the immediate source not being from the business of the assessee, the element of directness is missing. We are afraid we cannot agree. What is to be seen for the applicability of Sections 80-IB and 80-IC is whether the profits and gains are derived from the business. So long as profits and gains emanate directly from the business itself, the fact that the immediate source of the subsidies is the Government would make no difference, as it cannot be disputed that the said subsidies are only in order to reimburse, wholly or partially, costs actually incurred by the assessee in the manufacturing and selling of its products. The "profits and gains" spoken of by Sections 80-IB and 80-IC have reference to net profit. And net profit can only be calculated by deducting from the sale price of an article all elements of cost which go into manufacturing or selling it. Thus understood, it is clear that profits and gains are derived from the business of the assessee, namely profits arrived at after deducting manufacturing cost and selling costs reimbursed to the assessee by the Government concerned.

19. Similarly, the judgment in *Pandian Chemicals Limited v. Commissioner of Income Tax* is also distinguishable, as interest on a deposit made for supply of electricity is not an element of cost at all, and this being so, is therefore a step removed from the business of the

industrial undertaking. The derivation of profits on such a deposit made with the Electricity Board could not therefore be said to flow directly from the industrial undertaking itself, unlike the facts of the present case, in which, as has been held above, all the subsidies aforementioned went towards reimbursement of actual costs of manufacture and sale of the products of the business of the assessee.

20. Liberty India being the fourth judgment in this line also does not help Revenue. What this Court was concerned with was an export incentive, which is very far removed from reimbursement of an element of cost. A DEPB drawback scheme is not related to the business of an industrial undertaking for manufacturing or selling its products. DEPB entitlement arises only when the undertaking goes on to export the said product, that is after it manufactures or produces the same. Pithily put, if there is no export, there is no DEPB entitlement, and therefore its relation to manufacture of a product and/or sale within India is not proximate or direct but is one step removed. Also, the object behind DEPB entitlement, as has been held by this Court, is to neutralize the incidence of customs duty payment on the import content of the export product which is provided for by credit to customs duty against the export product. In such a scenario, it cannot be said that such duty exemption scheme is derived from profits and gains made by the industrial undertaking or business itself.

21. The Calcutta High Court in *Merino Ply & Chemicals Ltd. v. CIT*, 209 ITR 508 [1994], held that transport subsidies were inseparably connected with the business carried on by the assessee. In that case, the Division Bench held:-

"We do not find any perversity in the Tribunal's finding that the scheme of transport subsidies is inseparably connected with the business carried on by the assessee. It is a fact that the assessee was a manufacturer of plywood, it is also a fact that the assessee has its unit in a backward area and is entitled to the benefit of the scheme. Further is the fact that transport expenditure is an incidental expenditure of the assessee's business and it is that expenditure which the subsidy recoups and that the purpose of the recoupment is to make up possible profit deficit for operating in a backward area. Therefore, it is beyond all manner of doubt that the subsidies were inseparably connected with the profitable conduct of the business and in arriving at such a decision on the facts the Tribunal committed no error."

22. However, in *CIT v. Andaman Timber Industries Ltd.*, 242 ITR 204 [2000], the same High Court arrived at an opposite conclusion in considering whether a deduction was allowable under Section 80HH of the Act in respect of transport subsidy without noticing the aforesaid earlier judgment of a Division Bench of that very court. A Division Bench of the Calcutta High Court in *C.I.T. v. Cement Manufacturing Company Limited*, by a judgment dated 15.1.2015, distinguished the judgment in *CIT v. Andaman Timber Industries Ltd.* and followed the impugned judgment of the Gauhati High Court in the present case. In a pithy discussion of the law on the subject, the Calcutta High Court held:

"Mr. Bandhyopadhyay, learned Advocate appearing for the appellant, submitted that the impugned judgment is contrary to a judgment of this Court in the case of *CIT v. Andaman Timber Industries Ltd.* reported in (2000) 242 ITR, 204 wherein this Court held that transport subsidy is not an immediate source and does not have direct nexus with the activity of an industrial undertaking. Therefore, the amount representing such subsidy cannot be treated as profit derived from the industrial undertaking. Mr. Bandhyopadhyay submitted that it is not a profit derived from the undertaking. The benefit under section 80IC could not therefore have been granted.

He also relied on a judgment of the Supreme court in the case of *Liberty India v. Commissioner of Income Tax*, reported in (2009) 317 ITR 218 (SC) wherein it was held that subsidy by way of customs duty draw back could not be treated as a profit derived from the industrial undertaking.

We have not been impressed by the submissions advanced by Mr. Bandhyopadhyay. The judgment of the Apex Court in the case of *Liberty India (supra)* was in relation to the subsidy arising out of customs draw back and duty Entitlement Pass-book Scheme (DEPB). Both the incentives considered by the Apex Court in the case of *Liberty India* could be availed after the manufacturing activity was over and exports were made. But, we are concerned in this case with the transport and interest subsidy which has a direct nexus with the manufacturing activity inasmuch as these subsidies go to reduce the cost of production. Therefore, the judgment in the case of *Liberty India v. Commissioner of Income Tax* has no manner of application. The Supreme Court in the case of *Sahney Steel and Press Works Ltd. & Others versus Commissioner of Income Tax*, reported in [1997] 228 ITR at page 257 expressed the following views:-

". . . . Similarly, subsidy on power was confined to 'power consumed for production'. In other words, if power is consumed for any other purpose like setting up the plant and machinery, the incentives will not be given. Refund of sales tax will also be in respect of taxes levied after commencement of production and up to a period of five years from the date of commencement of production. It is difficult to hold these subsidies as anything but operation subsidies. These subsidies were given to encourage setting up of industries in the State of Andhra Pradesh by making the business of production and sale of goods in the State more profitable."

23. We are of the view that the judgment in *Merino Ply & Chemicals Ltd.* and the recent judgment of the Calcutta High Court have correctly appreciated the legal position.

24. We do not find it necessary to refer in detail to any of the other judgments that have been placed before us. The judgment in *Jai Bhagwan* case (*supra*) is helpful on the nature of a transport subsidy scheme, which is described as under:

"The object of the Transport Subsidy Scheme is not augmentation of revenue, by levy and collection of tax or duty. The object of the Scheme is to improve trade and

commerce between the remote parts of the country with other parts, so as to bring about economic development of remote backward regions. This was sought to be achieved by the Scheme, by making it feasible and attractive to industrial entrepreneurs to start and run industries in remote parts, by giving them a level playing field so that they could compete with their counterparts in central (non-remote) areas.

The huge transportation cost for getting the raw materials to the industrial unit and finished goods to the existing market outside the state, was making it unviable for industries in remote parts of the country to compete with industries in central areas. Therefore, industrial units in remote areas were extended the benefit of subsidized transportation. For industrial units in Assam and other north-eastern States, the benefit was given in the form of a subsidy in respect of a percentage of the cost of transportation between a point in central area (Siliguri in West Bengal) and the actual location of the industrial unit in the remote area, so that the industry could become competitive and economically viable." (Paras 14 and 15)

25. The decision in *Sahney Steel and Press Works Ltd. v. Commissioner of Income Tax, A.P.* - I, Hyderabad (1997) 7 SCC 764, dealt with subsidy received from the State Government in the form of refund of sales tax paid on raw materials, machinery, and finished goods; subsidy on power consumed by the industry; and exemption from water rate. It was held that such subsidies were treated as assistance given for the purpose of carrying on the business of the assessee.

26. We do not find it necessary to further encumber this judgment with the judgments which Shri Ganesh cited on the netting principle. We find it unnecessary to further substantiate the reasoning in our judgment based on the said principle.

27. A Delhi High Court judgment was also cited before us being *CIT v. Dharampal Premchand Ltd.*, 317 ITR 353 from which an SLP preferred in the Supreme Court was dismissed. This judgment also concerned itself with Section 80-IB of the Act, in which it was held that refund of excise duty should not be excluded in arriving at the profit derived from business for the purpose of claiming deduction under Section 80-IB of the Act.

28. It only remains to consider one further argument by Shri Radhakrishnan. He has argued that as the subsidies that are received by the respondent, would be income from other sources referable to Section 56 of the Income Tax Act, any deduction that is to be made, can only be made from income from other sources and not from profits and gains of business, which is a separate and distinct head as recognised by Section 14 of the Income Tax Act. Shri Radhakrishnan is not correct in his submission that assistance by way of subsidies which are reimbursed on the incurring of costs relatable to a business, are under the head "income from other sources", which is a residuary head of income that can be availed only if income does not fall under any of the other four heads of income. Section 28(iii)(b) specifically states that income from cash assistance, by whatever name called, received or receivable by any person against exports under any scheme of the Government of India, will be income

chargeable to income tax under the head "profits and gains of business or profession". If cash assistance received or receivable against exports schemes are included as being income under the head "profits and gains of business or profession", it is obvious that subsidies which go to reimbursement of cost in the production of goods of a particular business would also have to be included under the head "profits and gains of business or profession", and not under the head "income from other sources".

29. For the reasons given by us, we are of the view that the Gauhati, Calcutta and Delhi High Courts have correctly construed Sections 80-IB and 80-IC. The Himachal Pradesh High Court, having wrongly interpreted the judgments in Sterling Foods and Liberty India to arrive at the opposite conclusion, is held to be wrongly decided for the reasons given by us hereinabove.

30. All the aforesaid appeals are, therefore, dismissed with no order as to costs.

■ ■

IN THE ITAT DELHI BENCH 'H'
Deputy Commissioner of Income-tax, Circle -3(2), New Delhi

v.

Vertex Customer Management Ltd.

I.C. SUDHIR, JUDICIAL MEMBER
AND PRASHANT MAHARISHI, ACCOUNTANT MEMBER

IT APPEAL NOS. 3368 & 3759 (DELHI) OF 2013
[ASSESSMENT YEAR 2004-05]

MARCH 4, 2016

Ravi Sharma, Mudit Sharma and Ms. Sarika Bansal, CA *for the Appellant.* **Smt. Anshu Prakash,** Senior DR *for the Respondent.*

ORDER

Prashant Maharishi, Accountant Member - These cross appeals are filed against the order of the learned Commissioner of Income-tax (Appeals)-XXIX, Delhi dated 28.03.2013 for the Assessment Year 2004-05.

2. The brief facts of the case is that the assessee company is incorporated in United Kingdom and is a non-resident engaged in outsourcing sales for its clients in finance, utility and public sector. The main service provided by the appellant is customer management outsourcing business, service outsourcing and transfer of technology. Vertex Customer Service India Pvt. Ltd is an Indian entity in the group which is also carrying on outsourced work from the assessee. This outsource work is in relation to contracts of the assessee with PowerGen Retail Ltd. and Last Minute Networks Ltd. The total revenue earned by Vertex India to the assessee was Pound 4735037. Over the above this sum of pound 60528/- was retained by the assessee as cost incurred by the assessee in United Kingdom and recovered from the customers. The balance amount is remitted to Vertex India. The assessee allowed Vertex India right to use certain equipment located outside India and claimed reimbursement of expenses incurred by the assessee on behalf of the Vertex India.

3. The assessee filed its return of income on 29.10.2004 and offered the sum received from Vertex India for right to use equipment outside India as royalty in accordance with Article 13.3 (b) of Indo UK DTAA. Regarding the reimbursement it was claimed that same is non-taxable as it was on cost to cost basis. The Id AO held that the assessee has PE in India and according to DTAA and business connection according to India Income Tax Act and hence computed the profit of Rs.30626180/- attributable to such PE. Regarding reimbursement of Rs.52452014/- as it has effect of reducing the service fee payable to the Indian Company

was also considered as business profits of PE in India. Further royalty was also taxed as business profit of the PE in India. The assessee being aggrieved with this carried the order before the Id CIT(A) who in turn held as under:—

- i.* Appellant has fixed place PE in India in terms of article 5(1) of the INDO UK DTAA.
- ii.* Appellant does not have a service PE in terms of article 5(2)(k) of Indo UK DTAA
- iii.* Vertex India did not constitute dependent agent PE in India as per DTAA.
- iv.* Appellant does not have a sales outlet under Article 5(2)(f) of DTAA.
- v.* Assessee has a business connection within the meaning of section 9(1)(i) of the Income Tax Act.
- vi.* No further profits cannot be attributed to the appellant PE in India and hence profits attributable to such PE are NIL.
- vii.* Royalty income already declared by the appellant in its return of income cannot be taxed as business income.
- viii.* Regarding reimbursement of expenses on account of 3rd party cost of Rs.27940955/- is not chargeable to tax in India as it is directly relatable to Vertex India demonstrated by submission of documentary evidence.
- ix.* A sum of Rs.24511059/- being cost that has been allotted to Vertex India is taken up said with certainty with this amount was on cost to cost basis or not and hence same is chargeable to tax in India as business profits of PE and has royalty not as business profits.
- x.* It was also held that interest u/s 234B of the Act cannot be charged.

4. Against the above finding revenue is in appeal raising three effective grounds:—

- (1) On the facts and in the circumstances of the case, the Ld. CIT(A) has erred in holding that though the assessee is having a P.E, in India but is not having any Service PE and dependant Agent PE in the form of M/s Vertex India thereby ignoring the findings of the A.O in the case that there is continuous relationship between the assessee and M/s Vertex Customers is concluded in India,
- (2) On the facts and in the circumstances of the case, the Ld, CIT(A) has erred in holding that no further profits can be attributed after the transfer and

pricing analysis as it had already covered analysis of functions, assets and risks in the hands of the assessee's PE.

- (3) On the facts and in the circumstances of the case, the Ltd. CIT(A) has erred in not appreciating of the facts that attribution of profit is about determining income element of the assessee out of taxable transaction between the assessee (nonresident) and Indian Parties as well as Associated Enterprises in India.

5. The assessee is also in appeal raising three effective grounds:—

1. That on the facts and circumstance of the case and in law, the Commissioner of Income Tax (Appeals) - XXIX, New Delhi ['Ld. CIT(A)'] erred in upholding the order of the assessing officer ('Ld. AO') that the Appellant has a business connection in India under section 9(1) (i) of the Act.
2. That on the facts and circumstance of the case and in law, the CIT(A) erred in upholding the order of Id. AO that the Appellant has a fixed Permanent Establishment ('PE') in India under Article 5(1) of the Double Taxation Avoidance Agreement between India and United Kingdom ('DTAA' or 'treaty').
3. That on the facts and circumstance of the case and in law, the CIT(A) erred in holding that the payments in respect of access circuits, networks, bandwidth, call charges etc aggregating to Rs.2,45,11,059 (GBP306,076) is taxable as Royalty under Article 13-3(b) of the India UK DTAA.
- 3.1 Without prejudice to the above, that on facts and circumstances of the case and in law, the CIT(A) erred in holding that the reimbursement of expenses aggregating to Rs. 2,45,11,059 (GBP 306,076) was taxable in India despite there was no income element.

6. Before us the LD AR of the appellant submitted as under :—

- (a) It was submitted that vide service agreement dated 7 C holdings Limited UK and Seven C Customers Services India Private Limited , India where the subject matter of contract is mentioned. Indian Company was providing the services as per this agreement. 7C holdings Limited and vertex India entered in to a framework Agreement on 1-6-2012 and on 2/12/2002 the Framework agreement was novated by 7 C holdings Limited to vertex. 7 C holdings Limited were acquired by vertex UK and therefore there is novation of agreement. Vertex Customers Services India was formerly 7 C Customer Services India private limited. Vertex India Limited is a joint venture between vertex UK and GE capital Equity. Therefore there is an agreement in place of the work to be carried out in India. Hence allegation that the work was performed without there being an agreement is incorrect. He submitted that

at page no 24 and 25 of the paper book which are the agreement with Power gen Limited with 7 C customer services Limited India. He also drawn the attention at page no 36 of the paper book of the agreement where in the contracts of power gen were with 7 C customer services India limited and for sub contracting only the prior written consent of the of Powergen is required so it was not mandatory that work should be performed by Indian Subsidiary only he also explained that services to be provided are classified at page no 42 of the paper book C customers Services India Limited to powergen and now being provided by vertex India. He also took us to page no 106-107 , 164 and 166 of the paper book to demonstrate that there was an agreement in place, and the Indian entity is independent entity and therefore cannot be a permanent Establishment of the assessee. He also referred to the clause of Novataion at page no 195 of the agreement. Therefore it was submitted that there is no Service PE and there in Dependent Agent PE of the assessee in India. On fixed PE he relied on the decision of Honorable supreme court of India in case of Morgan Stanley and honourable Delhi high court in case of E Funds. He referred to various para of these judgments extensively. He submitted that CIT (A) has wrongly decided that assessee has a fixed place PE in India.

- (b) On profit attribution he submitted that when the transaction is at arm's length no further profit can be attributed to the PE. He also submitted that for AY 2006-07 the TPO in his order has accepted the transaction and has not given any adverse comments and therefore there cannot be any profit attribution.
- (c) On ground no 3 of the appeal regarding he relied on the decision of 14 SOT 20 (Del) and submitted that there is no element in reimbursement of expenses and hence it cannot be charged to tax.
- (d) Regarding reimbursements he submitted that it is actual cost which has been reimbursed based on cost recovery charges mechanism and company has not added mark up to these and therefore this just like a pass through cost and therefore there is no income in that. Regarding call charges it was submitted that there are the call charges incurred by the assessee o for powergen and last minute which have been incurred by the assessee and same are recharged to vertex India on actual basis. He also referred to a declaration furnished to the CIT for this. Therefore it was submitted that it is not Royalty as per article 13.3 (b) of Indo UK DTAA.

7. LD DR submitted that AO has rightly taxed the income of the assessee holding that assessee has Fixed place PE, services PE and DAPE and therefore income is attributed correctly. He vehemently supported the orders of AO and CIT (A). Regarding business connection he submitted that Para no 8 of CIT (A) and the decision of Honorable

Jurisdictional high court in case of UAE exchange center has been relied and therefore there is a business connection in India of the assessee.

8. In rejoinder LD AR submitted that regarding service PE LD AO himself has accepted in Remand report. Regarding DAPE he submitted that power and control test is not satisfied therefore there is no DAPE. Regarding attribution he argued that CIT (A) has correctly held that when the transaction with AE are at arms' length there cannot be further attribution of profit. He submitted that in next year AO has accepted the working of the assessee and for this he submitted that for AY 2006-01017 the issue of assessee has been accepted by the TPO and consequently assessment has been framed at Nil Income. Therefore AO has accepted the contention of assessee in subsequent years.

9. We have carefully perused the relevant rival contentions and also the decisions of Honorable courts placed before us. Brief facts have already been enunciated. Now following questions arise in this appeal for our determination which takes care of all the grounds of both the appeals.

- (a) Whether assessee has a business connection in India?
- (b) Whether assessee has a Fixed PE In India?
- (c) Whether assessee has a service PE In India?
- (d) Whether assessee has a dependent agent PE in India?
- (e) Whether any further profit can be attributed to PE after transaction is determined at Arms' length.
- (f) Whether the Reimbursement of Rs Rs.2,45,11,059 (GBP 306,076) is Royalty as per Indo UK DTAA and is chargeable to tax despite there being no income element.

10. Whether assessee has 'Business Connection "in India?

As per section 9(1)(i) of the Income tax Act any income earned, whether directly or indirectly, through or from any business connection in India, would be deemed to accrue or arise in India and hence would be taxable in India. However the term "Business Connection has not been defined in the Income tax Act. Thus rightly so, the Bombay High Court in *Blue Star Engg. Co. (Bom) (P) Ltd. v CIT* [1969] 73 ITR 283 (Bom) following the principle laid down by honorable Supreme court in *CIT v R D Aggarwal & Co.* [1965] 56 ITR 20, 24 (SC) has stated that since the term Business Connection admits of no precise definition, the solution of the question must depend upon the particular facts of each case. Further, various honorable High Courts in *Bangalore Woollen Cotton & Silk Mills Co. Ltd. v. CIT* [1950] 18 ITR 423 (Mad); *CIT v Evans Medical Supplies Ltd.* [1959] 36 ITR 418 (Bom.) and *Jethabhai Javeribhai v CIT* [1951] 20 ITR 331 (Nag) have also held that there is no definition of the words 'business

Connection' and the legislature has deliberately chosen words of wide import. Further, there is no determinative form, in which a business connection exists. As has been held by the honorable Supreme Court in a landmark case of *CIT v R D Aggarwal & Co* [1965] 56 ITR 20 that "a business connection may take several forms:- it may include carrying on a part of the main business or activity incidental to the main business of the non-resident through an agent, or it may merely be a relation between the business of the non-resident and the activity in India, which facilitates or assists the carrying on of that business. Honorable Bombay High Court in *CIT v National Mutual Life Association of Australia* [1933] 1 ITR 350 held that all that is necessary for a Business Connection to exist is that there should be:

- (i) a business in India;
- (ii) a connection between non-resident person or company and that 'business'; and
- (iii) Non-resident person or company has earned an income through such connection.

There are various factors, which need to be looked in to while determining whether a business connection exists in a particular situation, or not. The landmark judgment of the Honorable Andhra Pradesh High Court In *G V K Industries Ltd. v ITO* [1997] 228 ITR 564 compiles the ratios of various other judgments and lays down the following principles of Business connection :—

- i. Whether there is a Business connection between an Indian person and a non-resident is a mixed question of fact and law which has to be determined on the facts and circumstances of each case;
- ii. The expression 'Business connection is too wide to admit of any precise definition; however it has some well known attributes;
- iii. The essence of 'Business connection' is the existence of close, real, intimate relationship and commonness of interest between the non-resident and the Indian person;
- iv. Where there is control or management or finances or substantial holding of equity shares or sharing of profits by the non-resident of the Indian person, the requirement of principle (iii) is fulfilled;
- v. To constitute 'Business Connection' there must be continuity of activity or operation of the non- resident with the Indian party and a stray or isolated transaction is not enough to establish a Business Connection.

On reading of various decisions it requires to test the Business connection Principle with respect to Continuity, real and intimate connection, Attribution of income and Common Control and professional connection. The connection of the assessee with the Indian entity is continuous in order to have a business connection; there must be a real and intimate

connection between the activity carried on by the non-resident outside India and the activity carried out in India. Further, such activity must be one, which contributes to the earnings of profits by the non-resident in his business. It is also a settled principle that to conform with the requirements of the expression "Business Connection" it is necessary that a common thread of mutual interest must run through the fabric of the trading activity carried on outside and inside India and the same can be described as real and intimate connection. The commonness of interest may be by way of management control or financial control or by way of sharing of profits. It may come into existence in some other manner but there must be something more than mere transaction of purchase and sale between 'principal to principal' in order to bring the transaction within the purview of business connection. Further Where the Indian entity and the non-resident entity are both held by the same person, or have common control, then the non-resident would be regarded as having a business connection in India. In this case assessee company secures orders on behalf of the Indian company and outsources the job to Indian company. There is a continuous relationship between the assessee company and its affiliates and subsidiary company in India. The contract entered by the assessee company and its affiliates outside India are carried out in India. The responsibility of the assessee company vis a vis its customer is concluded in India. The responsibility of the assessee company cannot be segregated and will not complete unless the Indian company provides services to the customers. Based on these facts Ld CIT (A) has held that appellant has continuous revenue generating business activities with Vertex India and there is real and intimate relationship between activities of non-resident outside India and those inside India. In view of this we are of the view that the assessee has a business connection in India u/s 9 (1) (i) of the Act. On this score we confirm the order of CIT (A).

11. *Whether the assessee has a Fixed Place PE In India?*

Regarding Fixed place Permanent establishment of the assessee CIT (A) has dealt with this issue as under:—

"8.2 Fixed Place PE -

8.2.1 The appellant's main contention is that it has no physical presence in India and therefore there cannot be fixed place PE under Article 5(1) of DTAA. However, the Ld. AO has held that Vertex India is at the disposal of appellant and his reasoning is summarized here:

The contracts between Vertex India and the Appellant were entered retrospectively;

One of the contracts entered between the Appellant and its customer Powergen in UK in May 2001 specifically mentioned that the services will be provided from India; whereas the actual sub-contracting agreement between Appellant and the Indian Company (Vertex India) was entered in June 2002,

which is subsequent to the contract entered with Powergen.

8.2.2 The provisions contained in Article 5(1) of Indo-UK treaty are reproduced as below;

1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

The requirement of above mentioned article is that there should be a fixed place of business through which business is carried on wholly or partly. It is a settled proposition that the fixed place may not belong to the non-resident appellant. It will suffice if the fixed place is at disposal of the non-resident for carrying out its business wholly or partly through it. In present case, the appellant had entered into service contract with Powergen and Lastminute, its overseas customers. As per clause 20.2 of contract dated 10.05.2002 with Powergen, the appellant could sub-contract whole or part of the services only to its subsidiary in India. Accordingly, these contracts were sub-contracted to a subsidiary namely Vertex India. It is important to note that Vertex India started providing services in accordance with contract of the appellant with its overseas customers much before when services were sub-contracted to it retrospectively. It can be inferred that appellant and its overseas customers were in agreement that services shall be provided to overseas customers from subsidiary company based in India. Now, Vertex India is not doing anything else other than providing services to overseas customers of the appellant. The appellant is practically not doing anything with reference to its contracts with its overseas customers except that according to clause 20.2(ii) of the agreement dated 10.05.2002, it shall be responsible for acts, omissions, defaults or negligence of its sub-contractor. It means that the appellant assumes all the major risks whereas Vertex India is virtually a risk free enterprise. Therefore, in substance, the subsidiary Vertex India is operating as if it were a branch of the nonresident appellant. Vertex India is virtual projection of the appellant in India inspite of its having an independent legal status. In view of the above, it can be said that the premises of Vertex India were at the disposal of VCM. The business of the appellant is being carried on almost wholly through fixed place in India represented by Vertex India. In view of these facts, I am in agreement with the findings of the Ld. AO that the appellant has a fixed place PE in India within meaning of Article 5(1) of relevant DTAA."

We have carefully considered this issue of Fixed Place PE of the assessee in India. For establishing the Fixed Place PE test the following conditions should be satisfied cumulatively:—

- (a) There is a place of business (Place of Business Test)
- (b) Such Place of business is at the disposal of the assessee. (Disposal Test)

- (c) Such place of business is fixed (permanence Test)
- (d) The business of the entity is carried on wholly or partly through such fixed place of business. (Activity Test)

In the case of the assessee place of business test is satisfied as vertex India is the place of business. Whether that premises is at the disposal of the assessee or not. This is an important parameter to bear in mind is to constitute a PE that the fixed place of business must be at the disposal of the enterprise. It is not necessary that the premises need to be owned or even rented by the enterprise. All that is required is that the premises should be at the disposal of the enterprise. In this case it is not established that premises are made available to a foreign enterprise for the purposes of carrying out particular work on behalf of the owner of the premises; in that situation, the space provided is not at the disposal of the enterprise since it has no right to occupy the premises but is merely given access for the purposes of the work and hence disposal test is not satisfied in this case. Further nature of services provided by the assessee is BPO services and back office operations. Honorable supreme court in case of *DIT v. Morgan Stanley & co Inc.* 292 ITR 416 (SC) in case of whether back office services constitute permanent Establishment or not under article 5(1) of The DTAA has held as under

"Existence of P.E. in India

6. With globalization, many economic activities spread over to several tax jurisdiction. This is where the concept of P.E. becomes important under article 5(1). There exists a P.E. if there is a fixed place through which the business of an enterprise, which is a multi-national enterprise (MNE), is wholly or partly carried on. In the present case MSCo is a multi-national entity. As stated above it has outsourced some of its activities to MSAS in India. A general definition of the P.E. in the first part of article 5(1) postulates the existence of a fixed place of business whereas the second part of article 5(1) postulates that the business of the MNE is carried out in India through such fixed place. One of the questions which we are called upon to decide is whether the activities to be undertaken by MSAS consist of back office operations of the MSCo and if so whether such operations would fall within the ambit of the expression "the place through which the business of an enterprise is wholly or partly carried out" in article 5(1).

7. We quote herein below articles 5 and 7 of the DTAA* :

"Article 5

Permanent establishment

1. For the purposes of this Convention, the term 'permanent establishment' means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term 'permanent establishment' includes especially :

- (a) a place of management ;
- (b) a branch ;
- (c) an office ;
- (d) a factory ;
- (e) a workshop ;
- (f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources ;
- (g) a warehouse, in relation to a person providing storage facilities for others ;
- (h) a farm, plantation or other place where agriculture, forestry, plantation or related activities are carried on ;
- (i) a store or premises used as a sales outlet ;
- (j) an installation or structure used for the exploration or exploitation of natural resources, but only if so used for a period of more than 120 days in any twelve month period ;
- (k) a building site or construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or activities (together with other such sites, projects or activities, if any) continue for a period of more than 120 days in any twelve month period ;
- (l) the furnishing of services, other than included services as defined in article 12 (royalties and fees for included services), within Contracting State by an enterprise through employees or other personnel, but only if ;
 - (i) activities of that nature continue within that State for a period or periods aggregating more than 90 days within any twelve month period ; or
 - (ii) the services are performed within that State for a related enterprise (within the meaning of paragraph 1 of article 9 (associated enterprise)).

3. Notwithstanding the preceding provisions of this article, the term 'permanent establishment' shall be deemed not to include any one or more of the following :

- (a) the use of facilities solely for the purpose of storage, display, or occasional delivery of goods or merchandise belonging to the enterprise ;
- (b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display, or occasional delivery ;
- (c) the maintenance of a stock of goods, or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise ;
- (d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise ;
- (e) the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research or for other activities which have preparatory or auxiliary character, for the enterprise.

4. Notwithstanding the provisions of paragraphs 1 and 2, where a person—other than an agent of an independent status to whom paragraph 5 applies—is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned State if :

- (a) he has and habitually exercises in that first-mentioned State an authority to conclude contracts on behalf of the enterprise, unless his activities are limited to those mentioned in paragraph 3 which, if exercised through a fixed place of business, would not make that fixed place of business a permanent establishment under the provisions of that paragraph ;
- (b) he has no such authority but habitually maintains in the first mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise, and some additional activities conducted in that State on behalf of the enterprise have contributed to the sale of the goods or merchandise ; or
- (c) he habitually secures orders in the first-mentioned State, wholly or almost wholly for the enterprise.

5. An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent, or any other agent of an

independent status, provided that such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise and the transactions between the agent and the enterprise are not made under arm's length conditions, he shall not be considered an agent of independent status within the meaning of this paragraph.

6. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other . . .

Article 7

Business profits

1. The profits of an enterprise of a Contracting State shall be tax able only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to (a) that permanent establishment ; (b) sales in the other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment ; or (c) other business activities carried on in the other State of the same or similar kind as those effected through that permanent establishment.
2. Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly at arm's length with the enterprise of which it is a permanent establishment and other enterprises controlling, controlled by or subject to the same common control as that enterprise, in any case where the correct amount of profits attributable to a permanent establishment is incapable of determination or the determination thereof presents exceptional difficulties, the profits attributable to the permanent establishment may be estimated on a reasonable basis. The estimate adopted shall, however, be such that the result shall be in accordance with the principles contained in this article.
3. In the determination of the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the business of the permanent establishment, including a reasonable

allocation of executive and general administrative expenses, research and development expenses, interest, and other expenses incurred for the purposes of the enterprise as a whole (or the part thereof which includes the permanent establishment), whether incurred in the State in which the permanent establishment is situated or elsewhere, in accordance with the provisions of and subject to the limitations of the taxation laws of that State. However, no such deduction shall be allowed in respect of amounts, if any, paid (otherwise than towards reimbursement of actual expenses) by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents, know-how or other rights, or by way of commission or other charges for specific services performed or for management, or, except in the case of banking enterprises, by way of interest on moneys lent to the permanent establishment. Likewise, no account shall be taken, in the determination of the profits of a permanent establishment, for amounts charged (otherwise than toward reimbursement of actual expenses), by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents, know-how or other rights, or by way of commission or other charges for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the head office of the enterprise or any of its other offices.

4. No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.
5. For the purposes of this Convention, the profits to be attributed to the permanent establishment as provided in paragraph 1(a) of this article shall include only the profits derived from the assets and activities of the permanent establishment and shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.
6. Where profits include items of income which are dealt with separately in other articles of the Convention, then the provisions of those articles shall not be affected by the provisions of this article.
7. For the purposes of the Convention, the term 'business profits' means income derived from any trade or business including income from the furnishing of services other than included services as defined in article 12 (royalties and fees for included services) and including income from the rental of tangible personal property other than property described in paragraph 3 (b) of article 12 (royalties and fees for included services)."

8. In our view, the second requirement of article 5(1) of the DTAA is not satisfied as regards back office functions. We have examined the terms of the agreement along with the advance ruling application made by MSCo inviting the AAR to give its ruling. It is clear from a reading of the above agreement/application that MSAS in India would be engaged in supporting the front office functions of MSCo in fixed income and equity research and in providing IT enabled services such as data processing support centre and technical services as also reconciliation of accounts. In order to decide whether a P.E. stood constituted one has to undertake what is called a functional and factual analysis of each of the activities to be undertaken by an establishment. It is from that point of view, we are in agreement with the ruling of the AAR that in the present case article 5(1) is not applicable as the said MSAS would be performing in India only back office operations. Therefore to the extent of the above back office functions the second part of article 5(1) is not attracted."

Hence in view of the above and relying on the decision of Honourable supreme court in case of *DIT v. Morgan Stanley inc CO (supra)* we do not have any difficulty in holding that there is no Fixed Place PE in India of the assessee. To this extent we reverse the order of CIT (A).

12. Whether assessee has a service PE in India?

Ld CIT (A) has given its finding holding that the assessee does not have a service PE In India as under

"8.3 Service PE

The Ld. AO has held that the expatriate employees of the Appellant were providing services other than fees for technical services in India and therefore, the Appellant was held to be Service PE in India in terms of Article 5(2)(k) of the India-UK DTAA. However, the Ld. AO has not furnished any material on record to prove the same. On the contrary, the Appellant has submitted that no employees of the Appellant visited India and therefore, the Service PE clause does not apply. In the remand report sought from the Ld. AO, he has himself admitted that if the Appellant has not sent any employees to India then, it cannot be said to constitute a Service PE in India. In view of the above, I am of the view that the Appellant does not have a Service PE "under Article 5(2) (k) of the DTAA."

When in the remand report revenue has accepted that in absence of the employees of the assessee visited India for the work then there cannot be service PE In India. In the remand proceedings also no evidences were produced to this effect by Id. AO. Further in appeal before us only issue of continuous relationship is taken up. We are afraid that cannot be a ground of holding that there is a 'service PE' of the assessee company. In view of this we confirm the finding of CIT (A) on this issue.

13. Whether assessee has a dependent agent PE (DAPE) in India?

Ld. CIT (A) has dealt with this issue as under :-

"8.4 Dependent Agent PE

8.4.1 Regarding the constitution of dependent agent of PE (DAPE) of the Appellant in India, I am unable to agree with in the findings of the AO in this regard. In this case, none of three conditions in paragraph 4 of article 5 of India-UK DTAA is satisfied. Paragraph 4 and paragraph 5 of Article 5 of the treaty are reproduced below:

"4. A person acting in a Contracting State for or on behalf of an enterprise of the other contracting State - other than an agent of an independent status to whom paragraph (5) of this Article applies, shall be deemed to be a permanent establishment of that enterprise in the first mentioned State if:

- (a) he has, and habitually exercises in that State, an authority to negotiate and enter into contracts for or on behalf of the enterprise, unless his activities are limited to the purchase of goods or merchandise for the enterprise; or
- (b) he habitually maintains in the first-mentioned Contracting State a stock of goods or merchandise from which he regularly delivers goods or merchandise for or on behalf of the enterprise; or
- (c) he habitually secures orders in the first-mentioned State, wholly or almost wholly for the enterprise itself or for the enterprise and the enterprises controlling, controlled by, or subject to the same common control, as that enterprise.

5. An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of an independent status, where such persons are acting in the ordinary course of their business. However, if the activities of such an agent are carried out wholly or almost wholly for the enterprise (or for the enterprise and other enterprises which are controlled by it or have a controlling interest in it or are subject to same common control) he shall not be considered to be an agent of an independent status for the purposes of this paragraph."

8.4.2 Paragraph 5 of Article 5 of the treaty is not to be read alone but in conjunction with paragraph 4. Paragraph 5 is in the nature of proviso to paragraph 4. In other words, if the conditions provided in paragraph 4 are not met, then paragraph 5 is of no relevance even if the conditions provided in paragraph 5 are satisfied. The moment an enterprise is out of scope paragraph 4, it cannot constitute a DAPE. The AAR in the case of TVM Ltd. (237 ITR 230) has held that merely because the agent is not independent

would not automatically create an agency PE. The agent should be able to exercise the authority to conclude contracts.

8.4.3 The AO has held that the Appellant constitutes a dependent agent PE as per Article 5(4)(a) and 5(4)(c) of the DTAA. In this regard, he has alleged that the Indian and UK employees co-ordinate with each other for business development as well as marketing. They also secure orders for its parent company either in India or abroad. The AO has also stated in his order that they negotiate with customers and secures contract for Vertex and its affiliates. Though the AO has made all these allegations, no material has been brought on record in this regard. All these allegations were denied by the Appellant in his detailed submission; whereas the AO in his remand report has simply contended that the Appellant is not an agent of independent status. Therefore, in view of the business model of the Appellant and in the absence of material to suggest that the conditions mentioned in Article 5(4) are satisfied, I am of the view that Vertex India did not constitute a dependent agent PE of the Appellant in India.

We have carefully considered the issue of DAPE in case of the assessee. Paragraphs 4 and 5 of Article 5 of DTAA relate to creation of agency PE in the second contracting country. Agency replaces fixed place with personal connection. Transactions between a foreign enterprise and an independent agent do not result in establishment of a Permanent establishment under Article 5 if the independent agent is acting in ordinary course of their business. The expression 'ordinary course of their businesses' has reference to activity of the agent tested by reference to normal customs in the case in issue. It has reference to normal practice in the line of business in question. However as per paragraph 5 of Article 5, an agent is not considered to be an independent agent if his activities are wholly or mostly wholly on behalf of foreign enterprise and the transactions between the two are not made under arm's length conditions. The twin conditions have to be satisfied to deny an agent character of an independent agent. In case the transactions between an agent and the foreign principal are under arm's length conditions the second stipulation in paragraph 5 of Article 5 would not be satisfied, even if the said agent is devoted wholly or almost wholly to the foreign enterprise. Further in absence of any evidence brought on record to establish DAPE in the case of the assessee we confirm the finding of CIT (A) holding that assessee does not have Dependent Agent permanent Establishment in India.

14. Whether any further profit can be attributed to PE after transaction is determined at Arms' length. Though we have already held that there is no permanent establishments of the assessee in India and therefore the business income is not chargeable to tax in India. Despite the above we concur with the views of Ld CIT (A) who has decided this issue as under :-

"11.1 After having held that the appellant has PE in India, the AO has computed profit attributable to PE by resorting to Rule 10. During appellate proceeding, the appellant

filed a copy of TP study in respect of alleged PE in support of its contention that such PE has already been compensated at arm's length price and therefore nothing more should be attributed to it. Since this TP study report was new evidence, it was sent to AO for his remand report u/r 46A. The remand report has been received vide letter dated 23.08.2012. The appellant has also filed its rejoinder vide letter dated 10.10.2012. In his remand report, the AO has stated that TP study report was not furnished at time of assessment despite opportunities given to the appellant I have gone through the record and find that in letters dated December 21, 2006 and December 22, 2006, the Appellant had requested the AO that in case he was of the view that the Appellant has a PE in India and wanted to attribute further profits to the PE, then, the Appellant should be provided with an opportunity to explain his case. However, no such opportunity was granted by the AO or any show cause notice issued under section 92C(3) of the Act. Therefore, as far as TP study report is concerned, the appellant was prevented by sufficient cause for not producing it before AO during assessment stage. Given this, I admit the additional evidence under Rule 46A in the interest of justice as it is cardinal principle of International taxation law that profit attributable to PE has to be computed on separate entity basis following arm's length principle.

11.2 I have considered the observations of the Ld. AO contained in the assessment order, the submissions of the appellant and also the remand report of the Ld. AO. I am in agreement with the Appellant that to the extent of functions, assets and risks already captured in the transfer pricing analysis of the Indian associated enterprise, i.e. Vertex India, no further profit can be attributed to such functions, assets and risks in the hands of the Appellant's PE. The Appellant's PE can be taxed only in respect of functions, assets and risks which have not already been captured in the hands of Vertex India. In the facts of Appellant's case, the AO has alleged Vertex India or activities undertaken by Vertex India to be the PE of Appellant in India. The AO has not established that there were any functions, assets or risks other than activities of Vertex India that constitute PE of appellant in India. Hence, no further profits can be attributed in the hands of Appellant's PE in India otherwise it will lead to double taxation of income pertaining to same functions, assets and risks once in the hands of the Indian associated enterprise and again in the hands of the Appellant's PE. This is also in line with the judgment of Supreme Court in the case of Morgan Stanley. It is pertinent to mention that in the Appellant's own case in AY 2006-07, on the basis of TP study of PE, the TPO has held that no further attribution is required in Appellant's hands.

11.3 It is also pertinent to mention that in connection with the work outsourced to Vertex India by the Appellant, the entire amount of revenue was passed on to Vertex India by the Appellant, other than £ 60,5 1 8 which was towards pass through telephony costs incurred by the Appellant in UK and recovered from the end-customer.

It means that the appellant has retained only a portion of the contract revenue which pertains to functions performed by it outside India.

11.4 The Appellant has pointed 2 errors in the computation made by the AO out of which one of them has been rectified by the AO himself in the subsequent year in the assessment of the Appellant's affiliate. Rectifying both or even one of them related to leasehold improvements as done by AO, the computation results into a loss and therefore nothing is left to be attributed.

11.5 In view of the totality of facts of the present case, I hold that no further profits can be attributed to the Appellant's PE in India i.e. profits attributable to PE are Nil. The ground of appeal is decided in favour of the appellant."

In view of this even if assumed that there is a PE in India of the assessee no profit can be attributed to it as FAR (Functions performed, Assets deployed and Risk Assumed) such PE has already been compensated at arm's length price and therefore nothing more should be attributed to it. Furthermore when in the case of Assessee for AY 2006-07 Ld AO has made no addition and assessment is made at returned income it is apparent that the contention the assessee is accepted by the AO in subsequent year. In view of this we confirm the order of CIT (A) on this count that if there is a PE in India of the assessee, when PE is remunerated at arm's length no further attribution of profit can be made.

15. Whether the reimbursement of Rs Rs.2,45,11,059 (GBP 306,076) is Royalty as per Indo UK DTAA and is chargeable to tax despite there being no income element.

Facts of the case is that assessee has claimed reimbursement of expenses from the Indian company of Rs.5,24,52,0147- in the return of income the same was claimed as exempt from taxation on the ground that the reimbursement of expenses is not subject to tax in India in accordance with the provision of DTAA. Ld AO asked to explain the details of reimbursement of expenses and the nature of services provided for against these reimbursement. In reply the AR of the assessee submitted that the reimbursement of GBP 654982 represents the amount spent by company to facilitate Vertex India in delivering its services to the customer in UK including support in treasury, taxation, finance, etc. AO was of the view that it is responsibility of the Indian company to render services to the customer on the behalf of the assessee company therefore the disbursement of above expenses on behalf of Indian Co. does not arise. According to him even otherwise this is taxable as business income pertaining to Indian operation as the reimbursement of expenses has an effect of reducing the service fee payable to the Indian company. As on the basis of assets employed and salary and wages paid, the service fee payable to the Indian company comes out to be 78151587- and service fee actually paid was 7170443/-. Therefore if the reimbursement of expenses is reduced from the services fee actually received by the Indian company, then profit from Indian operation will enhance from the same value i.e. the reimbursement of expenses paid by Indian company to other. In the same logic the royalty and fee for technical services received by the assessee company and its affiliates will have effect of

reducing the fee actually paid to Indian company. Therefore without prejudice to the assessee's disclosure, the receipt as royalty and fee for technical services, the same is taxable as business profit. Therefore the profit margin of assessee company and its affiliate for Indian operations will further enhance by reimbursement of expenses and royalty and FTS paid by Indian co.. On appeal before CIT (A) he held that:-

"17.1 I have considered the observations of the Ld. AO contained in the assessment order and the submissions of the appellant. The appellant has put forward three contentions 1) that the reimbursements were on cost to cost basis and hence there is no income, 2) the said amount does not qualify as FTS under the DTAA, and 3) the said amounts are not effectively connected with the PE.

17.2 It has been stated that out of the total reimbursement of £ 654,982 (Rs. 52,452,014), amount aggregating to £ 348,906 (Rs. 27,940,955) pertains to third party costs directly relatable to Vertex India and the balance of £ 306,076 (Rs.24,511,059) pertains to costs that have been allocated to Vertex India, In this regard, the appellant has submitted a declaration along with copy of documentary evidence in the form of invoices. The argument of the appellant that there was no element of income in the entire amount of reimbursements cannot be accepted as it cannot be said with certainty that whether the amount of £ 306,076 allocated by the Appellant was on cost to cost basis or not. However, for the third party costs of £ 348,906 directly relatable to Vertex India which has been demonstrated in the form of documentary evidence also, the argument of the appellant is accepted.

17.3 The next question is whether the amount of £ 306,076 is taxable in India as Royalty/FTS or Business Profits attributable to PE. It is clear that the said amount is not effectively connected to the PE and hence cannot be taxed as Business Profits. Even otherwise, it has already been concluded above that no further profits can be attributed to the PE in the facts of present case. Hence, the only question remains whether the said amount is Royalty or FTS in nature.

17.4 The amount off 306,076 (Rs. 24,511,059) pertains to access circuits, network bandwidth etc. I am of the view that these are similar to the amount shown as Royalty in the return by the appellant himself. These amounts also pertain to use of equipment outside India and constitute Royalty as defined under Article 13.3(b) of India- UK DTAA. The appellant has not put forward any cogent objections to this proposition. Accordingly, AO is directed to treat Rs, 24,511,059 as royalty subject to taxation on gross basis under provisions of DTAA. The appellant shall get relief in respect of remaining amount of Rs. 27,940,955."

Further reliance by assessee on the decision of 14 SOT 204 (Del) in case of *ACIT v. Modicon network private limited* cannot be accepted in view of the finding of facts by CIT (A) that there was no element of income in the entire amount of reimbursements cannot be accepted as it cannot be said with certainty that whether the amount of £

306,076 allocated by the Appellant was on cost to cost basis or not. We have carefully considered above issues and we do not find any infirmity in the order of Ld CIT (A).

16. Based on above

- a.* we dismiss all the grounds of the appeal of the revenue holding that there is no permanent establishment of the assessee which can be classified as service PE or dependent Agent PE and in any case no further profit can be attributed to a PE , if any, if the transaction is determined at Arm's length. We confirm the order of CIT (A). Therefore Appeal no 3759/Del/2013 is dismissed.
- b.* In ITA NO 3368/Del/2013
 - i.* We dismiss ground no 1 of the appeal of the assessee holding that there is business connection of the assessee in India u/s 9 (1) (i) of the Income Tax Act.
 - ii.* We allow ground no 2 of the appeal of the assessee holding that there is fixed place PE of the assessee in India under Article 5 (1) of the Indo U K DTAA.
 - iii.* We dismiss ground no 3 and 3.1 of the appeal of the assessee holding that the payment in respect of access circuit , networks, bandwidth and call charges amounting to Rs. 24511059/- is taxable as royalty as per Article 13.3(b) of the Indo UK DTAA.

In the result Appeal no 3368/del/2013 of assessee is partly allowed.

■ ■

IN THE ITAT DELHI BENCH 'H'
Krishak Bharati Cooperative Ltd.

v.

Assistant Commissioner of Income-tax, Circle -30(1), New Delhi

H.S. SIDHU, JUDICIAL MEMBER
AND O.P. KANT, ACCOUNTANT MEMBER

IT APPEAL NOS. 6785 & 6786 (DELHI) OF 2015
[ASSESSMENT YEARS 2010-11 & 2011-12]

MARCH 9, 2016

Vijay Ranjan, Adv. Vartik Choksi and K.V.R. Krishna, CA *for the Appellant.* **Amit Mohan Govil** *for the Respondent.*

ORDER

H.S. Sidhu, Judicial Member - These two appeals filed by the Assessee are directed against the Order dated 02.11.2015 & 29.10.2015 respectively passed by the Ld. Principal Commissioner of Income Tax, Delhi-10, New Delhi u/s 263 of the Income Tax Act, 1961 relevant for the assessment years 2010-2011 & 2011-12. Since the issues involved in these appeals are common and identical, therefore, these appeals were heard together and are being disposed of by this common order for the sake of convenience, by dealing with ITA No. 6785/Del/2015 (AY 2010-11).

2. The Assessee has raised as many as 14 grounds of appeal. However, the effective grounds in both the appeals which require to be adjudicated are as under:—

- "(i) The impugned order passed u/s 263 of the I.T. Act is bad in law, being without jurisdiction for the following reasons:—
 - (a) While the show cause notice referred to only one issue, the final order passed by the learned PCIT is on three issues and thus the appellant-society was denied opportunity which is against the well established principles of natural justice and which vitiates the entire proceedings u/s 263.
 - (b) At the time of original assessment, there was full application of mind on the part of the Assessing on the same issue with regard to which the show cause notice was issued by the learned PCIT.
 - (c) After full application of mind and after considering the material on record and the replies filed by the appellant-society, the Assessing Officer has taken a view at the

time of original assessment which is a plausible view and under section 263 the learned PCIT cannot substitute his view for the view adopted by the Assessing Officer.

- (d) The order passed by the learned PCIT is violative of the well established principles of consistency of approach.
- (ii) On merits also the directions issued by the learned PCIT are totally unjustified."

3. The brief facts of the case are that the assessee is a co-operative society registered in India under the provisions of Multi-State Co-operative Societies Act, 2002, under the administrative control of the Department of Fertilizers, Ministry of Agriculture and Co-operation, Government of India. The principal business of the Assessee is manufacture of fertilizers like urea and ammonia. The Assessee entered into a joint venture with Oman Oil Company to form Oman Fertilizer Company SAOC (OMIFCO), which is a registered company in Oman under the Omani Laws. The Assessee holds 25% share in OMIFCO, which is engaged in manufacturing fertilizers. The fertilizers manufactured by OMIFCO are purchased by the Government of India under a long term agreement.

3.1 The Assessee has established a branch office in Oman to oversee its investment in OMIFCO. The branch office is independently registered as a company under the Omani laws and it is an accepted position by the Income Tax Department that the said branch office constitutes Permanent Establishment (PE) in Oman in terms of Article - 25 of Double Taxation Avoidance Agreement (DTAA) between India and Oman. The said branch office maintains its own Books of Account and files, Returns of Income as per the local income tax law of Oman.

3.2 The Return of Income was filed on 24.09.2010. Later on the case was selected for scrutiny and notices under Section 143(2) and 142(1) of the I.T. Act were issued along with detailed questionnaires. During the course of the Assessment Proceedings, detailed replies were filed on behalf of the Assessee. The Authorized Representative of the Assessee duly attended before the Assessing Officer and, as mentioned in the Assessment Order, all the necessary details were furnished, examined and the case was discussed. Thereafter, the assessment was completed under Section 143(3) vide order dated 27.02.2014 by the Assessing Officer. While completing the assessment, inter alia, the Assessing Officer allowed tax credit of a sum of Rs. 41.53 crores in respect of the dividend income of Rs. 134.41 crores received by the Assessee from OMIFCO. The said dividend Income was simultaneously brought to the charge of tax in the assessment as per the Indian Tax Laws. As per the Omani Tax Laws, exemption was granted to dividend income by virtue of the amendments made in the Omani Tax Laws with effect from the year 2000. However, by virtue of the provisions of Article -25 of DTAA referred to above, the Assessing Officer allowed credit for the aforesaid tax which would have been payable in Oman but for the exemption granted.

3.3 After the completion of the assessment, the Ld. Principal Commissioner of Income Tax (hereinafter referred as "Ld. PCIT"), issued a Show Cause Notice dated 28.09.2015 under Section 263 of the I.T. Act, 1961. The ground on the basis of which the said notice was issued is reproduced below for ready reference from the notice itself:

"A perusal of the records indicates that in the computation of income filed by the Assessee, dividend income received from OMIFCO, Oman, of Rs.143,83,99,800 was included in the total income of the Assessee. Thereafter, tax credit of Rs. 41,44,23,149 was claimed as relief u/s 90 of the Income Tax Act, 1961 read with Article 11, 7 and 25 of the India-Oman DTAA. This claim of tax credit was allowed by the Assessing Officer during the Assessment Proceedings.

Dividend income received in Oman is exempt from taxation in as per Article 8 (bis) of the Oman Company Income Tax Law, which is reproduced below:

"Tax shall not apply on dividends that the company earns from its ownership of shares in the capital of any other company.

Therefore, no tax was payable by KRIBHCO on the dividend receipts of Rs.143,83,99,800 in Oman. The DTAA between India and Oman allows tax credit in India for the taxes payable in Oman. Even though no taxes were actually paid on the dividend income from OMIFCO, the Assessee has claimed tax credit by relying on Article 25(4) of the India-Oman DTAA, which states —

"25(4) The tax payable in a Contracting State mentioned in paragraph 2 and paragraph 3 of this Article shall be deemed to include the tax which would have been payable but for the tax incentives granted under the laws of the Contracting State and which are designed to promote economic development."

Article 25(4) requires that in order to claim credit, tax should have been payable in Oman if not for the tax incentives granted in Oman,. since Article 8(bis) exempts dividend income received in Oman in totality, no tax was payable in Oman at all at any stage and thus no tax was foregone on account of tax incentives by Oman.

Article 3(2) of the India-Oman DTAA provides that if a term used in the agreement is not defined then the term will have the meaning which it has under the Law of that Contracting State concerning the taxes to which this Agreement applies (i.e. India). The term 'tax incentive' has not been defined in the India Oman DTAA. The meaning must, therefore, be inferred from Indian Law. The term tax incentive is not defined in the Income Tax Act, 1961. The tax incentive refers to income which would otherwise be taxable but has not been taxed with a view to promote economic activity in certain sectors or in the economy as a whole. Any income which is not taxed at all as per the tax laws cannot be construed as an incentive. The Omani Companies Income Tax Law vide Article 8(bis) exempts dividend income from taxation in Oman. this cannot be interpreted as an incentive as it exists across the board with no exceptions in Oman. It

is simply a feature of Oman's Tax Law that does not tax dividend income. Hence, it cannot be construed as an incentive granted under Oman's tax laws.

Consequently, reliance on Article 25(4) of the India Oman DTAA was erroneous in this case and no tax credit was due to the Assessee under Section 90 of the IT Act. The Assessment Order passed, accepting the contentions of the Assessee and allowing tax credit is erroneous as well as prejudicial to the interest of the Revenue. You are, therefore, in terms of provisions of sub-section (1) of Section 263 hereby given an opportunity to furnish justification as to why the tax credit of Rs. 41,44,23,149 should not be withdrawn for A.Y. 2010-11."

4. In response to the aforesaid Show Cause Notice, the Assessee has filed a detailed reply dated 13.10.2015 by raising the following contentions:—

- (i) Issue of notice under Section 263 is illegal and ab initio void for the reason that on the very specific issue relating to allowing tax credit for the deemed tax paid on dividend income in Oman, was allowed at the time of original assessment. after raising detailed enquiries and after considering the detailed reply filed before the Assessing Officer. It was pointed out that in the query letter issued under Section 142(1) of the I.T. Act, 1961 during the course of Assessment Proceedings, specific query was raised calling upon the Assessee to give a detailed note on the tax credit claimed by the Society in respect of dividend income received from OMIFCO. The Assessee filed a letter dated 11.12.2013 wherein he filed it filed the complete details to the Assessing Officer and the entire factual and legal position was explained with reference to the provisions of Section 90 of the IT Act, 1961 read with Article - 25(4) of the DTAA. On this basis it was pointed out to the Ld. PCIT that after thoroughly examining the issue the Assessing Officer has taken a view which was a plausible or possible view and, therefore, the Ld. PCIT is debarred from substituting his own view in place of the views correctly adopted by the Assessing Officer. Several decisions were also cited in support of this contention.
- (ii) On the merits of allowing credit of the deemed tax also, detailed submissions were made. The provisions of DTAA read with the relevant provisions of Omani Tax Laws, as clarified by the Ministry of Finance, Secretary General for Taxation, Muscat, Sultanate of Oman, were also referred to and copies of all relevant documents were filed before the Assessing Officer. It was contended in this reply that the tax credit has been allowed by the Assessing Officer after duly considering the merits of the claim made by the Assessee.

5. The Ld. PCIT vide his impugned order passed under Section 263 of the I.T. Act, 1961, has rejected the various submissions made before him. The Ld. PCIT, at the very outset of his order, has reproduced Article - 25 of DTAA which lays down that, Tax payable in a

'Contracting State' shall be deemed to include the tax which would have been payable but for the tax incentive granted under the Law of the Contracting State and which are designed to promote economic development". The Ld. PCIT observed that Article (115) of the Omani Tax Laws exempts from tax dividends received by the establishment, Omani Oil Company or Permanent Establishment from shares, allotments or shareholding it owns in the capital of any Omani Company. He has further observed that Article (116) specifically exempts various business activities from the charge of Omani tax. The Ld. PCIT has opined that under the Omani 'Tax Laws dividend is absolutely exempt and is not includible in the total income and, therefore, it cannot be said that any specific exemption was granted for the purpose of tax incentives for economic development. Regarding the contention of the Assessee that the Ld. PCIT has no jurisdiction under Section 263 of the I.T. Act, 1961, the Ld. PCIT has observed as under in his order passed under Section 263:

"The main point made by the Assessee with regard to non maintainability of notice under Section 263 of the Income Tax Act revolves around the argument that the Assessing Officer has granted relief under Section 90 of the Income Tax Act after considering the provisions of the Act, the treaty and since the order has been passed after making enquiries the order cannot be turned as erroneous. The Assessee has also made reference to the decision of Hon'ble Supreme Court in the case of *Malabar Industrial Company Ltd., v. err* [2000] 243 ITR 83 (SC) to support its claim. He has also made reference to certain other decisions. The claim of the Assessee that the Assessing Officer has not allowed deduction of tax credit after due application of mind and, therefore, jurisdiction under Section 263 will not lie without merit. The Assessee has erroneously tried to mix up the provisions of Section 147 and Section 263 of the Income Tax Act. Provisions of Section 147 which are initiated by the AO himself do restrict reopening of assessment where as a result of certain application of mind by the AO an opinion is formed. Under Section 147 of the Income Tax Act, the AO cannot change his opinion unless there is a certain new tangible information requiring change of opinion. This also includes a situation when there is application of mind but on account of failure on the point of Assessee to disclose full at time facts and income could not be assessed. The AO in such case would be free to record his reason and initiate action u/s 147 of the Act. Whereas, under Section 263 after having made enquiries, having applied his mind after taking all facts and the legal position into account the Assessing Officer passes an order which is erroneous and prejudicial to the interest of Revenue, the CIT would be competent to exercise jurisdiction under Section 263 of the Act. The jurisdiction under Section 263 is not restricted either to the limitation of Section 147 as claimed by the Assessee nor it can be restricted to the provisions of Section 154 which deal with the mistakes apparent from record only. Therefore, the claim of the Assessee is found to be without this merit and accordingly not maintainable.

Similarly, reliance on the decision in the case of *Malabar Industrial Company Ltd.*, is also misplaced. The decision of Hon'ble Supreme Court very clearly lays down that where

two equal views on a given set of facts are possible and the AO has taken one of the views the jurisdiction under Section 263 could not lie. The decision of Hon'ble Supreme Court merely reiterates that position of law which provides for action by the Commissioner in the case where the orders are found to be erroneous. In the case where one of the possible views has been taken by the Assessing Officer, after appreciating the position of law and facts of the case, definitely the order could not be considered to be erroneous. However, in order to fall within the benefit of this decision of Hon'ble Supreme Court, the Assessee has to clearly show that the view taken by the Assessing Officer was a possible view as per law. This, however, is not the case as indicated above. In view of the above the claim of the Assessee that the action under Section 263 is not maintainable does not serve any purpose and is accordingly rejected."

6. From the factual position as explained above, it was seen that the learned PCIT has taken a view that even if the Assessing Officer, during the course of the original scrutiny assessment proceedings, has fully applied his mind to a particular issue and has made the assessment. Accordingly, the Ld. PCIT would have jurisdiction u/s. 263 of the I.T. Act, if he feels that the view adopted by the Assessing Officer is legally untenable. The Ld. PCIT has, accordingly, made the following observations in his impugned order passed u/s. 263 of the I.T. Act.

"This from the plain and simple reading of both the Oman Tax Law as applicable from 01-01-2010 (Royal Decree No. 28/2009) or the earlier law (Royal Decree 68/2000) effective from the tax year 2000, there is no tax payable on dividend in Oman and accordingly, no tax has been paid. Further, the exemption is not available because of any economic incentive for economic development as the case of the Assessee is not covered under the exemption. The Royal Decree 28/2009, which came into force w.e.f. 01-01-2010 makes the position very clear and reiterates the position of exemption of dividend income provided for in the Article 8 of old Royal Decree 68/2000. The Royal Decree of 2009 also provides for incentive only for a period of five years. In case of Assessee that period has elapsed long back."

7. Ld. Counsel of the assessee stated that the Ld. PCIT did not confine himself to the particular issue referred to in the show cause notice issued by him u/s.263 of the I.T. Act, but he has also passed order and given directions to the Assessing Officer in respect of a totally new issue which does not find any mention in the aforesaid show cause notice. Thus, apparently with regard to this new issue no opportunity was allowed to the assessee-society. Ld. Counsel of the assessee further stated that in his order the learned PCIT has identified this new issue as under:—

".....Another interesting feature of the accounts is that Assessee has credited much more income than the dividend received by them. The movement of investment in the final accounts as on 31st December, 2010 in notes to the financial statement No. (4) it has been indicated as below:

31-12-2010 (US\$)		(US\$) 31 Dec.
93,521,908	Opening Balance	114,251,371
37,757,271	Share of profit for the year	59,781,818
(17 2027 2271)	Dividend received	(43 180 000)
(114,521,271)	Closing balance	130,853,189

The Assessee has, however, declared only its dividend income in its P&L Account written in India as per Indian Tax Laws and accounting standards and submitted to the Department. The accretion and addition to its opening capital in terms of the profit as per account of PE which have been duly audited and submitted during the proceedings are not disclosed in its accounts in India. This makes it abundantly clear that the dividend declared or received only is being shown in its income in India and thus confirming that the income received by the Assessee by its own admission is its dividend income and not business income as claimed by the Assessee."

7.1 The Ld. PCIT held that even the assumed profits reflected in the Books of Account of the PE of the Assessee by virtue of undistributed and un-received dividend income, were also chargeable to tax under the provisions of the I.T. Act, 1961.

7.2 At the end of the impugned order under Section 263, the Ld. PCIT directed the Assessing Officer to modify the Assessment Order as under:

- "1. That the tax credit allowed by the A. O. in respect of dividend income in the Assessment Order is not available to Assessee in terms of either para (1) or para (4) of the Article 25 of the Indo-Oman DTAA.
2. The share of profit of its investment in Oman (to the extent it is not declared as dividend) is to be included in the global income of the resident tax payer India as per Section 4 & 5 of the I.T. Act. This part of income would be eligible for allowance of tax credit as per para (4) of Article 25 of the Indo-Oman DTAA to the extent of taxes which would have been payable but for the incentive provided by the Royal Decree No. 28/2009 w.e.f. 01-01-2010 on any other notification,. The Assessee shall provide it to the A. O. if there is any such notification prior to this Royal Decree 28/2009 and still applicable for the current year. The income shall be computed in terms of notes to account of the financial statement of the branch office of the Assessee in Oman. the tax credit would be available for income earned after this date and tax credit shall be computed accordingly. However, the A.O. shall ensure that the Assessee has been granted exemption by the Oman Tax Authority as provided in Article 118 of Royal Decree No. 28/2009.]

It is also seen that the Assessee has not furnished complete and true income

or particulars of income and, therefore, the A.O. shall also frame a view thereon and take action as per laws."

8. From the above it is seen that that the Ld. PCIT gave directions to the Assessing Officer with regard to following three Issues:

- (i) Tax credit on dividend is not allowable.
- (ii) Profits pertaining to undistributed dividend should be brought to charge of tax.
- (iii) The Assessing Officer should also frame a view with regard to the default of not furnishing complete and true income or particulars of income on the part of the Assessee.

9. The factual position which emanates from the aforesaid discussions is that while the show cause notice was issued by the learned PCIT only on one Issue viz. tax credit on dividend, he passed his final order on the aforesaid three issues. The admitted position is that with regard to the other two issues no opportunity was allowed to the assessee before passing the order u/s 263 of the I.T. Act.

10. In support of aforesaid contentions, Ld. Counsel of the assessee has filed detailed written submissions, relevant documents and judicial pronouncements, For the sake of clarity, the relevant part of the written submissions of the Ld. Counsel of the Assessee is reproduced below:—

"9. At the very outset, the Assessee strongly challenges the legality of the order passed the Ld. PCIT under Section 263 of the I.T. Act, 1961. It is submitted that the jurisdictional conditions and the legal requirements of Section 263 are not satisfied so as to vest the Ld. PCIT with the powers under Section 263 with a view to reverse the concluded scrutiny assessment passed under Section 143(3) after due and full application of mind on the part of the Assessing Officer. In support of the contention that the impugned order under Section 263 is bad in law and ab initio void, the following submissions are made for the kind consideration of this Hon'ble Tribunal:

(i) As mentioned above, the Ld. PCIT issued notice under Section 263 with regard to only one issue but he has passed the order on three issues. He has directed the Assessing Officer to tax the assumed profits on account of the undistributed dividends by OMIFCO as reflected in the Books of Account of the PE. He has also directed the Assessing Officer to frame a view regarding non-furnishing of complete details or furnishing inaccurate particulars by the Assessee. On these two issues, there was complete denial of natural justice on the part of the Ld. PCIT for the reason that Assessee Society was not allowed any opportunity whatsoever to present its case on these Issues. In these circumstances, the entire order passed by the Ld. PCIT under

Section 263 is vitiated and rendered bad in law. It is an established legal position that there must be complete nexus between the reasons or grounds indicated in the Show Cause Notice issued under Section 263 and the final order passed under Section 263. Kind reference is invited to the Hon'ble Delhi High Court judgment in the case of *CIT v. Ashish Rajpal* 320 ITR 674. For ready reference the relevant part of the head note of this case is reproduced below:

"Held, dismissing the appeal, that there was nothing on record which would show that the Assessee was given an opportunity to respond to the discrepancies which formed part of the order in revision but were not part of notice dated 11.5.2016. Even though the notice issued by the Commissioner before commencing the proceedings under Section 263 referred to four issues, the final order passed referred to nine issues, some of which obviously did not find mention in the earlier notice and hence resulted in the proceedings being vitiated as a result of the breach of the principles of natural justice."

(emphasis supplied)

For the same proposition, the Assessee Society relies on the Hon'ble Mumbai Tribunal decision in the case of *Colorcraft v. ITO* 303 ITR (AT) 7. The relevant part of the head notes of this decision is reproduced below for ready reference:

"Held, (i) that the provisions of Section 263 provide that an opportunity is to be provided to the Assessee before passing an order. That means the Assessee is required to reply to the reasons given by the Commissioner in the Show Cause Notice. The opportunity to be granted must be effective and not an empty formality. A person who is required to show cause must know the basis on which action is proposed. Obviously, therefore, the notice issued must indicate the reasons on which the order of assessment is considered to be erroneous and prejudicial to the interests of the Revenue. This means there must be nexus between the reasons given in the Show Cause Notice and the order of the Commissioner under section 263. The reason given in the Show Cause Notice to the Assessee was that duty drawback received by the Assessee could not be considered as profit derived from export in view of the Supreme Court judgment and, therefore, the said amount did not qualify for deduction under Section 80HHC. However, the order under Section 263 held the assessment order erroneous on different grounds, namely, [i] the Assessing Officer should have excluded the export incentives of Rs. 18,99,015 instead of Rs.18,58,350, (ii) Central excise refund and sales tax set off should have been excluded from the business profits under clause (baa) of the Explanation to Section 80HHC, and (iii) Central excise refund and sales tax set off should have been included in the total turnover. This clearly showed that there was no nexus between the reasons given in the Show Cause Notice and the reasons given in the order for holding the order of the Assessment Order erroneous. qua deduction under Section 80HHC.: The order of revision was not valid with reference to Section 80HHC."

(emphasis supplied)

Similar view has been adopted in the following cases:

- (a) *CIT v. Roadmaster Industries of India Limited* 40 taxmann. Com 298 (P&H)
- (b) *Synergy Entrepreneur Solutions (P) Ltd v. CIT* 11 taxmann.com 385 (Mum.ITAT)

In the backdrop of the factual and the legal position explained above, it is respectfully submitted that there is an inherent and fatal defect in the order passed by the Ld. PCIT under Section 263 for the reason that on some of the issues covered in the order, the Assessee Society was not given any opportunity. Therefore, on this ground alone the order passed by the Ld. PCIT under Section 263 deserves to be quashed.

(ii) The Assessee Society also challenges the legality of the order passed under Section 263 on the ground that the Ld. PCIT has completely ignored the past history of the case and has tried to substitute his arbitrary and unreasonable view in place of the view adopted by the Department itself consistently for the past several years. The Ld. PCIT has discarded the view adopted by the Department in the past in spite of the fact that the factual and legal position continues to be the same. It is submitted that this very same issue was thoroughly examined in the case of the Assessee Society in the scrutiny assessment made under Section 143(3) of the I.T. Act, 1961 for the A.Y. 2006-07 vide Assessment Order dated 31 st December, 2008 passed by the Additional CIT, Rangc - 24, New Delhi. The relevant part of this order is reproduced below for ready reference:

"9. Tax credit as per DTAA with Oman:

The Assessee has claimed a tax credit of Rs.6,00,49,920 on the dividend income of Rs. 20,01,66,440 received from Oman India Fertilizer Company SAOC (herein after referred as OMIFCO). It has been submitted that the Assessee is a joint venture partner in the above company. It has received dividend of Rs. 20,01,66,400 during the previous year which has been included in its income under the head Misc. Income under Schedule 7 - 'Other Revenue'. The Assessee has referred to Section 90 of the Income Tax Act and claimed benefit of deemed tax paid in Oman by its PE in Oman. a reference has further been made to Article 25 of DTAA, Article 7, 11 and 25 of the DTAA between India and Oman.

The Assessee has submitted that it has filed its return for the year ended 31-3-2006 under Oman's Income Tax Law for its branch namely KRIBHCO Musket Branch PE. Reference has further been made to Article 8 (bis) under Oman's Income Tax Law. A copy of the Assessment Order as made in Oman for its PE has been filed to support its contention that the dividend income has been exempted in Oman in accordance with Article 8(bis) of Income Tax Law of Oman. The Assessee's claim of tax sparing @ 30 as per the Royal Decree No. 68/2000 read with Royal Decree No. 48/81 under Company's

Income Tax Law, appears to be justified. The credit for Rs.6,00,49m,920 as deemed tax paid under DTAA in addition to the prepaid taxes as claimed in Return of income is allowed.

(emphasis supplied)

10. In respect of the Assessment Years 2007-08 to 2009-10 also assessments were made under Section 143(3) of the I.T. Act, 1961 and the Department has consistently adopted the view that the Assessee Society was entitled to tax credit of the deemed tax which would have been payable in Oman. The Department has taken a conscious view after considering the provisions of the Omani Tax Law, Section 90 of the I.T. Act, 1961, Article 25 of the DTAA and the clarifications issued by the Royal Decrees of the Sultanate of Oman. In respect of assessment for A.Y. 2010- 11, which is the subject matter of the present appeal, the Assessing Officer has adopted the same view in consonance with the view adopted in the past and further after full application of mind and after raising detailed queries and after considering the detailed replies filed by the Assessee Society vis-a-vis the provisions of Law and DTAA. Therefore, the view taken by the Ld. PCIT is totally outside the ambit and purview of Section 263 of the I.T. Act, 1961. The Assessee Society strongly relies on the following decision:

(i) Honble Delhi High Court judgment in the case of *CIT v. Escorts Limited* 338 ITR 435, the relevant part of which reads as under:

"Where a fundamental aspect of a transaction is found to have been permeated through different assessment years and this fundamental aspect has stood uncontested then the Revenue cannot be allowed to change its view it is able to demonstrate a change in circumstances in the subsequent assessment year.

Held, that the Commissioner's order did not contain a finding to the effect that the stand taken by the Assessee that the units purchased from the Unit Trust of India had actually been physically delivered along with executed transfer deed was false. Without such a finding the allegation that the transactions were speculative could not be sustained. The fundamental nature of the transactions was examined year after year more importantly in the Assessment Year 1986-87 it was specifically considered by the Commissioner (Appeals) and it remained the same. Given the fact that the Assessee had been engaged in these transactions in the preceding Assessment Years, the Commissioner could have had no occasion to have recourse to the revisional powers under section 263 of the Act on the fundamental aspects of the transactions in issue on which a view had been taken and not shown to have been challenged. "

(emphasis supplied)

11. It is respectfully submitted that even though the principle of res judicata may not be strictly applicable to Income-tax proceedings but, at the same time, consistency in

approach in similar facts and circumstances, is very important for the legal system as held by various Courts as below:

- (i) *CIT v. N. P. Mathew (Deed.)* [2006] 280 ITR 44 (Ker.) The relevant part of the ratio is reproduced from the Heads note:

"Held, dismissing the appeal, that with regard to another assessee, the same view was taken by the Tribunal and the Department accepted it for earlier years in the assessee's case also. Those orders were allowed to become final. The Department should be consistent at least in respect of the same assessee and it cannot also differentiate between different assessees. The assessee was entitled to the concessional rate of taxation under section 115H for the assessment year 1991-92.

(emphasis supplied)

- (ii) The assessee, for the same proposition, also relies on the Hon'ble Supreme Court decision in the case of *Radhasoami Satsang v. CIT* [1992] 193 ITR 321. This Supreme Court decision together with other judgments of the Supreme Court have been referred to by the Hon'ble Gujarat High Court in the case of *Taraben Ramanbhai Patel v. ITO* [1995] 215 ITR 323. The observations of the Hon'ble Gujarat High Court may be reproduced below from page 330 of the report:

".....It is no doubt true that the strict rule of the doctrine of res judicata does not apply to proceedings under the Income-tax Act. At the same time, it is equally true that unless there is a change of circumstances, the authorities will not depart from previous decisions at their sweet will in the absence of material circumstances or reasons for such departure:"

- (iii) The desirability of following the principle of consistency again came up for consideration before the Hon'ble Delhi High Court in the case of *Director of Income-tax (Exemptions) v. Escorts Cardiac Diseases Hospital Society* [2008] 300 ITR 75. In this case exemption u/s.10(22A) was granted from assessment years 1988-89 to 1994-95. There was no change in facts. The Hon'ble High Court held that on the principle of consistency, exemption cannot be denied for the subsequent assessment years. It is further stated that in recent decision Hon'ble Apex court in case of *CIT v. J .K. Charitable Trust* in Civil appeal No. 1698,1699/2008 vide order date 7/11/2008 has also held on similar line as stated herein above on principle of consistency.
- (iv) Similar view has been adopted by the Hon'ble Delhi High Court in the case of *CIT v. Dalmia Promoters Developers P. Ltd.*, [2006] 281 ITR 346. For ready reference, the relevant part of the Heads note is reproduced below:

".....For rejecting the view taken for the earlier assessment years, there must be a material change in the fact situation. 'There was no gainsaying that the previous view would have no application even in cases where the law itself had undergone a change but before an earlier view could be upset or digressed from, one of two things must be demonstrated, namely, a change in the fact situation or a material change in law whether enacted or declared by the Supreme Court. In the absence of a change in the facts or any additional input there was no compelling reason for taking a different view. Therefore, the Commissioner (Appeals) and the Tribunal were justified in holding that the view taken for the earlier assessment years continued to be applicable even for the year under consideration.

Radhasoami Satsang v. CIT [1992] 193 ITR 321 (SC), *Parashuram Pottery Works Co. Ltd. v. ITO* [1977] 106 ITR 1 (SC), *CIT v. A.R.J. Security Printers* [2003] 264 ITR 276 (Delhi) and *CIT v. Neo Poly Pack P. Ltd.* [2000] 245 ITR 492 (Delhi) followed."

- (v) On the rule of consistency, kind reference is invited to the Hon'ble Madras High Court decision in the case of *CIT v. Gopala Naicker Bangaru*, [2012] 344 ITR 297. For ready reference, the Heads note of this case is reproduced below:

"The devotees of the assessee spiritual leader, made their offerings voluntarily to him at the time of his birthday. These offerings were accounted as capital receipts and receipts were also issued. In the accounting year relevant to assessment year 2004- 05, an amount of Rs. 1,75,70,347 was received as gifts. The Assessing Officer held that this amount was assessable but the Tribunal held that it was not. On appeal to the High Court:

Held, dismissing the appeal, that the assessee as a religious head was not involving himself in any profession or avocation nor performing any religious rituals/ poojas for his devotees for consideration or other. The amounts or gifts received by the assessee could not be said to have any direct nexus with any of his activities as a religious head. In the absence of a link or connection between the gifts made by the devotees and the profession or avocation carried on by the assessee, the personal gifts could not be termed as income taxable under the Income-tax Act, 1961. In the assessee's own case in assessment year 1988-89, the Department had accepted the position that gifts received by him on birthdays and other occasions were not taxable. Where a fundamental aspect permeating through different assessment years has been found as a fact one way or the other and parties have allowed that position to be sustained by not challenging the order, it would not be appropriate to allow the position to be changed in subsequent years. Since there was no change in the facts and law the amounts were not taxable.

[The Supreme Court has dismissed the special leave petition filed by the Department against this judgment see [2011] 336 ITR (St.) 15-Ed.

(emphasis supplied)

11.6 The rule of consistency has also been approved by various High Courts in the following cases:

- (i) *CIT v. Haryana Tourism Corporation Ltd.*, [2010] 327 ITR 26 (Punj. & Har.)
- (ii) *CIT v. Haryana State Industrial Development Corporation Ltd.*, [2010] 326 ITR 640 (Punj. & Har.)
- (iii) *CIT v. Siva Springs* [2008] 304 ITR 24 (Mad.)
- (iv) *CIT v. Goel Builders* [2011] 331 ITR 344 (All.)
- (v) *CIT' v. Hitech Arai Limited* 368 ITR 577 (Mad.)

The relevant part of this judgment is reproduced below from page 587 of the Report:

"We find no justifiable reason to differ with the said finding rendered by the Tribunal, more so taking note of the fact that the Department had for the Assessment Years 1986-87 to 1994-95, namely, for a period of nine years, accepted the fact that the payment made towards royalty is revenue expenditure and had not raised dispute thereon. That apart, even for the Assessment Year 1995-96, the Assessing Officer has partially treated the payment of royalty as revenue expenditure. The sudden volte face by the Department on this issue appears to be on account of a new interpretation by the subsequent Assessing Officer. At this juncture, we would like to observe that the view of the Department, while interpreting the very same agreement, cannot be inconsistent. Unless there is a change in law or on the basis of new and acceptable material which went unnoticed, the opinion should not differ from time to time based on the perception of individual officers. Citizens expect consistency not only in judicial orders, but also in the orders passed by quasi-judicial authorities."

12. It is respectfully submitted that the order passed by the Ld. PCIT under Section 263 of the I.T. Act, 1961 also suffers from another jurisdictional defect for the reason that the relevant issue regarding tax credit of deemed tax on dividend was not only thoroughly examined and allowed during the preceding Assessment Years 2006-07 to 2009-10, but even during the previous year relevant to the Assessment Year under appeal, this very same issue was further examined by the Assessing Officer and on this Issue detailed questionnaires were issued under Section 142(1) of the I.T. Act, 1961. In the questionnaire, the Assessing Officer raised detailed queries on thirty different issues relevant for the completion of the assessment and with regard to allowing tax credit on deemed dividend tax, enquiries were raised at serial numbers (xxviii) to (xxx).

The Assessee Society responded to these queries as per detailed submissions dated 11th December, 2013. The relevant parts of these submissions are reproduced below which contain the points of query and the replies thereto:

"Query No. (xxvii) : Give details of income earned, income assessed, taxes payable and taxes paid in Oman.

Query No. (xxviii): In respect of any income covered in DTAA, please furnish detailed note with copy of respective agreement and also give reason for claiming relief u/s 90 of the Income Tax Act, 1961.

Query No. (xxix): Please give detailed note on tax credit claimed by the Society in respect of dividend income received from OMIFCO.

Query No. (xxx): Explain as to the condition of carrying on business in Oman through PE and the holding in respect of which the dividends are paid is effectively connected with such permanent establishments; and Article 11 (4) of the DT AA is applicable in your case.

Please refer Note No. 2 of the notes forming part of computation of taxable income annexed to original return of income of the Society at page 40, wherein the details of claim of deemed tax credit on dividend income received from Oman is elaborated. A copy of the notes forming part of computation is herein again enclosed as Annexure 02 to this letter for ready reference.

The Society by virtue of it being a joint venture partner in Oman in Oman India Fertilizer Company SAOC (hereinafter referred as OMIFCO) has received during the year, dividend US\$30.2325 equivalent to Indian Rupees of Rs. 143,83,99,800.

The dividend was received by the Permanent Establishment (PE) namely the Branch Office of the Assessee Society. The dividend was received in Oman and was deposited in the bank account maintained by the (PE) branch office, with Bank of Baroda, London, on 21-08-2009, 04-01-2010 and 16-03-2010. Later on the dividend was remitted through banking channel into the State Bank of India, NOIDA, INDUSIND Bank, Nehru Place, and ICICI Bank, New Delhi, account of the Assessee.

The dividend is 43.51% of the equity share capital held by the Society in the joint venture OMIFCO, Oman. The Director's Report of OMIFCO, Oman, and the Minutes of 12th Annual General Meeting of OMIFCO, Oman, held on March 10, 2010 in support of the amount of dividend declared by OMIFCO, Oman, are enclosed for ready reference as Annexure 03. The Copy of the certificate issued by M/s. OMIFCO SAOC indicating the dividend amount paid is enclosed to this letter as Annexure 04.

The said dividend income of Rs. 143,83,99,800 has been included in the profit taken as starting point of computation. The dividend income from OMIFCO, Oman, is included under the Schedule 7 - "Other Revenue" under the item "Dividend". The said dividend is

considered as part of the total income of the Assessee Society. The tax liability has been computed on such total income.

Thereafter, the Assessee Society has claimed deemed tax credit of Rs.41,44,23,149 because of the following reasons:

- (a) Since the said dividend income is subject matter of taxation in both the countries, one has to read Section 90 of the Income Tax Act, 1961 along with the provisions of DTAA between India and Oman.
- (b) The copy of the DTAA agreement between India and Oman is enclosed as Annexure 05 and particular reference is invited to Article 11, 7 and 25 of the DTAA.
- (c) Article 11 (4) of DTAA provides that the provisions of Article 11 (1) shall not apply if the beneficial owner of the dividends being a resident of a contracting state carries on business in the other Contracting States of which the company is paying the dividends is a resident, through a permanent establishment situated therein, then in such a case provisions of Article 7 of DTAA would apply. Since the Assessee Society has a permanent establishment through the branch office, Article 7 would apply.
- (d) Article 7 of DTAA deals with business profits and it provides that where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein profits attributed to that permanent establishment to the extent they are attributable directly or indirectly to that permanent establishment may be taxed in the other Contracting State.
- (e) The Assessee Society has duly filed the Return of Income under the Omani's Income Tax Law by including the said dividend income as part of its total income, copy of the Income Tax Return filed for the year ended March 31, 2010 under the Omani's Income Tax Law along with a copy of the annual accounts of the Branch (PE) and that of OMIFCO, Oman, are enclosed as Annexure 06.
- (f) The dividend received in Oman by the permanent establishment in Oman of the Assessee Society, therefore, can be taxed only by the Omani Tax Law. However, Royal Decree 68/2000 (copy enclosed as Annexure 07) issued by the Omani Authorities, provides that no tax is leviable on dividends, which a company earns from its ownership of shares in the capital of any other.....(not legible) in accordance with the exigencies of public good. This tax exemption is, therefore, granted by the Omani Tax Authorities as an incentive for promoting economic development. Further reference is invited to the letter dated 11th December, 2000 of Secretary General of Taxation,

Ministry of Finance, Oman, addressed to the joint venture partner, which clarifies that Article 8 (bis) under the Omani Income Tax Law is for achieving the main objective of promoting economic development with Oman by attracting investment. Copy of the letter is enclosed as Annexure 08.

- (g) Now coming to Article 25 of the DTAA it will be noticed that under Article 25(4) the tax payable in a Contracting State (i.e. Oman) shall be deemed to include the tax which would have been payable but for the tax incentive granted under the laws of Oman and which are designed to promote economic development.
- (h) The tax treaties provide for such deemed tax credit with respect to tax forgone by the developing countries so that the benefit is retained by the investor. Such credit is known as tax sparing. If the credit is given only to actual tax paid and not for the tax which would have been payable then the benefit which the developing country intended to offer to the concerned tax payer would be nullified. The country's sacrifice of the revenue would ultimately accrue to the state of residence.
- (i) As a consequence of the above, Article 25(4) of the DTAA read with the provisions of Article 8(bis) under the Omani Tax Law and the Royal Decree 68/2000 and the letter dated December 11, 2000 of the Secretary General of Taxation, Ministry of Finance, during the year, Society has received a dividend income of Rs.143,83,99,800 on its equity investment in Oman India Fertilizer Company SAOC (OMIFCO). The breakup of the dividend received date-wise are as under:

Rs 76,20,15,375 - received on 24- 08-2009, Rs.58,14,02,250 - received on 31-12-2009 and Rs.9,49,82,175 - received on 16-03-2010
- (j) In view of the changes in the local Omani Income Tax Law with effect from Tax Year 2010, wherein the PE's income is chargeable to tax @ 120/0 instead of 30 as per the old Omani Law applicable upto 31-12-2009. Accordingly, the deemed tax credit benefit will be available 300/0 for the amount of dividend received upto 31-12-2009 and 12 of the amount of dividend received during January to March 2010. Accordingly, the claim of Deemed Tax Credit is Rs.41,44,23,149 (Rs.403025288 plus Rs.11397861). This may kindly be allowed to the Assessee against the total tax.

Further, we wish to inform you that the Omani Tax Authorities have done the Tax assessment vide their order dated 14-12-2008 of the Permanent Establishment of KRIBHCO at Muscat. The Omani Tax Assessment Order indicates that the ".....Dividend income is exempt from tax in accordance with Article 8 (bis)(1) of the Company Tax Law. The tax exemption on dividend is

granted with the objective of promoting economic development within Oman by attracting investments." A copy of the Assessment Order of the Omani Tax Authorities as received by us for the Tax Years 2002 to 2006 is enclosed for your kind perusal. Copy of the Assessment Order for year 2007-08 is also enclosed for your kind reference. (Annexure 10) The assessment of the Society for the Assessment Year 2006-07 was completed u/s 143(3) by order dated 31-12-2008 and by a speaking order, the Assessing Officer has accepted the contention of the Society and has granted credit for the tax that is deemed to have been paid in Oman and the same position has been followed in the Assessment Year 2007-08, 2008-09, 2009-10 also and hence the Income Tax Authorities in India have accepted the above position."

(emphasis supplied)

The aforesaid submissions are self-explanatory and reference therein has been made to the relevant Articles of DTAA, the Omani Tax Laws and Royal Decrees and the Clarifications issued by the Omani Tax Authorities as also Assessment Orders passed by them. It was also clearly pointed out in this reply that in respect of A.Y. 2006-07 credit for deemed tax was allowed after thoroughly discussing these issues in the Assessment Order and the same view was adopted during the subsequent Assessment Years and upto the A.Y. 2009-10. This shows that during the course of the Assessment Proceedings, there was full application of mind on the part of the Assessing Officer on this issue. The discussion given at paras 4.6 and 4.7 of the Assessment Order also shows application of mind by the Assessing Officer. At para 4.6 the Assessing Officer has referred to Article 8 (bis) which exempts the dividend income which is otherwise taxable by virtue of Article 10. At para 4.7 the Assessing Officer has mentioned that in respect of the deemed dividend tax payable in Oman, the Assessee has claimed relief under Section 90 of the I.T. Act, 1961 read with the relevant provisions of DTAA. He has also observed that by virtue of this claim made by the Assessee, the Assessee Society effectively is not paying any tax on dividend income either in Oman or in India. In the last para of the Assessment Order, he has observed: "Relief under Section 90 of the Income Tax Act, 1961, as claimed by Assessee is also allowed". These facts abundantly prove that the relevant issue has been thoroughly examined by the Assessing Officer during the course of the Scrutiny Assessment Proceedings and he has allowed the credit after full application of mind. The Assessing Officer was also fully conscious of the fact that during the preceding Assessment Years such credit was already allowed by the Department and thus, it was a settled issue.

13. The Ld. PCIT in his order under Section 263 has not doubted that on this issue the Assessing Officer raised enquiries and there was full application of mind on his part. He has also not doubted that in preceding Assessment

Years such credit of deemed tax has been allowed by the Department consistently after due application of mind. However, the Ld. PCIT has tried to justify the assumption of jurisdiction under Section 263 of the I.T. Act, 1961 by observing that even if there is application of mind by the Assessing Officer, the PCIT has power under Section 263 to set aside his order for the reason that the powers vested under Section 263 cannot be equated with the requirements of Section 147 of the I.T. Act, 1961. This observation by the Ld. PCIT is devoid of any merit and defies the settled legal position which emerges from a chain of Supreme Court and High Court decisions to which a reference is made infra. The Ld. PCIT has also observed in his order that as per the provisions of para 4 of Article 25 of the DTAA read with Omani Tax Laws, the exemption in respect of dividend is available only for a period of five years which is long over. Obviously, the Ld. PCIT has misinterpreted the relevant provisions as also the letters and clarifications and Royal Decrees issued by Omani Authorities. The exemption in respect of dividend income under the Omani Tax Laws continues even in the Income Tax Law by the Royal Decree No. 28 of 2009. In any case, this is a totally irrelevant point raised by the Ld. PCIT. The disputed issue pertains to merely the question as to whether deemed tax on dividend payable in Oman is eligible for credit while making the assessment under the Indian Income Tax Act. In any case, the moot point is as to whether the issue was examined by the Assessing Officer and there was full application of mind on his part and whether the view adopted by the Assessing Officer is one of the possible views which could have been taken. In the present case, it is a part of record that there was full application of mind on the part of the Assessing Officer and he has adopted a view which is consistent with the various clarifications issued by the Omani Tax Authorities and also which is in consonance with the consistent view adopted by the Department itself in the preceding Assessment Years. In these circumstances, the established position of Law is that the Ld. PCI cannot substitute his view in place of the view taken by the Assessing Officer while exercising powers under Section 263 of the Income Tax Act, 1961.

14. In the backdrop of the factual position explained above, it is humbly submitted that the order passed by the Ld. PCIT under Section 263 is bad in law for the following reasons:

- (i) There is complete lack of opportunity for the reason that there is no nexus between reasons indicated in the Show Cause Notice and the final order passed under Section 263. The legal position on this issue has already been explained supra.
- (ii) The order passed by Ld. PCIT is against the well established principle of consistency of approach and the legal position on this point is also explained above by citing

several cases.

- (iii) During the course of original Assessment Proceedings, the relevant issue was thoroughly examined and there was full application of mind on the part of the Assessing Officer who adopted a view which is plausible view and, therefore, the Ld. PCIT has no jurisdiction to substitute his view. For this proposition, the Assessee relies on the legal position as explained below:

(a) The assessee relies on the Hon'ble Gujarat High Court decision in the case of CIT v. Arvind Jewelers 259 ITR 502. The facts and the ratio of this case are reproduced below for your kind consideration:

"The provisions of section 263 of the Income-tax Act, 1961, cannot be invoked to correct each and every type of mistake or error committed by the Assessing Officer. It is only when an order is erroneous that the section will be attracted. An incorrect assumption of facts or an incorrect application of law will satisfy the requirement of the order being erroneous. The phrase "prejudicial to the interests of the Revenue" has to be read in conjunction with an erroneous order passed by the Assessing Officer and every loss of revenue as a consequence of an order of the Assessing Officer cannot be treated as prejudicial to the interests of the Revenue. When an Assessing Officer adopts one of the courses permissible in law and it has resulted in loss of revenue, or where two views are possible and the Income-tax Officer has taken one view with which the Commissioner does not agree, it cannot be treated as an erroneous order prejudicial to the interests of the Revenue unless the view taken by the Income-tax Officer is unsustainable in law.

The assessee- firm had filed its return of income disclosing a net loss of Rs. 2,777 in the business of purchase and sale of ornaments and jewellery. The Income-tax Officer issued notices under sections 143(2) and 142(1) of the Income-tax Act along with the requirement letter. After considering the material produced by the assessee and the explanation offered, the Income-tax Officer framed the assessment determining the total income at Rs. 32,900. The Commissioner of Income-tax held that the order was erroneous and prejudicial to the interests of the Revenue, in so far as the Income- tax Officer had not carried out any investigation either while adding certain amounts in the total income or while accepting the assessee's explanations on the various points. The Tribunal set aside the order of the Commissioner of Income-tax. On a reference:

Held, that the finding of fact by the Tribunal was that the assessee had produced relevant material and offered explanations in pursuance of the notices issued under section 142(1) as well as section 143(2) of the Act and after considering the material and explanations, the Income- tax Officer had come to a definite conclusion. Since the material was there on record and the said material was considered by the Income- tax Officer and a particular view was taken, the mere fact that different view can be taken

should not be the basis for an action under section 263. The order of revision was not justified."

(emphasis supplied)

[Special Leave Petition dismissed vided 266 ITR (St.) 101]

(b) From the above Gujarat High Court judgment, it is clear that even if two views are possible on merits of a question, and if the Assessing Officer has adopted one view, his order cannot be said to be erroneous and prejudicial to the interests of Revenue. For the same proposition, reliance is placed on the leading Supreme Court decision in the case of *Malabar Industrial Company Ltd. v. CIT* 243 ITR 83 and the Hon'ble Supreme Court decision in the case of *CIT v. G. M. Mittal Stainless Steel P. Ltd.* 263 ITR 255.

Reliance is also placed on the Allahabad High Court judgement in the case of *CIT v. Mahendrakumar Bansal* 297 ITR 99 wherein it has been held that merely because the ITO had not written a lengthy order, it would not establish without bringing on record specific instances that the assessment order passed u/s. 143(3) is erroneous and prejudicial to the interests of the Revenue. The assessee strongly relies on the Born bay High Court decision in the case of *CIT v. Gabriel [India] Ltd.* 203 ITR 108. In this case, it was held that if the Assessing Officer has raised queries and the assessee has reiled written submissions / explanation, merely because there is no discussion in the Assessing Officer's order on the relevant issue, it cannot be said that such order becomes erroneous. Similar view has been taken by the Rajasthan High Court in the case of *CIT v. Ganpat Ram Bishnoi* 296 ITR 292."

13. In the written submissions the assessee-society has also relied on the following cases:—

- (i) *CIT v. Ashish Rajpal*, 320 ITR 674 (Del.)
- (ii) *CIT v. Hindustan Coco Cola Beverages P. Ltd.* 331 ITR 192 (Del.).
- (iii) *CIT v. Anil Kumar Sharma*, 335 ITR 83 (Del.).
- (iv) *CIT v. R.K. Construction Co.* 313 ITR 65 (Guj.).
- (v) *CIT v. DLF Ltd.*, 350 ITR 555 (Del.).
- (vi) *CIT v. Greenworld Corporation*, 314 ITR 81 (SC).
- (vii) *CIT v. Munjal Castings*, 303 ITR 23 (P&H.)
- (viii) *Spectra Shares and Scrips Pvt. Ltd. v. CIT*, 354 ITR 35 (AP).

- (ix) *Cadila Healthcare Ltd. v. CIT*, 51 taxmann.com 255 (Ahmedabad Trib.).
- (x) *CIT v. P.D. Abraham*, 53 taxmann.com 217 (SC).
- (xi) *Sterling Construction & Investments v. ACIT* 374 ITR 474 (Born)
- (xii) *CIT v. Fine Jewellery (India) Ltd* 372 ITR 303 (Born)

14. Besides challenging the legality of the order passed by the learned PCIT u/s 263 of the I.T. Act, the assessee-society, in the written submissions and also by way of the elaborate arguments submitted by the learned A.R., has strongly contended that even on merits the appellant-society is legally entitled to getting credit for deemed dividend tax. With regard to the merits of the claim, the following submissions have been made in writing:—

"15.1 The factual position has already been explained supra. To recapitulate briefly, the Assessee Society is entitled to tax credit in respect of the deemed tax on dividend received in Oman, having regard to the relevant provisions of the DTAA read with Section 90 of the Income Tax Act, 1961. The relevant provisions of DTAA may be reproduced below for ready reference:

(i) Article - 3(2):

As regards the application of this Agreement by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning which it has under the Law of that Contracting State concerning the taxes to which this agreement applied.

(ii) Article - 7 -- Business Profits:

The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carried on business in the other Contracting State through a Permanent Establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other Contracting State but only so much of them as is attributable directly or indirectly to that Permanent Establishment.

(iii) Article - 25:

Avoidance of Double Taxation

- (1) The law in force in either of the Contracting States will continue to govern the taxation of income in the respective Contracting States except where provisions to the contrary are made in this Agreement.

- (2) Where a resident of India derives income which, in accordance with the provisions of this Agreement, may be taxed in the Sultanate of Oman, India shall allow as a deduction from the tax on the income of that resident an amount equal to the income-tax paid in the Sultanate of Oman, whether directly or by deduction. Such deduction shall not, however, exceed that part of the income-tax (as computed before the deduction is given) which is attributable to the income which may be taxed in the Sultanate of Oman.
- (3) Where a resident of the Sultanate of Oman derives income which, in accordance with the provisions of this Agreement, may be taxed in India, the Sultanate of Oman shall allow as a deduction from the tax on the Income of the resident an amount equal to the income-tax paid in India, whether directly or by deduction. Such deduction shall not, however, exceed that part of the income-tax (as computed before the deduction is given) which IS attributable to the income which may be taxed in India.
- (4) The tax payable in a Contracting State mentioned in paragraph 2 and paragraph 3 of this Article shall be deemed to include the tax which would have been payable but for the tax incentive granted under the laws of the Contracting State and which are designed to promote economic development.
- (5) Income which, in accordance with the provisions of this Agreement, is not to be subjected to tax in a Contracting State, may be taken into account for calculating the rate of tax to be imposed In that Contracting State.

(emphasis supplied)

15.2 Para - 4 of Article - 25 lays down that the tax payable shall be deemed to include the tax which would have been payable but for the tax incentives granted under the Omani Tax Law which are designed to promote economic development. In the present case, dividend income is exempt under the Omani Tax Laws and, therefore, tax payable would include the tax which would have been payable. The only requirement is that such incentive should have been granted with the object of promoting economic development. Therefore, this issue has to be analysed from this angle. It may kindly be noted that till the year 2000 dividend income was chargeable to tax under Omani Tax Laws. By virtue of Royal Decree No. 68/2000 read with the consequential Royal Decree No. 47/81, Article 8(bis) was inserted in the Law of Income Tax of Companies whereby dividend income was specifically exempted from the levy of tax. As per Chapter - 3 of the aforesaid Law, all incomes are includable in the total income by virtue of Article 8. Article 8(bis) was inserted with the object of exempting dividend income and his Article reads as under:

Article 8(bis):

In exception to the provisions of Article 8 of this Law, tax shall not apply on the following:

1. Dividends received by the company against equity shares, portions or stocks in the capital of any other company.
2. Profits or gains realized by the Company from the sale of securities listed in Muscat Securities Market or from their disposal.

The question is whether this exemption was subsequently granted with the purpose of promoting economic development.

The expression "incentive" is neither defined in the Omani Tax Laws nor in the Income Tax Act, 1961. Therefore, for clarification as to whether this incentive was for the purpose of promoting economic development, a letter dated 23rd November, 2000 was addressed by OMIFCO to Oman Oil Company SAOC requesting them to obtain authentic clarification from Oman Tax Authorities regarding the purpose of Article 8(bis). This issue was clarified by the Sultanate of Oman, Ministry of Finance, Secretariat General for Taxation, Muscat, vide their letter dated 11th December, 2000 addressed to Oman Oil Company SAOC. Since this letter is a very important document, text of this letter is reproduced below for ready reference:

"We refer to your letter dated 2 December, 2000 and our previous letter dated 6 August, 2000 on the above subject.

Under Article 8 of the Company Income Tax Law of Oman, dividend forms part of the gross income chargeable to tax. The tax law of Oman provides income tax exemption to companies undertaking certain identified economic activities considered essential for the country's economic development with a view to encouraging investments in such sectors.

Before the recent amendments to the Profit Tax Law on Commercial and Industrial Establishments, Article 5 of this law provided for exemption of dividend income in the hands of the recipients if such dividends were received out of the profits on which Omani income tax was paid by distributing companies. It meant that Omani income tax was payable by the recipients on any dividend income received out of the exempt profits from tax exempt companies. As a result, investors in tax exempt companies that undertake those activities considered essential for the country's economic development suffered a tax cost on their return on investments. the tax treatment under the above mentioned Article 5 had the negative impact on investments in tax exempt project.

The Company Income Tax Law of 1981 was, therefore, recently amended by Royal Decree No. 68/2000 by the insertion of a new Article 8(bis) which is effective as from the tax year 2000.

As per the newly introduced Article 8(bis) of the Company Income Tax Law, dividend distributed by all companies, including the tax exempt companies would be exempt from payment of income tax in the hands of the recipients. In this manner, the Government of Oman would achieve its aim objective of promoting economic development within Oman by attracting investments.

We presume from our recent discussions with you that the Indian investors in the above Project would be setting up Permanent Establishment in Oman and that their equity investments in the Project would be effectively connected with such Permanent establishments.

On the above presumption, we confirm that tax would be payable on dividend income earned by the Permanent Establishments of the Indian Investors, as it would form part of their gross income under Article 8, if not for the tax exemption provided under Article 8(bis).

As the introduction of Article 8(bis) is to promote economic development in Oman, the Indian Investors should be able to obtain relief in India under Article 25(4) of the Agreement for Avoidance of Double Taxation in India.

All other matters covered in our letter No. FT/13/92/, dated 6th August, 2000 remained un-changed. "

From the above, there is no doubt that the purpose of amendment in Omani Tax Laws is to promote economic development in Oman and to encourage investment in Omani companies. From the above it may kindly be appreciated that the Sultanate of Oman itself has clarified the issue regarding interpretation of Article 8(bis). It is an accepted position of interpretation that if there is some doubt about the interpretation of a particular provision of Law, the Competent Authority to clarify that provision is only the Government of that particular country. The Income Tax Department of India has no locus standi in this matter. The issue has been clarified by the highest Authority of the Sultanate of Oman through the Secretariat General of Taxation. In this connection, kind reference is invited to the Article (6) of Omani Income Tax Law of Companies No.47 /1981 wherein the functions of the Secretariat General are specified. Para 3 of the aforesaid Article (6) is reproduced below for ready reference:

"3 - Any form or notification of document issued or published or delivered by the Secretary General in accordance with this Law shall be considered an official document if it carries the name or description of the Secretary General or the responsible officer who is designated by virtue of Paragraph (2) of Article (3) and this shall be whether the name or description is printed, stamped or written."

From the above it is clear that any notification/ document issued by the Secretary General has the force of official document. The position clarified in the Omani letter dated 11th December, 2000 is further authenticated by the assessments made in

respect of the Permanent Establishment of the Assessee Society under the Omani Tax Laws. In respect of the tax years 2002 to 2006, a common order has been passed under Article 26 (2) (b) of the Income Tax Law of Oman. The opening para of this order reads as under:

"We refer to the returns of income and determine the taxable income as under:

Kribhco Muscat is a permanent establishment supported by M/s. Krishak Bharati Cooperative Limited, a multi- state cooperative society registered in India. As per the accounts, Kribhco-Muscat is in receipt of dividend income from Omifco, a joint stock company registered in Oman, and that dividend income is connected with the investment of Kribhco-Muscat. The dividend income is, however, exempt from tax in accordance with Article 8(bis)(1) of the Company Income Tax Law. The tax exemption on dividend is granted with the objective of promoting conomic development within Oman by attracting investments."

In the said Order the dividend income is first included in the total income and thereafter deduction is granted. For the subsequent years also, the assessments are made in similar manner. Up to the tax year 2011 dividend has been first included in the total income and thereafter deduction has been granted. The facts mentioned above clearly establish that the Assessee Society is entitled to getting credit for the deemed dividend tax by virtue of the provisions of DTAA read with Section 90 of the Income Tax Act, 1961 together with the clarifications issued by the Sultanate of Oman and the assessment made under the Omani Laws. In view of the above it is respectfully submitted that on merits also Assessee Society is entitled for the tax credit which has been rightly allowed by the Assessing Officer and, therefore, the Ld. PCIT has completely erred in giving directions to the Assessing Officer under Section 263 to withdraw the said tax credit."

15. As already noted by us above, besides giving directions to the Assessing Officer for withdrawing the tax credit for deemed dividend tax, which forms part of the show cause notice, the learned PCIT further directed the Assessing Officer to bring to the charge of tax, the undistributed share of profit which is reflected in the accounts of the P.E. of the appellant-society in Oman. The learned PCIT has raised this new issue in his order as under:

"..... Another interesting feature of the accounts is that Assessee has credited much more income than the dividend received by them. The movement of investment in the final accounts as on 31st December, 2010 in notes to the financial statement No. (4) it has been indicated as below:—

31-12-2010 (US\$)		(US\$) 31 Dec. 2011
93,521,908	Opening Balance	114,251,371

37,757,271	Share of profit for the year	59,781,818
(17,027,271)	Dividend received	(43,180,000)
114,521,271)	Closing balance	130,853,189

16. With regard to this new issue, on behalf of the appellant-society it has been strongly contended before us that any directions issued by the learned PCIT on this issue are bad in law and ab initio void for the reason that there is no mention of this issue in the show cause notice and, therefore, there is complete denial of opportunity to the appellant-society, which renders the entire proceedings u/s. 263 as bad in law. It is further contended that even on merits no such addition as directed by the learned PCIT can be made to the total income of the appellant-society to be computed under the provisions of the Income-tax Act. With regard to the merits of this issue the following submissions have been made on behalf of the appellant-society:—

"It may kindly be appreciated that the annual accounts of the PE are prepared in accordance with the International Financial Reporting Standards (IFRS). As per the IFRS - 28, the share of PE in the profit/loss in OMIFCO at 25 has to be accounted as income in the Profit & Loss Account of the PE even though such income is neither accrued nor received. The actual income received is only to the extent of dividend declared and distributed. Out of the total distributable profits, OMIFCO is required to transfer a specified amount to reserves under the Omani Law and the remaining profits are distributed to shareholders. Therefore, the PE in Oman offers to taxation the dividend income actually received and not the total share of the PE in the profits of OMIFCO. On the other hand, Books of Account of the Assessee Society in India are prepared in accordance with the Indian Accounting Standards. As per Accounting Standard - 13 read with Accounting Standard - 27, only the dividend received is recognised as income and credited to the Profit & Loss Account. The undistributed share of profit reflected in the books of the PE does not partake the character of income under the provisions of the Income Tax Act, 1961. It is a settled position of law that accounting entries are not determinative of taxability under the Income Tax Act, 1961. For this proposition, reference is made to the following Supreme Court decisions which settle this issue:

- (i) *Sutlej Cotton Mills Limited v. CIT* 116 ITR 1
- (ii) *Kedarnath Jug Mfg. Co. Limited v. CIT* 82 ITR 363

Further, it is a well settled principle of taxation that no income can be taxed on hypothetical basis and only real income can be brought to tax under the Income Tax Act. For this proposition, kind reference is invited to the following cases:

- (i) *Shoorji Vallabhdas & Co.* 46 ITR 144 (SC)

- (ii) *Godhra Electricity Company Ltd v. CIT* 225 ITR 746 (SC)
- (iii) *CIT v. Raman & Co.* 67 ITR 11 (SC)
- (iv) *UCO Bank v. CIT* 237 ITR 889 (SC)
- (v) *Airports Authority of India v. CIT* 340 ITR 407 (Del)]

It is reiterated that as a shareholder the PE and the Assessee cannot be taxed on the entire income earned by OMIFCO. The PE is only liable to tax in respect of the income distributed by OMIFCO to the shareholder. The share in the undistributed profits of OMIFCO is merely a book entry in the books of the PE and it does not represent any real income earned by the Assessee Society. Such income has neither been credited nor been received by Assessee Society and, therefore, cannot be taxed under the Income Tax Act, 1961. As a matter of fact, even the Oman Tax Authorities have excluded such income while assessing the income of the PE.

17. In view of the above it is humbly submitted that the directions issued by the Ld. PCIT for bringing to charge of tax the undistributed profit from OMIFCO is not only bad in law but also not warranted even on merits. These directions deserve to be quashed."

11. Ld. Counsel for the Assessee further stated that Ld. PCIT In his order u/s.263, has also directed the Assessing Officer to frame a view with regard to the default of non-furnishing complete and true income or particulars of income on the part of the assessee. Admittedly, this issue does not find any place in the show cause notice issued by the learned PCIT. With regard to this issue the following submissions have been made on behalf of the assessee:—

"18. Lastly, the Ld. PCIT has directed the Assessing Officer to frame a view regarding non-furnishing on the part of the Assessee complete and true income or particulars of Income. It is respectfully submitted that such directions are totally illegal and invalid. Firstly, there is no mention in the Show Cause Notice regarding this issue, and secondly, initiation of any Penalty Proceedings under Section 271 of the Income Tax Act, 1961 depends upon the satisfaction of the Assessing Officer and the Ld. PCIT has no legal power or authority to influence such satisfaction which is to be arrived at only by the Assessing Officer."

12. On the other hand, Ld. CIT(DR) controverted the various submissions and arguments advanced by the Ld. Counsel of the Assessee. He has strongly relied upon the impugned Order passed u/s. 263 by the Ld. PCIT and has invited our attention to the various findings recorded by the learned PCIT in his impugned order. The learned CIT(DR) has vehemently argued that under the Tax Laws of Sultanate of Oman, dividend income enjoys a general exemption across the board and, therefore, it cannot be said that any specific exemption in respect of dividend income was granted for the purpose of achieving economic development of Oman. It was further stated by him that the Assessing Officer while

completing the original assessment has taken a view which is unsustainable in law and, therefore, it is contended that the Ld. PCIT is well within his right and jurisdiction to invoke the provisions of section 263 with a view to set right the legal error committed by the Assessing Officer. With regard to the other issue pertaining to undistributed dividend income, the learned CIT(DR) has argued that the learned PCIT has given elaborate reasons in his order to justify such addition. It was argued that the said undistributed dividend income is reflected in the audited accounts of the P.E. of the assessee in Oman and, therefore, there is no reason why such income should not be brought to the charge of tax. It is pointed out that the Assessing Officer completely failed to apply his mind on this issue and, therefore, the assessment order is erroneous and prejudicial to the interest of the revenue. It is reiterated that such income is liable to be brought to the charge of tax under the provisions of the Income-tax Act.

13. We have carefully considered the rival submissions and perused the relevant records available with us, especially the impugned order passed by the Ld. PCIT u/s. 263 of the Act alongwith the legal position on the relevant issues which emanates from the various decisions cited before us. At the threshold, we find that that there is no dispute with regard to the following factual position:—

- (i) In this show cause notice issued by the learned PCIT the only issue referred to pertain to allowing tax credit on dividend income earned in Oman.
- (ii) At the time of original assessment proceedings detailed inquiry letter was issued by the Assessing Officer with regard to tax credit of deemed dividend tax which would have been payable in Oman but for the exemption granted. The assessee had filed detailed replies which were duly considered by the Assessing Officer before allowing tax credit.
- (iii) Such tax credit was also allowed by the Department in respect of the assessment year 2006-07 as per the assessment order wherein, a detailed discussion on this point has been made which shows that after proper application of mind the tax credit was allowed in the assessment year 2006-07. Further, such tax credit has been consistently allowed in scrutiny assessments made by the Department right up to the assessment year 2009-10. Thus, in respect of the assessment years 2010-11 and 2011-12 the Assessing Officer has only followed the view adopted by the Department in the preceding several assessment years.

14. Keeping in view of the facts and circumstances of the case and the precedents relied upon, the validity of the order passed u/s.263 needs to be considered. As per the admitted position, show cause notice was issued only with regard to one issue whereas order u/s.263 has been passed on certain other issues also as discussed above. Admittedly on the other issues, we find that there was complete denial of opportunity to the assessee-society, which is violative of well established principles of natural justice. The Hon'ble Jurisdictional High

Court in the case of *CIT v. Ashish Rajpal (supra)* has held that if in the show cause notice issued u/s.263 reference is made only to four issues whereas order u/s.263 is passed on nine issues, the entire proceedings u/s.263 get vitiated as a result of the breach of principles of natural justice. Similar view has been adopted in several other cases referred to above. In the case of *Ashish Rajpal (supra)* the Hon'ble Delhi High Court have further observed that the threshold condition for setting aside the assessment u/s.263 is that before passing an order, opportunity has to be granted to the assessee and such opportunity is a necessary concomitant of the inquiry the Commissioner is required to conduct to come to a conclusion. The defect of not allowing opportunity cannot be cured by first reopening assessment and then granting an opportunity to respond to the issue before the Assessing Officer during the course of the fresh assessment proceedings. Having regard to the legal position emerging from various cases including Hon'ble Jurisdictional High Court case, we are of the view that lack of opportunity on some of the issues in the show cause notice, vitiates the proceedings u/ s.263 and consequently the order u/s. 263 passed by the learned PCIT is also rendered bad in law.

15. Further, we find that the same very issue on which the show cause notice was issued by the learned PCIT was not only thoroughly examined during the course of scrutiny assessment proceedings in respect of the assessment year under appeal, but the same was consistently examined during the preceding assessment years starting from the assessment year 2006-07. As a matter of fact, in the assessment order passed u/s. 143(3) for the A.Y. 2006-07, there is a detailed discussion on this point and after proper and thorough application of mind the Assessing Officer allowed credit for deemed dividend tax. The same view was adopted upto the assessment year 2009-10. Thus, the view adopted by the Assessing Officer during the assessment year under appeal is in consonance with the consistent view adopted by the Department itself in the preceding assessment years. Further, the Assessing Officer has not blindly followed the view adopted in the preceding assessment years but has also independently examined this issue by raising detailed inquiries and after considering the replies filed by the assessee-society. Thus, the view adopted by the Assessing Officer is a possible and plausible view and the Assessing Officer has adopted this view having regard to the well established principles of consistency of approach and also after considering the merits of the claim. In view of the legal position which emerges from the various cases cited above, it is an undisputed legal position that the learned PCIT cannot substitute his view for the view of the Assessing Officer by invoking jurisdiction u/s.263 of the I.T. Act. Therefore, for these reasons also the order passed by the learned PCIT u/s. 263 totally fails to meet the jurisdictional requirements of section 263 of the I.T. Act. Therefore, we have no hesitation in holding that the order passed by the learned PCIT u/s.263 is bad in law for the following reasons:—

- (i) No opportunity in the show cause notice was allowed on certain issues on which directions have been issued in the order passed u/s. 263.

- (ii) The issue communicated to the assessee in the show cause notice was thoroughly examined at the time of original assessment and, therefore, there was complete application of mind on the part of the Assessing Officer on this issue.
- (iii) Further, the Assessing Officer at the time of original assessment has adopted a view which is consistent with the view adopted by the Department itself in the preceding assessment years and, therefore, the view taken by the Assessing Officer gets supported from the principles of consistency of approach when the facts and circumstances are similar.
- (iv) Thus, when the Assessing Officer has taken a plausible view after thorough application of mind the learned PCIT cannot substitute his view by assuming jurisdiction u/s.263 of the I.T. Act.

16. In the background of the aforesaid discussions and precedents relied upon, we quash the impugned order passed by the learned PCIT u/s.263 of the I.T. Act.

17. Since the order passed by the learned PCIT which is under appeal has been quashed by us, going into the merits of the issues is only of academic interest. However, since detailed arguments have been raised on the merits of the issues, for the sake of completeness, we proceed to examine and decide the issues on merits as well.

18. With regard to allowing credit for deemed dividend tax which would have been payable in Oman, we have gone through the relevant provisions of the DTAA between the Republic of India and the Sultanate of Oman read with section 90 of the I.T. Act. Clause (4) of Article 25 of DTAA lays down that the tax payable shall be deemed to include the tax which would have been payable but for the tax incentive granted under the laws of the contracting State and which are designed to promote economic developments. Thus, the crucial issue to be examined is whether the dividend income was granted exemption in Oman with the purpose of promoting economic development. The exemption has been granted under Article 8(bis) of the Omani Tax Laws. The said provision has been clarified and explained vide letter dated 11.12.2000 issued by the Sultanate of Oman, Ministry of Finance, Secretariat General for Taxation, Muscat. The text of this letter has already been reproduced (*supra*). From this letter, the following points emerge:—

- (a) Under Article-8 of the Omani Tax Laws, dividend forms part of gross income chargeable to tax.
- (b) As a result, investors in tax exempt companies that undertake activities considered essential for the country's economic development suffered a tax cost which had the negative impact.
- (c) The Company Income-tax Law of 1981 was therefore amended by Royal

Decree No.68/2000 by insertion of a new Article 8 (bis).

- (d) Thereby the Government of Oman would achieve its main objective of promoting economic development by attracting investments.
- (e) Tax would be payable on dividend income if not for the tax exemption provided under Article 8(bis).
- (f) As the introduction of Article 8(bis) is to promote economic developments in Oman, the Indian investors should be able to obtain relief in India under Article 25(4) of the Agreement for Avoidance of Double Taxation.

19. From the above clarifications there remains no doubt regarding the purpose of granting exemption to dividend income. The interpretation of Omani Tax Laws can be clarified only by the highest tax authorities of Oman and such interpretation given by them must be adopted in India. Further, in the tax assessments made in Oman in respect of the PE of the assessee-society it is clearly mentioned that the dividend income which is included in the gross total income is, however, exempt in accordance with Article 8(bis) and such exemption is granted with the objective of promoting economic developments within Oman by attracting investments. In view of the facts stated above, we are of the considered view that on merits also the assessee-society is entitled to tax credit in respect of deemed dividend tax which would have been payable in Oman. Therefore, we hold that on merits also the learned PCIT was not justified in directing the Assessing Officer to withdraw the aforesaid tax credit. Further such credit was allowed by the Assessing Officer during several preceding assessment years and, therefore, when there is no change in the facts and the relevant provisions of law, following the well settled principle of consistency of approach, as emerging from a chain of decisions referred to above, credit for deemed dividend tax is clearly allowable in respect of the assessment year under appeal.

20. We note that in his impugned order passed u/s. 263 of the I.T. Act, the Ld. PCIT has given directions to the AO on another issue which did not find any mention in the show cause notice issued. The Ld. PCIT has directed the AO to add the amount of undistributed dividend from Omani Company as reflected in the Profit and Loss Account of the PE of the assessee in Oman. We have already recorded a finding that the Ld. PCIT has no jurisdiction whatsoever to issue any directions with regard to any issue on which no show cause notice was issued and on that account even the order of the Ld. PCIT gets vitiated. Coming to the merits, from the factual position discussed, as aforesaid, it is seen that the annual accounts of the PE are prepared in accordance with the International Financial Reporting Standards (IFRS). As per IFRS-28 the share of PE in the profit / loss in OMIFCO at 25% has to be accounted as income in the Profit and Loss account of the PE even though such income received is only to the extent of dividend declared and distributed. Out of the total distributable profit, OMIFCO is required to transfer a specified amount to reserves under the Omani law and only the remaining profits are distributed to the shareholders. Therefore, even under the Omani Tax

Laws, the PE offers for taxation only the dividend income actually received and not the total share of the PE in the profits of OMIFCO. On the other hand, books of account of the assessee in India are required to be prepared in consonance with the Indian Accounting Standards. Obviously, the undistributed share of profit reflected in the books of P.E. cannot be said to partake the character of income under the provisions of the Income-tax Act. It is settled position that accounting entries are not determinative of taxability under the Income-tax Act and further only the real income can be brought to the charge of tax. In the present case even the undistributed profits reflected in the books of the P.E. are not brought to the charge of tax under the Omani Tax Laws. In our view having regard to the above mentioned facts the said income by assuming undistributed profit cannot be taxed under the I.T. Act. Therefore, on merits also the directions issued by the learned PCIT on this issue are not justified and the same are hereby vacated.

21. In view of the above, we hold that the impugned order passed by the learned PCIT u/s.263 of the I.T. Act is without jurisdiction and not sustainable in law. Accordingly, the said order is hereby quashed and as a result, the Assessee's Appeal No. 6785/Del/2015 (AY 2010-11) stands allowed.

22. Since the facts and circumstances pertaining to the A.Y. 2011-12, the grounds of appeal raised by the assessee-society and the arguments and submissions made before us on behalf of the assessee as well as on behalf of the Department are identical and same. Therefore, following the consistent view taken in ITA No. 6785/Del/2015 (AY 2010-11) as aforesaid, we hold that the Order passed u/s.263 by the learned PCIT in ITA No. 6786/Del/2015 (AY 2011-12) also suffers from fatal jurisdictional defects and is, therefore not sustainable in the eyes of law, hence, the same is also quashed accordingly. Similarly, on merits also the learned PCIT is not justified in giving directions to the Assessing Officer for withdrawal of tax credit in respect of deemed dividend tax as well as addition with regard to the undistributed profits reflected in the books of the P.E. Accordingly, for the A.Y. 2011-12 also the impugned order of the Ld. PCIT passed u/s. 263 of the I.T. Act is quashed and accordingly, this Appeal of the Assessee also stands allowed.

23. In the result, both the Appeals filed by the Assessee stand allowed.

■ ■

IN THE ITAT LUCKNOW BENCH 'A'

State Bank of India

v.

Deputy Commissioner of Income-tax (TDS), Kanpur

SUNIL KUMAR YADAV, JUDICIAL MEMBER
AND A.K. GARODIA, ACCOUNTANT MEMBER

IT APPEAL NOS. 138 TO 140 (LUCK.) OF 2015
[ASSESSMENT YEAR 2012-13]

MARCH 4, 2016

Pradeep Mehrotra, Advocate *for the Appellant*. **Amit Nigam** *for the Respondent*.

ORDER

Sunil Kumar Yadav, Judicial Member - These appeals are preferred by the assessee against the respective orders of the Id. CIT(A). Since common issues are involved in these appeals, these were heard together and are being disposed of through this consolidated order for the sake of convenience. We, however, prefer to reproduce the grounds raised in I.T.A. No. 138/LKW/2015 as under:—

1. That the Learned Commissioner of Income Tax (Appeal) has erred on facts and in law in holding that LTC paid to the employees involving foreign travel as well does not qualify for exemption u/s, 10(5) of the I.T. Act.
2. That the Learned Commissioner of Income Tax (Appeal) has erred on facts and in law in holding that the Assessing Officer was right in holding the assessee liable for TDS on the payment of LTC to the employees.
3. That the Learned Commissioner of Income Tax (Appeal) has failed to appreciate that the foreign travel was not the only destination but was part of the package and circuitous route offered by the travel agency under the package availed by the employees.
4. That the Learned Commissioner of Income Tax (Appeal) has erred on facts in dismissing the appeal on the point of TDS liability is erroneous, not based on the facts of the case is unjustified & bad in law liable to be quashed.
5. That the order dated 13/01/2015 passed by the CIT (A) is not based on the correct appreciation of the case laws cited during the course of hearing of

Appeal.

2. The facts borne out on the impugned issue, are that an information was received from the departmental channel to the effect that some of the branches of the State Bank of India have not deducted TDS on the amount of reimbursement of Leave Travel Concession (LTC)/Leave Fare Concession (LFC) given to the employees even in the cases where a foreign destination was included in the itinerary of their journey. Section 10(5) of the Income Tax Act, 1961 (hereinafter called in short "the Act") clearly stipulates that exemption under section 10(5) of the Act is available only for travel to any place in India and restricted to the amount of expenses actually incurred for the purpose of such travel read with conditions as per rule 2B of the Income Tax Rule, 1962. The Assessing Officer accordingly issued notice under section 201(1)/(201(1A) of the Act to the assessee requiring to explain as to why TDS was not deducted on the amount of reimbursement of LFC. Since the said amount cannot be treated as exempt under section 10(5) of the Act, as a foreign destination was included in the journey, the assessee was asked to explain as to why he may not be treated as assessee in default for not deducting TDS on the said amount of LFC reimbursement. Since no reply was filed by the assessee, the Assessing Officer treated the assessee to be in default in respect of payments mentioned in the assessment orders and was also directed to pay the same. Interest under section 201(1A) of the Act was also charged.

3. Aggrieved, the assessee preferred appeals before the Id. CIT(A) with the submission that the Assessing Officer has not appreciated the bona fide plea of the bank in granting benefit of LTC paid to the bank employees to travel out of India. It was further contended that the employee is entitled for exemption under section 10(5) of the Act to the extent of expenses incurred for travelling in India where the employees' designated place is not in India. It was further contended that the Assessing Officer has erred in applying a flat rate of 30% for computation of TDS instead of applying the actual income tax rate applicable in case of each employee.

4. The Id. CIT(A) re-examined the case of the assessee but was not convinced with the contentions of the assessee and confirmed the assessment order holding the assessee to be in default for non-deduction of TDS. He, however, accepted the contention of the assessee for calculation of tax at higher rate. He accordingly directed the Assessing Officer to recalculate the liability for TDS @ 10%.

5. Aggrieved, the assessee is in appeal before the Tribunal and reiterated its contentions. The Id. counsel for the assessee has also placed reliance upon the Circular/letter issued by the Dy. Managing Director of State Bank of India in the light of order of the Hon'ble Madras High court dated 16.2.2015 whereby the Hon'ble Madras High Court has directed not to deduct TDS on the amount paid or reimbursed to the employee of the bank in respect of LTC/HTC availed where the employee has visited a foreign city/country irrespective of the fact whether the LFC bills were submitted and paid prior to 16.2.2015. Copy of this Circular is placed on record. The Id. counsel for the assessee has further contended that in the light

of the Circular, the assessee should not be held to be in default for non-deduction of TDS on the amount of LTC to its employees.

6. The Id. D.R., on the other hand, has contended that as per provisions of section 10(5) of the Act, only that reimbursement of expenses, which were incurred on travel of employees and his family to any place in India subject to certain limits, are exempt. Since the employee of the assessee has travelled to foreign countries, the benefit of exemption available under section 10(5) of the Act cannot be granted to the employees. No doubt, at the time of advancement of LTC amount, the employer may not be knowing, but at the time of settlement of bills of LTC/LFC complete details must have been obtained by the employer and once it is noted that the employee has visited foreign countries and he is not entitled for exemption of reimbursement of LTC under section 10(5) of the Act, the employer should have deducted TDs while finalizing LTC/LFC bill. Since the assessee has intentionally did not deduct TDS on a payment, to which the employee is not entitled for any exemption, the Assessing Officer has rightly held the assessee to be in default and raised the demand under section 201(1) and 201(1A) of the Act.

7. So far as the Circular issued by the banker is concerned, the Id. D.R. has invited our attention that the interim order was passed by the Hon'ble Madras High Court on 16.2.2015, in which they have stated that after 16.2.2015 no TDS would be deducted on the reimbursement to the employee of the banker in respect of LTC/HTC availed. But in the instant case, the date of journey was in the year 2012, therefore, at the relevant point of time when the reimbursement was made to the employees, there was no interim order of the Hon'ble Madras High Court. Therefore, the assessee cannot take shelter of the aforesaid interim order of the Hon'ble Madras High Court.

8. Having carefully examined the orders of the lower authorities in the light of the rival submissions and the documents placed on record, we find that as per provisions of section 10(5) of the Act, only that reimbursement of travel concession or assistance to an employee is exempted which was incurred for travel of the individual employee or his family members to any place in India. Nowhere in this clause it has been stated that even if the employee travels to foreign countries, exemption would be limited to the expenditure incurred to the last destination in India. For the sake of reference, we extract the provisions of section 10(5) of the Act as under:—

10. In computing the total income of a previous year of any person, any income falling within any of the following clauses shall not be included—

[(5) in the case of an individual, the value of any travel concession or assistance received by, or due to, him,—

- (a) from his employer for himself and his family, in connection with his proceeding on leave to any place in India ;

- (b) from his employer or former employer for himself and his family, in connection with his proceeding to any place in India after retirement from service or after the termination of his service,

subject to such conditions as may be prescribed (including conditions as to number of journeys and the amount which shall be exempt per head) having regard to the travel concession or assistance granted to the employees of the Central Government:

9. On perusal of this section, we are of the view that this provision was introduced in order to motivate the employees and also to encourage tourism in India and, therefore, the reimbursement of LTC/LFC was exempted, but there was no intention of the Legislature to allow the employees to travel abroad under the garb of benefit of LTC available by virtue of section 10(5) of the Act. Undisputedly, in the instant case the employees of the assessee have travelled outside India in different foreign countries and raised claim of their expenditure incurred therein. No doubt, the assessee may not be aware with the ultimate plan of travel of its employees, but at the time of settlement of the LTC/LFC bills, complete facts are available before the assessee as to where the employees have travelled, for which he has raised the claim; meaning thereby the assessee was aware of the fact that its employees have travelled in foreign countries, for which he is not entitled for exemption under section 10(5) of the Act. Thus, the payment made to its employees is chargeable to tax and in that situation, the assessee is under obligation to deduct TDS on such payment, but the assessee did not do so for the reasons best known to it. We have also carefully examined the Circular placed by the Id. counsel for the assessee during the course of hearing, in which a reference was made to the interim order of the Hon'ble Madras High Court dated 16.2.2015. Through the interim order, the Hon'ble Madras High Court has permitted the bankers not to deduct TDS on or after 16.2.2015 on the amount paid/reimbursed to the employees of the bank in respect of LTC/HTC availed where the employee has visited a foreign city/country, irrespective of the fact whether the LFC bills were submitted and paid prior to 16.2.2015; meaning thereby this Circular was passed consequent to the interim order of the Hon'ble Madras High Court. But in the present case, the journey was undertaken in the year 2012 and the bills were settled during that year; meaning thereby at the relevant point of time when the bills were settled, there was no order of the Hon'ble Madras High Court and the assessee was under obligation to deduct TDS on the reimbursement of expenditure incurred by the assessee on foreign travel. In the light of these facts, we are of the considered opinion that the Revenue has rightly held the assessee to be in default, as the assessee has not deducted TDS intentionally on the reimbursement of expenditure incurred on LTC/LFC. Moreover, the Id. CIT(A) has directed the Assessing Officer to recalculate the liability of TDS at 10%. We, therefore, find no infirmity in the order of the Id. CIT(A) and we confirm the same.

10. In the result, appeals of the assessee are dismissed.

■ ■

IN THE ITAT KOLKATA BENCH 'A'

Stewarts & Lloyds of India Ltd.

v.

Commissioner of Income-tax, Circle -1, Kolkata

N.V. VASUDEVAN, JUDICIAL MEMBER
AND WASEEM AHMED, ACCOUNTANT MEMBER

IT APPEAL NO. 372 (KOL.) OF 2009
[ASSESSMENT YEAR 2004-05]

MARCH 2, 2016

Soumen Adak and **Prakash Singh** ACA *for the Appellant.* **Radhey Shyam** *for the Respondent.*

ORDER

N.V. Vasudevan, Judicial Member - This appeal by the Assessee is directed against the order dated 15.01.2009 of CIT, Circle-1, Kolkata passed u/s 263 of the Income Tax Act, 1961, (Act) relating to A.Y. 2004-05.

2. The Assessee is a company. For A.Y.2004-05, assessee filed return of income declaring total income of Rs.2,15,82,920/-. In the return of income filed by the assessee, the assessee had declared long term capital loss on sale of its property located at Ambattur Industrial Estate, Plot No.40-A(NP) in Saidapet Taluk and Chingleput M.G.R. District in the State of Tamil Nadu, hereinafter referred to as "the Property". The property was a vacant plot measuring about 3.44 Acres with compound wall. The Computation of long term capital loss as given by the assessee was as follows :—

<i>Particulars</i>	<i>Amount</i> (Rs.)
A.Long Term Capital Gain on sale of Land located at Ambattur Industrial Estate, Plot No.40-A(NP) in Saidapet Taluk and Chingleput M.G.R. District in the State of TamilNadu	
Sale Consideration (As per enclosed agreement for sale	32,325,000
Less : Commission paid on the sale of aforesaid land	1,073,926
	31,251,074
Less :- Indexed cost of acquisition (Note 1)	34,419,420
Long-term Capital Gain/(Loss)	(3,168,346)

Note-1 Indexed cost of acquisition is determined as under :-

Estimated Fair market value of Land as on 01-04-1981 (Year of acquisition – 1971)

[As per valuation report attached]	7,434,000
Indexed cost of acquisition[74,34,000*463/100]	34,419,420

3. The assessee sold the property to Reliance Infocom Ltd., under a sale deed dated 02.12.2003 for a total consideration of Rs.3,25,00,000. The Sale consideration towards the value of the land and the compound wall was apportioned at Rs.3,23,25,000 for the value of land and Rs.1,75,000 towards compound wall. In the computation of long term capital loss, the assessee claimed that it had paid Rs.10,73,926 as commission for sale of the said plot. The assessee deducted the indexed cost of acquisition i.e.,Rs.3,41,19,420 calculated on the fair market value of the land as on 01.04.1981 of Rs.74,34,000 from the said net sale consideration of Rs.3,23,25,000 and computed the long term capital loss at Rs.31,68,346 and claimed carried forward the same to the A. Y. 2005-06.

4. The AO completed the assessment u/s 143(3) of the Act by his order dated 05.12.2006. In the said order, the AO had accepted long term capital loss as declared by the assessee.

5. AO thereafter moved a proposal to the C.I.T. requesting him to exercise powers u/s 263 of the Act as the assessment order dated 05.12.2006 passed u/s 143(3) of the Act was erroneous and prejudicial to the interest of the revenue. The CIT after considering the proposal of the AO and after perusing the records was of the view that the order passed by the AO was erroneous and prejudicial to the interest of the revenue. He accordingly issued a show cause notice dated 11.08.2008.

6. It was the case of the CIT in the show cause notice that on 3rd March, 1971, the Government of Tamilnadu assigned the property to the assessee by an Indenture for construction of building and erection of machinery and equipments for the manufacture of fabricated pipe works and tubular structures. The Assignment was subject to many conditions including the condition that the assignee i.e., the assessee (i) shall not use the plot for any purpose other than that for which it was assigned; (ii) shall commence construction within six months from the date of taking possession of the said plot and complete the construction within two years from the said date; (iii) shall comply with the building regulation and other conditions as specified in the Indenture of assignment. The consideration for assignment was Rs.20,000 per acre and the total consideration was Rs.68,800 for 3.44 acres of land. In the Indenture of assignment there were 19 conditions to be observed by the assessee. According to CIT from the above mentioned conditions in the Indenture of assignment it was very much clear that the Government of Tamilnadu assigned the developed plot of land to the assessee for its use and the assessee was not conferred the absolute right over the land by virtue of the Indenture. Therefore, according to CIT the

assessee was not the owner of the property but a user of the property and right of the assessee over the property was limited to use of plot of land for business purposes. Later, by a G.O. Ms.N-959 dtd. 23.7.76, the Government of Tamilnadu handed over the management and maintenance of the Industrial Estate at Ambattur to Tamilnadu Small Industries Development Corporation Ltd. and transferred the ownership of the Industrial Estate at Ambattur to the said Corporation by G.O.Ms.N-785 dtd.7.8.88 and the said Corporation became the absolute owner of the Industrial Estate. Thereafter, at the request of the assessee, the said corporation sold the property to the assessee as per the sale deed dtd. 19.04. 1994 for a consideration of 68,800 already paid by the assessee as per the terms of the deed of assignment. In the sale deed, certain conditions were also imposed upon the assessee. One of the conditions was that the purchaser shall not transfer, sell or mortgage the property or change the ownership/constitution/partners/shareholders or directors within five years from the date of allotment without the prior approval of vendor i.e., Tamilnadu Small Industries Development Corporation Ltd.. But, however, beyond five years from the date of allotment, the purchaser was given the right to effect the changes after informing the vendor subject to compliance of the covenants contained in the sale deed. Therefore, according to CIT, from the language of the sale deed it was clear that the assessee became the owner of the property only in April, 1994 and further had right to dispose of the land only after five years from the date of the said sale deed dtd. 19.04.1994.

7. The property was sold by the Assessee to M/s.Reliance Infocom Ltd., under a sale deed dated 2.12.2003. It is only on this transfer capital loss in question was claimed in the return of income for AY 2004-05. According to CIT in the computation of long term capital loss, the assessee estimated the fair market value of the property as on 1/4/1981 at Rs.74,34,000 and calculated the cost of acquisition at Rs.3,44.19,420. The assessee claimed that the year of acquisition of the said plot was 1971 at a consideration of Rs.68,800 only. This according to CIT was wrong because according to CIT the year of acquisition was 19.4.1994 when a registered conveyance was obtained by the Assessee in respect of the property. According to CIT, in course of the regular assessment proceedings, for the A. Y. 2004-05, the Assessing Officer did not examine the long term capital loss calculated as above by the assessee and also he did not make any enquiry relating to the claim of the assessee that there was long term capital loss on sale of the property. The A.O. also did not make any enquiry as to whether the payment of commission on sale of the property amounting to Rs.10,73,926 was genuine and whether the assessee had constructed any factory building on the property and sold the factory building with the property to Reliance Infocom Ltd. on 02.12.2003. The Assessing Officer also did not examine the issue whether the fair market value of the land as on 01.04.1981 estimated in the valuation report filed with the return was at all applicable for calculation of Long Term Capital Loss since the assessee became the owner of the land only in April, 1994 when Tamilnadu Small Scale Industries Development Corporation had sold the property to the assessee by a Registered Deed and the assessee was only an assignee of the property till then and used the land as tenant/user by virtue of the Indenture of assignment dtd. 03.03.1971. The CIT was therefore of the view that the order

of the AO was erroneous and prejudicial to the interest of the revenue and was liable to be revised in exercise of his powers of revision u/s.263 of the Act.

8. In reply to the show cause notice as above, the Assessee submitted that the Assessee became owner of the property by virtue of assignment deed dated 3.3.1971 and complied with all the conditions of the assignment and thus became de facto owner of the property much before 1.4.1981 and in terms of Sec.55(2)(b)(i) of the Act, it was entitled to adopt the fair market value of the property as on 1.4.1981. In this regard the Assessee pointed out that the definition of Transfer for the purpose of Sec.2(47) of the Act under clause (v) of Sec.2(47) of the Act also includes "Any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882". The Assessee pointed out that Sec.2(14) of the Act defines "Capital Asset" to mean property of any kind "held by an Assessee". The expression "held by an Assessee" only means that "de jure" ownership is not a condition precedent for regarding a person as owner of a capital asset. The Assessee placed reliance on the decision of the Hon'ble Madras High Court in the case of *Madathil Brothers v. DCIT* 301 ITR 345 (Mad) wherein it was held as follows:

"....the definition of "capital asset" refers to property of any kind "held" by an assessee. In contradistinction to the word "owner" or "owned", the definition uses the phrase "held". A reading of s. 45 as it stands today, shows that capital gain is chargeable on "any profits or gains arising from the transfer of the capital asset...". Read in the context of the definitions of "capital asset" and "transfer" the section carries no words of limitation to read that a transfer effected by a person backed up with a title passed on under a registered deed alone could be considered as resulting in a profit or gain assessable under s. 45. All that the present section looks at is the transfer of a capital asset held as understood under s. 2(14) and under s. 2(47). The question then is, what will be the effect of the amendment brought forth to s. 2(47) by the insertion of sub-cl. (v) to s. 2(47) relating to the definition of "transfer" under the Finance Act, 1987 w.e.f. 1st April, 1988. The definition under s. 2(47) is an inclusive one which starts by saying "transfer in relation to the capital asset includes"; as such, it is not possible to accept the stand of the respondent that the transactions falling under s. 53A of the Transfer of Property Act for the purpose of considering the capital gains would fall for consideration for the purpose of considering the same as falling under long-term capital asset only on and from the amendment inserted under the Finance Act, 1987, w.e.f. 1st April, 1988. The insertion is only declaratory of the law already there by reason of inclusive terms under s. 2(47) which is a wide definition in its import. The capital gain arising on the transfer of capital assets has to be worked out from the date of the agreement under which the assessee was put in possession of the property....."

The Assessee also placed reliance on the following other decisions laying down identical proposition as laid down by the Hon'ble Madras High Court referred to above, viz., *CIT v.*

Ved Praksh & Sons (HUF) 207 ITR 148 (P & H) and *Griipwell Industries Ltd. v. ITO* 99 ITD 368 (Mum).

9. The CIT however did not agree with the aforesaid contention put forth by the Assessee. He held that the words "held by an Assessee" would mean de jure ownership and such ownership was acquired by the Assessee only on 19.4.1994 when a registered conveyance was executed in its favour. In coming to the above conclusion, the CIT placed reliance on the decision of the Hon'ble Karnataka High Court in the case of *CIT v. Dr. VV Mody* 218 ITR 1 (Karn.) wherein the facts were that the assessee, an individual, was allotted a site by the Bangalore Development Authority on the 25th May, 1972 in accordance with the relevant rules of allotment. A lease-cum-sale agreement was executed according to which the assessee was required to pay a certain amount to the Bangalore Development Authority and at the end of the 10th year, secure a conveyance in his favour upon payment of the entire sale consideration. Consequently, a sale-deed was executed in favour of the assessee by the Bangalore Development Authority on the 29th March, 1982, registered on the 13th May, 1982. Shortly, thereafter, on 27th Nov., 1982, the assessee sold the site to a third person for a total consideration of Rs. 1,69,200. The question before the Court was as to whether it can be said that the Assessee "held the property" from the year 1971 or only when the registered conveyance was executed in his favour. The Hon'ble Karnataka High Court held as follows:

"12. The term capital asset as defined by s. 2(14) of the Act means property of any kind held by the assessee whether or not connected with his business or profession, but does not include the specified items of property. Leasehold rights held by an assessee do not fall under any one of the exclusions contemplated by the definition. The expression "property" is of the widest import and subject to any limitations which the context may require, it signifies every possible interest which a person can acquire, hold and enjoy—Refer *Ahmed G.H. Arif & Ors. v. CWT* [1970] 76 ITR 471 (SC). It is, therefore, true that if any one of such interests was alienable by the holder of the same, it could give rise to a capital gain short or long-term depending upon the period for which the interest was held by the person concerned.

13. The question, however, is not whether the leasehold right held by the assessee could independent of the sale in favour of the assessee have been treated as a property right capable of generating a capital gain in the hands of the assessee. The question really is as to whether any such right existed and could be transferred by the assessee after the same had merged in the larger estate acquired by the assessee. This is particularly so because what is transferred by the assessee is not the lesser interest held by him earlier to his becoming the absolute owner but the total interest acquired by him in the form of absolute title to the property, transferred. In the circumstances, unless it was possible for the assessee to hold the two estates simultaneously and independent of each other, the transfer of the title in the property could not be deemed to be transferring the lesser and the larger estates both so as to make them

amenable to a process of splitting for purpose of taxing the capital gain arising as a short-term or long-term gain. This, however, was not so in the present case. As from the 29th March, 1982, the assessee held only one estate representing the title to the property in question and any capital gain arising from the transfer of the said estate made on 27th Nov., 1982, could only be giving rise to a short-term gain. The Tribunal was in these circumstances in error in holding otherwise."

10. The CIT also held that the payment of property tax by the Assessee was only for the purpose of levy and recovery of property tax in view of clause-7 of the deed of assignment dated 3.3.1971 and that did not confer any ownership rights over the property in favour of the Assessee. With regard to the argument of the Assessee by placing reliance on Sec.2(47)(v) of the Act, the CIT was of the view that those provisions are not applicable when one of the contracting parties was Government. He also held that even otherwise the conditions necessary for application of Sec.53A of the Transfer of Property Act, 1887 were not present in the case of the Assessee.

11. For the above reasons, the CIT set aside the order of the AO in so far as it relates to acceptance of capital loss on sale of the property and directed the AO to frame assessment on the above issue by considering the date of acquisition of the property as 19.4.1994 and further directed the AO to enquire into the actual cost of acquisition and expenditure in connection with the transfer claimed by the Assessee.

12. Aggrieved by the order of the CIT, the Assessee has preferred the present appeal before the Tribunal.

13. We have heard the submissions of the learned counsel for the Assessee and the learned DR. The first argument of the learned counsel for the Assessee was that u/s.263 of the Act it is only the CIT who can suo motto initiate proceedings and in this case the AO has mooted the proposal for revision u/s.263 of the Act and therefore the order u/s.263 of the Act has to be held to be invalid, illegal. We are of the view that this argument is liable to be rejected. It is no doubt true that the CIT in the show cause notice u/s.263 of the Act has set out the proposal of the AO that his order suffered from an error and by reason of such error his order was prejudicial to the interest of the revenue. In para 3 of the show cause notice the CIT has clearly set out that he has perused the proposal and the assessment record and has also expressed satisfaction that the AO has failed to make proper verification and that there was an error in his order which was prejudicial to the interest of the revenue. There is no prohibition u/s.263 of the Act for the CIT to act on the basis of proposal by the AO and that the CIT has to initiate action u/s.263 of the Act only suo motto. So long as there is application of mind on errors brought to his notice and the other conditions u/s.263 of the Act are satisfied, there can be no grievance whatsoever to the Assessee. We therefore reject this argument made on behalf of the Assessee.

14. The next contention of the learned counsel for the Assessee was that Property 'held' by the assessee is relevant in computing capital gain and not 'owned'. According to him in all

sections dealing with the computation of capital gain viz., Sec. 2(14) Capital Assets, Sec. 2(42A) Short Term Capital Assets and Explanation (iii) to Sec. 48 indexed cost of acquisition, the term used is 'held' and not 'owner' or 'owned'. According to him therefore, for the purpose of determining date of acquisition in computing long term capital gain, absolute ownership is not relevant. He again placed reliance on the decision of the Hon'ble Madras HC in *Madathil Brothers v. DCIT* [2008] 301 ITR 345 (Mad) wherein it was held that the definition of 'capital asset' u/s 2(14) refers to property of any kind "held" by an assessee as distinguished from the word 'owner' or 'owned'. He also placed reliance on an identical view taken by Hon'ble Kolkata ITAT in *Anindya Dutta v. DCIT* [2013][ITA No. 473/Kol./2012]. His further submission was that the only difference between 'short term capital asset' and 'long term capital asset' is the period over which the property has been held by the assessee and not the nature of the title of the property. It was his submission that in the case of the Assessee, possession of land was given to the Assessee in 1970 and by way of sale deed executed in 1994, only improvement of the existing right in the said land has taken place. The said improvement will not have any impact on determination of holding period. He placed reliance upon the decision of Hon'ble Allahabad HC in *CIT v. Rama Rani Kalra* 358 ITR 499 (All). It was further submitted that depreciation u/s 32 of the Act is allowable, inter-alia, if the assets are wholly or partly owned by an assessee. Even in such cases, it has been held that legal ownership is not necessary and possession of assets would suffice for allowance of depreciation. Reference was made to the decision of the Hon'ble Apex Court in *Mysore Minerals Ltd. v. CIT* [1999] 239 ITR 775 (SC) wherein it was held that anyone in possession of property for the time being in his own title and having right to use or occupy it and/ or to enjoy it in his own right for the purpose of business or profession would be the owner of the property though a formal deed of title may not have been executed and registered. It was argued that if possession and control over the property was sufficient to be owner of the asset for the purposes of sec. 32 it can be said that same would be more than sufficient to treat that the Assessee as owner of the property from 1970 for the purposes of computation of Capital Gains/loss. It was further submitted that enabling enjoyment of any immovable property falls within the definition of 'transfer' as per Sec. 2(47)(vi) of the Act. Sec. 2(47)(vi) of the Act, defines 'transfer', as transactions, which inter-alia, have the effect of transferring or enabling the enjoyment of any immovable property by way of any agreement or arrangement or in any other manner. It was pointed out that in the case of the Assessee, in terms of agreement dated 03-03-1971, the assessee was enjoying the possession of immovable property from 08-04-1970 onwards. Accordingly in terms of clause (vi) of Sec. 2(47) the plot of land was transferred to the assessee only on 08-04-1970. It was submitted that the decision relied upon by the Ld. CIT in *CIT v. Dr. V.V. Mody* [1996] 218 ITR 1 (Kar) does not hold good since the same was rendered without considering the amendments made vide Finance Act 1987 in Sec. 2(47) by way of insertion of clause (v) & (vi) as held in the case of *CIT v. Smt. C. Shakuntala* (ITA No. 117 of 2006) (Kar) & *Smt. Anita Venugopalchar v. ITO* (ITA No. 3667/Mum/2010). Without prejudice, it was submitted that in view of Explanation 2 to Sec. 2(47) inserted by Finance Act, 2012 w.e.f. 01-04-1962 the

impugned property has to be regarded as transferred to the Assessee on 08- 04-1970 i.e. the date on which the possession of land was handed over. It was also pointed out that, Explanation 1 to Sec. 2(47) r.w.s. 269UA(d)(i) adopts definition of 'transfer' from clause (f) of Sec. 269UA which provides that the term 'transfer' includes lease for a term not less than 12 years. It was argued that in the case of the Assessee, possession of immovable property has been transferred for an indefinite period (certainly for more than 12 years) since 1971 and hence the same constitutes transfer u/s 2(47)(vi) of the Act.

15. The learned DR placed reliance on the order of the CIT and the decision of the Hon'ble Karnataka High Court in the case of *CIT v. Dr.V.V.Modi (supra)*.

16. We have given a very careful consideration to the rival submissions. Sec.45 of the Act lays down that any profit or gain arising from the transfer of a capital asset effected in the previous year shall be chargeable to income tax under the head "capital gains" and shall be deemed to be the income of the previous year in which the transfer took place. Sec.2(47) of the Act defines "transfer" for the purpose of the Act and it reads thus:

(47) "transfer", in relation to a capital asset, includes,—

- (i) the sale, exchange or relinquishment of the asset; or
- (ii) the extinguishment of any rights therein ; or
- (iii) the compulsory acquisition thereof under any law ; or
- (iv) in a case where the asset is converted by the owner thereof into, or is treated by him as, stock-in trade of a business carried on by him, such conversion or treatment ; or
- (iva) the maturity or redemption of a zero coupon bond; or
- (v) any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882 (4 of 1882) ; or
- (vi) any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of, any immovable property.

Explanation[1]: For the purposes of sub-clauses (v) and (vi), "immovable property" shall have the same meaning as in clause (d) of section 269UA;

Explanation 2.— For the removal of doubts, it is hereby clarified that "transfer" includes and shall be deemed to have always included disposing of or parting with an asset or any interest therein, or creating any interest in any asset in any manner whatsoever, directly or indirectly, absolutely or conditionally, voluntarily or involuntarily, by way of an agreement (whether entered into in India or outside India) or otherwise, notwithstanding that such transfer of rights has been characterised as being effected or dependent upon or flowing from the transfer of a share or shares of a company registered or incorporated outside India;'.

17. Sec.48 lays down the method of computation of long term capital gain and it reads as follows:

"Sec.48: The income chargeable under the head "Capital gains" shall be computed, by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset the following amounts, namely :—

- (i) expenditure incurred wholly and exclusively in connection with such transfer;
- (ii) the cost of acquisition of the asset and the cost of any improvement thereto:

Provided that in the case of an assessee, who is a non-resident, capital gains arising from the transfer of a capital asset being shares in, or debentures of, an Indian company shall be computed by converting the cost of acquisition, expenditure incurred wholly and exclusively in connection with such transfer and the full value of the consideration received or accruing as a result of the transfer of the capital asset into the same foreign currency as was initially utilised in the purchase of the shares or debentures, and the capital gains so computed in such foreign currency shall be reconverted into Indian currency, so however, that the aforesaid manner of computation of capital gains shall be applicable in respect of capital gains accruing or arising from every reinvestment thereafter in, and sale of, shares in, or debentures of, an Indian company:

Provided further that where long-term capital gain arises from the transfer of a long-term capital asset, other than capital gain arising to a non-resident from the transfer of shares in, or debentures of, an Indian company referred to in the first proviso, the provisions of clause (ii) shall have effect as if for the words "cost of acquisition" and "cost of any improvement", the words "indexed cost of acquisition" and "indexed cost of any improvement" had respectively been substituted :

Provided also that nothing contained in the second proviso shall apply to the long-term capital gain arising from the transfer of a long-term capital asset being bond or debenture other than capital indexed bonds issued by the Government : Provided also that where shares, debentures or warrants referred to in the proviso to clause (iii) of

section 47 are transferred under a gift or an irrevocable trust, the market value on the date of such transfer shall be deemed to be the full value of consideration received or accruing as a result of transfer for the purposes of this section:

Provided also that no deduction shall be allowed in computing, the income chargeable under the head "Capital gains" in respect of any sum paid on account of securities transaction tax under Chapter VII of the Finance (No. 2) Act, 2004.".'.

Explanation : For the purposes of this section,—

- (i) "foreign currency" and "Indian currency" shall have the meanings respectively assigned to them in section 2 of the Foreign Exchange Management Act, 1999 (42 of 1999);
- (ii) the conversion of Indian currency into foreign currency and the reconversion of foreign currency into Indian currency shall be at the rate of exchange prescribed in this behalf;
- (iii) "indexed cost of acquisition" means an amount which bears to the cost of acquisition the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the Cost Inflation Index for the first year in which the asset was held by the assessee or for the year beginning on the 1st day of April, 1981, whichever is later;
- (iv) "indexed cost of any improvement" means an amount which bears to the cost of improvement the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the Cost Inflation Index for the year in which the improvement to the asset took place;
- (v) "Cost Inflation Index", in relation to a previous year, means such Index as the Central Government may, having regard to seventy-five per cent of average rise in the Consumer Price Index (Urban) for the immediately preceding previous year to such previous year, by notification in the Official Gazette, specify, in this behalf."

18. From a reading of Sec.48 of the Act it is clear that from the full value of consideration received on transfer the cost of acquisition of the capital asset and the cost of its improvement are one of the permissible deduction to arrive at the capital gain/loss. The expression "cost of acquisition" has been defined in Sec.55 (2) of the Act. The clause of Sec.55(2) of the Act which is relevant in the present case is clause (b)(i) which reads thus:

"(2) For the purposes of sections 48 and 49, "cost of acquisition",—

(b) in relation to any other capital asset,—

- (i) where the capital asset became the property of the assessee before the 1st day of April, 1981, means the cost of acquisition of the asset to the assessee or the fair market value of the asset as on the 1st day of April, 1981, at the option of the assessee;

19. It can be seen that clause (b)(i) of Sec.55(2)(b) would be attracted only when "the capital asset became the property of the Assessee" before 1st April, 1981. It was the plea of the Assessee that though a registered conveyance in respect of the property was obtained by the Assessee only on 19.4.1994, it became the owner of the property by paying the entire consideration as set out in the deed of assignment dated 3.3.1971 and by complying with the conditions of assignment much before 1.4.1981 and therefore under clause (b)(i) of Sec.55 of the Act, it was entitled to adopt the fair value market value as on 1.4.1981 as cost of acquisition while computing capital gain/loss.

20. The undisputed facts are that the property was assigned by the Tamil Nadu Government through Governor by a deed of assignment dated 3.3.1970. The consideration payable by the Assessee for the assignment of the property was a sum of Rs.34,400/-. The Assessee paid Rs.17,200/- on the date of assignment. The remaining sum was to be paid in two equal instalments, the 1st instalments to be paid within 2 years from the date of taking possession of the property and the second installment was to be paid within one year from the date on which the second instalment is due. It is also not in dispute that the monies payable by the Assessee as per the deed of assignment have been duly paid well before 1st April, 1981. It is not in dispute that the Assessee took possession of the property on 8.4.1970.

21. It is important to understand what is the interest in the property created by the deed of assignment dated 3.3.1970 in favour of the Assessee. The preamble to the deed of assignment refers to the Government having formulated a scheme for the laying of developed plots for industries at Ambattur and the layout plan in respect thereof having been approved by the Town Planning authorities. It thereafter refers to the Assessee having applied for assignment to them of the property. Thereafter there is a reference to the consideration for the assignment and the mode in which it has to be paid. Thereafter the deed of assignment recites that the Government assigns to the Assignee the property on the terms and conditions set forth. There are about 19 clauses thereafter. It will be useful to refer to certain clauses which are relevant for the present case

"12. The assignee shall not, without the previous sanction of the Director, transfer the whole or any part of his interest in the said plot or in any superstructures constructed thereon, or part with the possession of the said plot or superstructure or any portion thereof.

"15. Notwithstanding anything hereinbefore contained, in the event of a breach of any of the these conditions by the assignee, the Director may after giving reasonable notice, cancel this assignment and resume that plot and on such resumption, the said plot shall vest absolutely in the government free from all encumbrances and the

assignee shall be paid for the land only the price actually paid by the assignee after deducting the penal interest, if payable under clause 14 above. "

16. If for any reason, the assignee desires to relinquish his right over the said plot, the director may resume the land and the assignee shall be paid/or the land only the price as actually paid by the assignee after deducting penal interest. if any, payable under clause 14 above. "

22. The deed of assignment does not say what interest over the property that is assigned to the Assignee. Nevertheless some interest is created in favour of the Assignee and that is clear from clause-12 of the deed of assignment. The deed of assignment cannot be construed as conveying absolute ownership/interest over the property in favour of the Assessee because such ownership/absolute interest is conveyed only by deed of sale dated 19.4.1994. The deed of assignment does not confer any right on the Assessee to demand conveyance from the Assignor nor was there any agreement to convey the property to the Assessee. The Assessee was therefore not an agreement holder in possession of the property. In such circumstances, we fail to see as to how the Assessee can lay claim on the basis of Sec.2(47)(v) of the Act. The Assessee in the present case was neither a lessee nor an agreement holder in respect of the property. The capacity in which the Assessee was in occupation of the property prior to the sale deed dated 19.4.1994 was as a permissive user and that did create interest over the property in favour of the Assessee. By the deed of sale dated 19.4.1994 such possessory right got enlarged into an absolute ownership rights. We are of the view that the sale deed merely recognized the Assessee's ownership with reference to original deed of assignment dated 3.3.1970 and payment of full consideration in respect of the property prior to 1.4.1981. The title of the Assessee to the property can be traced to the original assignment deed dated 3.3.1970.

23. Sec.55(2)(b)(i) of the Act defines "Cost of acquisition" and the expression "where the capital asset became the property of the Assessee before 1st April, 1981" used therein has to be interpreted keeping in mind the policy and object of the statute. The benefit of indexation is also given so that the inflation in value is taken care of and only the real gain is brought to tax. The expression "where the capital asset became the property of the Assessee before 1st April, 1981 in the context of Sec.55(2)(b)(i) of the Act, is rather ambiguous, in the sense that it does not speak of the date of vesting of legal title to the property. Even the provisions of sec.2(47)(v) & (vi) of the Act which defines what is "transfer" for the purpose of the Act, considers possessory rights as akin to legal title. It is therefore necessary to look into the policy and object of the provisions giving exemption from levy of tax on capital gain. In the present case the Assessee had paid the entire consideration for the property prior to 1.4.1981. Therefore the claim of the Assessee that the property became property of the Assessee before 1st April, 1981 as it held the property from the year 1970 has to be accepted, keeping in mind the policy and object of the provisions giving the benefit of inflation by adopting fair market value as on 1.4.1981 in respect of properties acquired prior to that date. In our view that the legislature would not

have intended to give a meaning to the expression "where the capital asset became the property of the Assessee before 1st April, 1981" used in Sec.55(2)(b)(i) of the Act, as referring to only vesting of legal title. It is unlikely that the legislature would wish to deny benefit of adopting Fair Market value as on 1.4.1981 while computing cost of acquisition for the purpose of Sec.48 of the Act, in a case where, otherwise the Assessee satisfies all parameters for grant of fair market value as on 1.4.1981. The expression "where the capital asset became the property of the Assessee before 1st April, 1981" as used in Sec.55(2)(b)(i) of the Act should not be therefore be equated to legal ownership. In the present case the Assessee had an antecedent interest over the property as early as 3.3.1970 and a vested right over the property by paying the entire sale consideration and complying with the other terms of the deed of assignment much prior to 1.4.1981. We are therefore of the view that the CIT was not justified in directing the AO to adopt the date of acquisition of the property by the Assessee for the purpose of computing capital gain u/s.48 as 19.4.1994. The claim of the Assessee that it was entitled to adopt fair market value of the property as on 1.4.1981 as cost of acquisition and consequent indexation benefit is correct. We reverse and modify the order of the CIT to this extent.

24. As far as what is the cost of acquisition and as to whether the expenditure incurred by the Assessee in connection with the transfer were allowable deduction or not, has not been examined by the AO while completing the assessment u/s.143(3) of the Act. To this extent we uphold the order of the CIT directing the AO to examine these two aspects and compute capital gain accordingly.

25. In the result the appeal by the Assessee is partly allowed.

■ ■

HIGH COURT OF BOMBAY

Techpac Holdings Ltd.

v.

Deputy Commissioner of Income-tax (OSD-II), Mumbai

M.S. SANKLECHA AND B.P. COLABAWALLA, JJ.

WRIT PETITION NO. 241 OF 2014

MARCH 18, 2016

J.D. Mistry, Sr. Counsel, **Madhur Agarwal** and **Atul K. Jasani** *for the Petitioner.* **A.R. Malhotra** and **N.A. Kazi** *for the Respondent.*

JUDGMENT

B. P. Colabawalla, J - This Petition under Article 226 of the Constitution of India challenges the Assessment Order dated 25th March, 2013 passed by Respondent No.1 [Dy. Commissioner of Income Tax (OSD-II), Mumbai] in relation to A.Y. 2005-06. This Assessment Order was passed under section 144 read with section 147 of the Income Tax Act, 1961 (for short, "the Act"). By this Assessment Order, Respondent No.1 has inter alia held that a sum of Rs.575.39 crores is the capital gains in the hands of the Petitioner arising out of a transfer of a capital asset in India. Accordingly, a demand of Rs.697.94 crores has been raised on the Petitioner as and by way of capital gains tax which is inclusive of interest etc under different provisions of the Act.

2. In this Petition, rule was issued on 23rd June, 2014 and interim relief in terms of prayer clause (d) was granted. Thereafter, a request was made on behalf of the Revenue that the Writ Petition be taken up out of turn as the total tax impact in the present proceedings was a very large sum. In this view of the matter, this Writ Petition is taken up for hearing and final disposal.

3. The two principal grounds of challenge to the impugned Assessment Order are that:—

- (i) none of the notices [viz. under sections 148, 142(1) or 143(2) of the Act] were ever served on the Petitioner which is a company incorporated under the laws in Bermuda. Since service of these notices was mandatory before any Assessment Order could be passed under section 144 of the Act, the impugned Assessment Order is wholly without jurisdiction; and
- (ii) that in any event, the notice issued under section 148 of the Act and which finally led to the Assessment Order being passed under section 144 of the Act, was wholly without jurisdiction as Respondent No.1 could not have any

reason to believe that income chargeable to tax had escaped assessment. This argument is canvassed on the basis that admittedly the Petitioner is not a transferor of any capital asset in India and hence there was no question of levying any capital gains tax on the Petitioner.

4. It is therefore the case of the Petitioner that the impugned Assessment Order is wholly without jurisdiction and it is in these circumstances that the Petitioner has sought to justify invocation of our writ jurisdiction under Article 226 of the Constitution of India without first exhausting the statutory remedies available to it under the Act for challenging the impugned Assessment Order.

5. To understand the present controversy, it would be necessary to refer to some relevant facts which are as under:—

- (a) The Petitioner is a company incorporated under the laws of Bermuda and is the holding company of the entire Techpac Group. Respondent No.1 is the Deputy Commissioner of Income Tax (OSD-II) who has passed the impugned Assessment Order dated 25th March, 2013 under section 144 of the Act for A.Y. 2005-06 inter alia holding that the Petitioner is liable to pay capital gains tax on a sum of Rs.575.39 crores. Respondent No.2 is the Union of India and is the employer of Respondent No.1.
- (b) It is an undisputed position that the shares of the Petitioner company (equity as well as preferential) were held by certain non-resident as well as resident shareholders. The bulk of the shareholding was held by three private equity funds viz. CVC Capital Partners Asia Pacific LP, Asia Investors LLC, and Hagemeyer Caribbean Holding NV. The Petitioner is a holding company and has under its fold several operating companies in Australia, New Zealand and Thailand including a company called Tech Pacific Asia Ltd., a company registered in the British Virgin Islands. In turn, Tech Pacific Asia Ltd. was the holding company of Techpac Mauritius Ltd. as well as other operating companies in Hong Kong, Malaysia and Singapore. Techpac Mauritius Ltd. was in turn the holding company of an Indian subsidiary by the name of Tech Pacific (India) Ltd. (hereinafter referred to as "Tech Pacific India"). This Indian subsidiary in turn was the holding company of Tech Pacific India (Exports) Pte. Ltd., which was a company incorporated in Singapore. All the aforesaid companies (over 20 Companies in 13 different countries) are hereinafter referred to as the Techpac Group. Hence the Petitioner was the ultimate holding company of the Techpac Group.
- (c) The Techpac Group was a technology distributor and a leading technology sales, marketing and logistics group in the Asia Pacific region. One Ingram Micro Inc., USA, a company registered in the United States of America is also one such company who has its presence worldwide. The Ingram Micro

Group also consists of several companies throughout North America, Europe, Middle East, Africa, Latin America and Asia Pacific regions which support global operations through an extensive sales and distribution network (hereinafter referred to as the "Ingram Group"). We must mention here that Ingram Micro Inc., USA was the holding Company of inter alia a company called Ingram Micro Asia Holdings Inc., USA (hereinafter referred to as "Ingram Micro Asia") which was also a company incorporated in USA. Ingram Micro Asia had a fully owned subsidiary in India by the name Ingram Micro India Pvt. Ltd.

- (d) The Ingram Group felt that it required to strengthen its presence in the Asia Pacific region and accordingly offered to take over the Techpac Group. Accordingly, in November 2004, Ingram Micro Asia acquired the shares of the Petitioner company under a share purchase agreement in which Ingram Micro Asia was the purchaser, the shareholders of the Petitioner company (described in Schedule I to the said agreement) were the sellers, and Ingram Micro Inc., USA (the ultimate holding company of the Ingram Group) was the guarantor. The consideration under the said share purchase agreement was set out in clause 2 thereof and inter alia came to a sum of approximately AUD 730 million (Australian dollars). After the aforesaid acquisition, the Indian entity of the Ingram Group [Ingram Micro India Pvt. Ltd.] was merged into the Indian entity of the Techpac Group [Tech Pacific India] and post the merger, the name of Tech Pacific India was changed to Ingram Micro India Ltd (hereinafter referred to as "Ingram Micro India"). In other words, Tech Pacific India continued to exist post the merger, but under a new name viz. Ingram Micro India. In this fashion, the Ingram Micro Group took over the Techpac Group.
- (e) During the course of search and seizure proceedings carried out at the premises of Ingram Micro India [earlier known as Tech Pacific India] on 17th September 2007, the annual report of Ingram Micro Inc., USA for the year 2005 was inter alia found alongwith the share purchase agreement. Looking at the documents seized during the search, Respondent No.1 was of the opinion that since the shares of the Petitioner company had been transferred to the Ingram Group, capital gains had accrued to the Petitioner. Accordingly, Respondent No.1 served a notice under section 163 of the Act dated 22nd November, 2010 on Ingram Micro India [previously known as Tech Pacific India] seeking to treat them as an agent of the Petitioner in respect of the alleged capital gains which had arisen in the previous year relevant to A. Y. 2005-06. In addition thereto, Respondent No.1 by its letter dated 24th November, 2010 also called upon Ingram Micro India to furnish details of the sale of shares of the Petitioner company alongwith the details of the amounts received. Thereafter, on 3rd December 2010, Ingram Micro India received another letter from Respondent No.1 calling upon it to furnish the details as

required failing which assessment would be completed under section 144 of the Act.

- (f) To challenge this action of Respondent No.1, Ingram Micro India [previously known as Tech Pacific India] filed a Writ Petition being Writ Petition (L) No.2710 of 2010. By an order dated 7th December, 2010, this Court disposed of the said Writ Petition directing Respondent No.1 to give a hearing to Ingram Micro India before passing any order under section 163 of the Act. The said order further recorded that in case the order passed by Respondent No.1 was adverse to Ingram Micro India, no further action would be taken thereupon for a period of four weeks from the date of communication of the said order.
- (g) Be that as it may, Respondent No.1, after hearing Ingram Micro India passed an order dated 14th January, 2011 under section 163 of the Act inter alia holding it to be an agent of the Petitioner company and also computing capital gains in the hands of the Petitioner at Rs.575.39 crores.
- (h) Being aggrieved by the aforesaid order, Ingram Micro India approached this Court in its writ jurisdiction by filing Writ Petition No.285 of 2011. This Court by its order dated 30th November, 2011 quashed the order passed by Respondent No.1 under section 163 of the Act on the ground that the same was beyond the period of limitation prescribed under the Act. In other words, this Court quashed the order of Respondent No.1 treating Ingram Micro India as an agent of the Petitioner company. This order has not been challenged by the Revenue and has attained finality.
- (i) In this Writ Petition, it is the specific stand of the Petitioner that after passing of the aforesaid order dated 30th November, 2011 (in Writ Petition No.285 of 2011), it was not aware of any proceedings being taken by the Revenue authorities to make any assessment in the hands of the Petitioner company of the alleged capital gains arising from the transfer of its shares. It is the specific case of the Petitioner that no notice of whatsoever nature either inter alia under section 148 or under section 142(1) or under section 143(2) of the Act has been served on the Petitioner and the Petitioner was not aware of any other procedure / proceedings sought to be adopted by the Revenue authorities in this regard.
- (j) Be that as it may, on 29th October 2013, Ingram Micro Inc., USA (having its address at 1600 E. St. Andrew Place, Santa Ana, CA 92705, USA) received the impugned Assessment Order dated 25th March, 2013 passed under section 144 of the Act holding that the total taxable income computed in relation to the Petitioner company was Rs.575.39 crores. It is the case of the Petitioner that this Assessment Order was forwarded by Ingram Micro Inc.,

USA to the Petitioner on 30th October, 2013. It is only at this time that the Petitioner first came to know of the impugned Assessment Order and has therefore approached this Court in its writ jurisdiction seeking to quash the same.

6. In this factual background, Mr Mistry, learned Sr. Counsel appearing on behalf of the Petitioner, principally urged two contentions before us. They are :

- (A) despite the fact that the impugned Assessment Order records that notices under sections 148, 143(2) as well as 142(1) of the Act were issued and served on the Petitioner, no such notices were ever received by the Petitioner. Mr Mistry contends that this has now become expressly clear from the affidavit in reply filed in this Writ Petition wherein it has now been admitted that the notices under sections 148, 142(1) and 143(2) were sought to be served not on the Petitioner but on Ingram Micro India [previously known as Tech Pacific India]. This is despite the fact that the Revenue authorities were in possession of the address of the Petitioner in Bermuda and yet chose not to serve any notice on the Petitioner on the said address. He submitted that in the facts of the present case before any Assessment Order could be passed under section 144 of the Act, it was a sine-qua-non that a notice under section 148 of the Act ought to have been served on the Assessee. If this was not done, the Assessment Order passed under section 144 was wholly without jurisdiction requiring our interference under Article 226 of the Constitution of India. In support of the aforesaid proposition, Mr Mistry relied upon a decision of the Supreme Court in the case of *Y. Narayana Chetty and another v. Income Tax Officer, Nellore and others*; [1959] 35 ITR 388
- (B) that in any event of the matter, in law, no capital gains had accrued in the hands of the Petitioner as the shares of the Petitioner company were transferred by its shareholders to Ingram Micro Asia and therefore Respondent No.1 could never have any reason to believe that income chargeable to tax had escaped assessment as contemplated under section 147 of the Act. To elaborate this point further, Mr Mistry contended that in the facts of the present case, it was the shares of the Petitioner company that were transferred by its shareholders to Ingram Micro Asia. If there was any capital gains that accrued to any person in this transaction, if at all, the same would be in the hands of the shareholders of the Petitioner and not in the hands of the Petitioner company viz. Techpac Holdings Ltd. To put it simply, he gave an illustration that if "A" transferred his shares in "Larsen & Toubro Ltd" to "B", the capital gains if at all could be taxed in the hands of "A" but certainly not in the hands of "Larsen & Toubro Ltd". To attract capital gains, Mr Mistry submitted that (i) the person who is sought to be taxed has to have transferred a capital asset; and (ii) some gain ought to have arisen by virtue

of such transfer in the hands of the transferor. In the facts of the present case, Techpac Holdings Ltd. (the Petitioner) has neither transferred any capital asset and neither has it received any gain by virtue of any such transfer. In this view of the matter, he submitted that the Revenue Authorities have proceeded on a total misconception in seeking to tax capital gains, if any, in the hands of the Petitioner company.

7. For all the aforesaid reasons, Mr Mistry submitted that the impugned Assessment Order is wholly without jurisdiction and ought to be set aside by us in our writ jurisdiction under Article 226 of the Constitution of India.

8. On the other hand, Mr Malhotra, learned counsel appearing for the Revenue authorities, submitted as under :

- (A) it is an admitted fact that Ingram Micro India [earlier known as Tech Pacific India] is a down-stream company of the Petitioner. The Revenue was having the last known address of the Petitioner as that of Ingram Micro India [earlier known as Tech Pacific India] being Gate No.1A, Godrej Industrial Estate, Phirozsha Nagar, Eastern Express Highway, Vikhroli (East), Mumbai 400 079. Since this was the last known address of the Petitioner, the notice dated 29th March, 2012 under section 148 of the Act was sent to this address on 30th March, 2012. This notice was duly received by Ingram Micro India [earlier known as Tech Pacific India] and was thereafter returned to the Revenue Authorities. Mr Malhotra submitted that Ingram Micro India opened the postal envelope and after seeing the contents thereof, closed it and sent it back to the Revenue Authorities. He submitted that therefore a request was made to the authorized representative of Ingram Micro India [earlier known as Tech Pacific India] for submitting the correspondence address of the Petitioner, which was not supplied to them. Since Ingram Micro India [earlier known as Tech Pacific India] was having a business understanding with the Petitioner, the service of the notice issued under section 148 of the Act on Ingram Micro India [earlier known as Tech Pacific India] was good service on the Petitioner;
- (B) With reference to the service of notices dated 16th January, 2013 issued under sections 142(1) and 143(2) of the Act, Mr Malhotra gave an identical explanation. Mr Malhotra submitted that these notices were also served on the last known address being that of Ingram Micro India [earlier known as Tech Pacific India] and the same were returned back to the Revenue authorities with the remarks "Refused". He submitted that since these notices were duly served and not responded to by the Petitioner, and time to carry out the assessment proceedings was getting over, the Revenue had no option but to pass an ex-parte Assessment Order under section 144 of the Act on 25th March, 2013.

In these circumstances, Mr Malhotra submitted that there was no merit in the contention of the Petitioner that they were not served with the notices under sections 148, 142(1) or 143(2) of the Act;

- (C) The Assessing Officer clearly had reason to believe that income chargeable to tax had escaped assessment because by virtue of the aforesaid share purchase agreement entered into in November, 2004 there was clearly a transfer of a capital asset in India as contemplated under section 9(1)(i) of the Act. Mr Malhotra submitted that as a consequence of the said agreement, Ingram Micro India [earlier known as Tech Pacific India] alongwith all its assets and liabilities was transferred to Ingram Micro Asia. Since Ingram Micro India [earlier known as Tech Pacific India] was a company situated in India, there was clearly a transfer of a capital asset in India and therefore by virtue of the provisions of section 9(1)(i) of the Act, the income from such transfer was deemed to accrue in India. Mr Malhotra submitted that as the income was earned towards consideration of transfer of its business / economic interest i.e. Ingram Micro India [earlier known as Tech Pacific India] by reason of the above transaction, the Petitioner had earned income liable for capital gains tax in India. Mr Malhotra submitted that the share purchase agreement entered into in November, 2004 would clearly establish that the same was not really between the shareholders of the Petitioner and Ingram Micro Asia but was one between the Petitioner and Ingram Micro Asia. He therefore submitted that even on this count, the submissions made on behalf of the Petitioner were of no substance and ought to be rejected by us.

9. With the help of learned counsel, we have gone through the papers and proceedings in the above Writ Petition as well as the annexures thereto. As far as the issue of service of notices under sections 148, 142(1) and 143(2) of the Act are concerned, it is an admitted position that the said notices were never served on the Petitioner. The Revenue seeks to justify service of these notices on the Petitioner by contending that they have served the said notices on the last known address of the Petitioner which was the address of Ingram Micro India [earlier known as Tech Pacific India], the downstream company of the Petitioner. We fail to see how the notices being served on Ingram Micro India [earlier known as Tech Pacific India] would amount to service on the Petitioner. This is more so in the facts of the present case considering that admittedly on the date when these notices were sought to be served on Ingram Micro India [earlier known as Tech Pacific India], the Revenue was aware of the address of the Petitioner. This is clearly borne out by (i) the share purchase agreement that was in the possession of the revenue authorities on the said dates in which (at Recital "A" pg 34 of the paper-book) the registered office of the Petitioner company is clearly mentioned; and (ii) the letter dated 30th March, 2012 (Exh.R-2, page 203 of the paper-book) addressed by Respondent No.1 to the Joint Secretary, (FT & TR)-II, Central Board of Direct Taxes, North Block, New Delhi 110 001 in which Respondent No.1 clearly mentions that the registered office of the Petitioner is Charladon House, 2-Churchstreet,

Hamilton, HM-11, Bermuda. Despite having this address prior to issuance of the notices under section 148, 142(1) and 143(2) of the Act, we fail to understand why these notices were not served on the Petitioner at this address. In these circumstances, we cannot accede to the contention of Mr Malhotra that service of the aforesaid notices on Ingram Micro India [earlier known as Tech Pacific India] (which is a subsidiary of the Petitioner) would be good service on the Petitioner.

10. We must also not lose sight of the fact that in the present case Ingram Micro India [earlier known as Tech Pacific India] was not the assessee or even a representative – assessee of the Petitioner. In fact, the Revenue in the earlier round of litigation, sought to treat Ingram Micro India [earlier known as Tech Pacific India] as an agent of the Petitioner under the provisions of section 163 of the Act. Being aggrieved by this action of the Revenue, Ingram Micro India [earlier known as Tech Pacific India] approached this Court in its writ jurisdiction by filing Writ Petition No.285 of 2011. This Court by its order dated 30th November, 2011 quashed the order of the Revenue Authorities passed under section 163 of the Act treating Ingram Micro India [earlier known as Tech Pacific India] as the agent of the Petitioner. Once this Court struck down the action of the Revenue treating Ingram Micro India [earlier known as Tech Pacific India] as an agent of the Petitioner, all the more, service of the notices under sections 148, 142(1) and/or 143(2) of the Act on Ingram Micro India [earlier known as Tech Pacific India] could never be considered as good service on the Petitioner.

11. Section 148 of the Act clearly stipulates that before making any assessment, re-assessment or re-computation under section 147 of the Act, the Assessing Officer shall serve on the assessee a notice requiring him to furnish within such period as may be specified in the notice a return of income or the income of any other person in respect of which he is assessable in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed. The section further stipulates that once this is done, the provisions of the Income Tax Act shall, so far as may be, apply as if such return were a return required to be furnished under section 139 of the Act. Therefore, clearly as stipulated in the said section, the notice issued under section 148 of the Act has to be served on the assessee. This is a sine-qua-non before any further action can be taken. If this notice itself is not served, all other proceedings that flow therefrom would have no legs to stand on and would fall to the ground. This is no longer res-integra as it stands concluded by the decision of the Supreme Court in the case of *Y. Narayana Chetty and another* [1959] 35 ITR 388. The Supreme Court, whilst considering similar provisions under the Income Tax Act, 1922 held that service of the requisite notice on the assessee is a condition precedent to the validity of any re-assessment. If a valid notice is not issued as required, proceedings taken by the Income Tax Officer in pursuance of the invalid notice and the consequent orders on assessment passed by him, would be void and inoperative. The Supreme Court opined that the notice under section 34 of the 1922 Act (similar to section 148 of the 1961 Act) cannot be regarded as a mere procedural requirement. It is only if the said notice is served on the

assessee as required, that the Income Tax Officer would have jurisdiction to proceed further against him. If no notice is issued or if the notice issued is invalid, then the proceedings taken by the Income Tax Officer without a notice, or in pursuance of the invalid notice, would be illegal and void. The relevant portion of the Supreme Court decision [at pg 392 of the ITR report] reads thus:—

"The first point raised by Mr Sastri is that the proceedings taken by Respondent No.1 under Section 34 of the Act are invalid because the notice required to be issued under the said section has not been issued against the assessee contemplated therein. In the present case the Income Tax Officer has purported to act under Section 34(1)(a) against the three firms. The said sub-section provides inter alia that "if the Income Tax Officer has reason to believe that by reason of the omission or failure on the part of the assessee to make a return of his income under Section 22 for any year or to disclose fully and truly all material facts necessary for his assessment for that year, income, profits or gains chargeable to income tax has been underassessed", he may, within the time prescribed, "serve on the assessee a notice containing all or any of the requirements which may be included in the notice under subsection (2) of Section 22 and may proceed to reassess such income, profits or gains". The argument is that the service of the requisite notice on the assessee is a condition precedent to the validity of any reassessment made under Section 34; and if a valid notice is not issued as required, proceedings taken by the Income Tax Officer in pursuance of an invalid notice and consequent orders of reassessment passed by him would be void and inoperative. In our opinion, this contention is well-founded. The notice prescribed by Section 34 cannot be regarded as a mere procedural requirement; it is only if the said notice is served on the assessee as required that the Income Tax Officer would be justified in taking proceedings against him. If no notice is issued or if the notice issued is shown to be invalid then the validity of the proceedings taken by the Income Tax Officer without a notice or in pursuance of an invalid notice would be illegal and void. That is the view taken by the Bombay and Calcutta High Courts in the *CIT v. Ramsukh Motilal* [(1955) 27 ITR 54] and *R.K. Das & Co. v. CIT* [(1956) 30 ITR 439] and we think that that view is right."

(emphasis supplied)

12. Looking to the facts of the present case and since the notice issued under section 148 of the Act was admittedly not served upon the Petitioner (who is the assessee in the present case), the consequent Assessment Order passed under section 144 of the Act is clearly without jurisdiction and ought to be set aside on this ground alone.

13. In view of our above finding that in the absence of service of notice issued under section 148 of the Act, the Assessing Officer does not acquire jurisdiction to proceed further, the notices issued under section 142(1) and 143(2) both dated 16th January, 2013 (and which, in the facts of this case, can only be issued post the service of notice issued under section

148), also fall to the ground. Nevertheless, in the present facts we find that both these notices under section 142(1) and 143(2) were not served on the Petitioner. More importantly, we fail to understand how a notice under section 142(1) and under section 143(2) can be issued on the same date. Section 142(1) of the Act stipulates that for the purpose of making an assessment under the Act, the Assessing Officer may serve on any person who has made a return under section 115WD or section 139 or in whose case, the time allowed under sub-section (1) of section 139 for furnishing the return has expired, a notice requiring him on a date therein specified (a) where such person has not filed a return within the time allowed under sub-section (1) of section 139 of the Act or before the end of the relevant assessment year, inter alia to furnish a return of income. Section 143(2) in turn applies where a return has been furnished either under section 139 or in response to a notice under sub-section (1) of section 142 of the Act. Therefore, clearly, sub-section (2) of section 143 would come into play only when a return is furnished under section 139 or a return is furnished in response to a notice under subsection (1) of section 142. This would clearly establish that a notice under section 142(1) and under section 143(2) can never be issued on the same date. Furthermore in the facts of the present case, section 143(2) could never apply because admittedly no return had ever been filed by the Petitioner. We find that the Assessment Order merely records that notices under sections 148, 142(1) and 143(2) have been served on the Petitioner. Apart from the fact that this is factually incorrect, we find that there is a total non-application of mind on the part of the Assessing Officer in issuing a notice under section 143(2) of the Act. We therefore have no hesitation in holding that the Assessment Order passed under section 144 of the Act is wholly without jurisdiction as the notices under section 148 as well as under section 142(1) were never served on the Petitioner.

14. Having held so, we must state that in the facts of the present case, we find that even otherwise the Assessing Officer could never have reason to believe that income chargeable to tax had escaped assessment warranting the issuance of a notice under section 148 of the Act. Section 147 of the Act (to the extent it is relevant for our purpose) reads as under :—

"147. Income escaping assessment.—If the Assessing Officer, has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may, subject to the provisions of Sections 148 to 153, assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section, or recompute the loss or the depreciation allowance or any other allowance, as the case may be, for the assessment year concerned (hereafter in this section and in Sections 148 to 153 referred to as the relevant assessment year):

Provided that where an assessment under sub-section (3) of Section 143 or this section has been made for the relevant assessment year, no action shall be taken under this section after the expiry of four years from the end of the relevant assessment year, unless any income chargeable to tax has escaped assessment for such assessment year

by reason of the failure on the part of the assessee to make a return under Section 139 or in response to a notice issued under sub-section (1) of Section 142 or Section 148 or to disclose fully and truly all material facts necessary for his assessment, for that assessment year:"

15. Section 147 of the Act stipulates that if the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may, subject to the provisions of sections 148 to 153, assess or re-assess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section, or recompute the loss or the depreciation allowance or any other allowance, as the case may be, for the assessment year concerned. Therefore, before any notice under section 148 of the Act can be issued for initiating assessment / re-assessment proceedings, the Assessing Officer ought to have reason to believe that any income chargeable to tax has escaped assessment for that particular assessment year. This "reason to believe" is a sine-qua-non for issuance of the notice under section 148.

16. The facts of the present case and as more elaborately set out earlier in the judgment, clearly show that the shares of the Petitioner company were transferred by its shareholders to Ingram Micro Asia. The Petitioner itself has not transferred anything. In order to attract capital gains tax there are two requirements that need to be fulfilled – (1) that there is a transfer of a capital asset; and (2) there is a gain by virtue of such transfer. If these conditions are satisfied, then capital gains tax is to be computed as set out in section 48 of the Act.

The facts of the present case would clearly show that the Petitioner has not transferred any capital asset in India that would give rise to any capital gains tax in their hands. This is borne out from the share purchase agreement which itself stipulates that the 100% shareholding of the Petitioner company was transferred by its shareholders (described in schedule I thereof) to Ingram Micro Asia for a total consideration of AUD 730 million (Australian dollars) equivalent to Rs.2,501.72 crores (conversion rate being 1 Australian dollar = Rs.34.127). Even if we were to assume that by virtue of Ingram Micro Asia purchasing the 100% shareholding of the Petitioner, there was a transfer of a capital asset in India, the same could never be taxed as capital gains in the hands of the Petitioner company. This is for the simple reason that the shares of the Petitioner company have been transferred to Ingram Micro Asia by the Petitioner's shareholders and therefore the transferor in the aforesaid transaction is the shareholders of the Petitioner and not the Petitioner company. In these circumstances, if there was any liability towards capital gains tax, if at all (we are not called upon to consider this aspect), it was that of the shareholders of the Petitioner and not the Petitioner itself. This being the position in law, the Assessing Officer could never have reason to believe that income of the Petitioner chargeable to tax in India had escaped assessment. If the Assessing Officer could not have had any reason to form the aforesaid belief, then naturally what follows is that no notice under section 148 of the Act could be

issued in the facts of the present case. Consequently, the Assessment Order passed under section 144 of the Act was therefore wholly without jurisdiction. On this count also, we find that the Assessment Order passed under section 144 of the Act is unsustainable and has to be set aside.

17. Faced with this situation, Mr Malhotra very feebly tried to contend that the share purchase agreement entered into in November, 2004 was one which was actually between the Petitioner company and Ingram Micro Asia and not between the shareholders of the Petitioner and Ingram Micro Asia. We are afraid we are unable to accept this argument for more than one reason. Firstly, the impugned Assessment Order does not proceed to compute the capital gains on the basis that the aforesaid share purchase agreement was ostensibly entered into between the Petitioner company and Ingram Micro Asia. This argument is being canvassed for the first time by the Revenue in this Writ Petition. Secondly, we find this argument without any substance as we fail to see how the Petitioner company can enter into any agreement for sale of its own shares. The shares of the Petitioner company are held by its shareholders who are the owners of the shares and who alone can transfer the same to a third party. Therefore, we are unable to understand the basis of the argument of Mr Malhotra that the share purchase agreement was ostensibly between the Petitioner company and Ingram Micro Asia.

18. In view of our earlier findings the Petitioner must succeed. However, it is clarified that we have not examined whether any capital gains have accrued to the shareholders of the Petitioner. If the Revenue Authorities are of the opinion that in fact capital gains have accrued to the shareholders of the Petitioner, they are free to take such action against the shareholders of the Petitioner as are permitted in law. Equally, if such proceedings are adopted by the Revenue against the shareholders of the Petitioner, all contentions to contest the same are left open. Thus all contentions of all the parties concerned are kept open in that regard. For all the aforesaid reasons, rule is made absolute and the Petition is granted in terms of prayer clause (a). No order as to costs.

■ ■

IN THE ITAT BANGALORE BENCH 'B'

Telelogic India (P.) Ltd.

v.

Deputy Commissioner of Income-tax, Circle 12(4), Bangalore

ABRAHAM P. GEORGE, ACCOUNTANT MEMBER
AND VIJAY PAL RAO, JUDICIAL MEMBER

IT(T.P.) A. NO.1599 (BANG.) OF 2012
[ASSESSMENT YEAR 2008-09]

MARCH 9, 2016

Padamchand Khincha, C.A. *for the Appellant.* **Smt. Neera Malhotra, Addl. CIT (D.R)** *for the Respondent.*

ORDER

Vijay Pal Rao, Judicial Member - This appeal by the assessee is directed against the assessment order dt.30.11.2011 passed under Section 143(3) rws 144C in pursuant to the directions of the Dispute Resolution Panel (in short 'DRP') dt.16.8.2012 passed under Section 144C(5) of the Income Tax Act, 1961 (in short 'the Act') for the Assessment Year 2008-09.

2. The assessee has raised the following grounds :

1 Assessment and reference to Transfer Pricing Officer are bad in law

- (a) The learned Deputy Commissioner of Income-tax, Circle 12(4) ['DCIT' or 'AO'] / Deputy Commissioner of Income Tax - Transfer Pricing - V ['TPO'] erred in law and on facts in making a addition of INR 33,452,024 to the total income of the Appellant on account of adjustment to the arm's length price with respect to software development service transaction entered into by the Appellant with its associated enterprises.
- (b) The AO/TPO erred in law and on facts as he failed to establish that the Appellant shifted profits outside India.

2 Comparability analysis adopted by the TPO for determination of arm's length price

- (a) The AO/TPO grossly erred on facts and in law in rejecting the filters and search process adopted by the Appellant in the Transfer Pricing Study. Further, the

AO/TPO also erred on facts and in law by conducting a fresh benchmarking analysis in respect of captive software services provided by the Appellant and wrongly comparing the Appellant's activities with companies operating as full-fledged entrepreneurs without considering the differences in functions performed, assets employed and risks assumed by the Appellant vis-à-vis comparable companies.

- (b) The AO/TPO erred in law in applying arbitrary filters as criterion for rejection of companies identified by the Appellant in the Transfer Pricing Study such as (i) companies whose data for financial year ('FY') 2007-08 was not available, (ii) companies with software development service revenue less than 75% of total operating revenue, (iii) companies with software development service revenue less than INR 1 crore, (iv) companies with export sales less than 25% of total revenue, (v) companies with related party transactions greater than 25% of operating revenue, (vi) companies with employee cost is less than 25% of total revenues, (vii) companies with different financial year ending (i.e. other than 31 March 2008), (viii) companies having diminishing revenues / persistent losses during financial year 2007-08 and (ix) companies whose onsite income is greater than 75% of export revenues.
- (c) The AO/TPO also erred on facts and in law in excluding the foreign exchange gain or loss while calculating the net margins of the comparable companies.
- (d) The AO/TPO also erred on facts in arbitrarily accepting companies without considering the turnover and size of the Appellant and comparables and also erred on facts in arbitrarily rejecting companies based on their financial results without considering the functional comparability.
- (e) The AO/TPO erred in considering a set of 'secret data', i.e. data which was not available in public domain and not allowing the Appellant an opportunity to cross examine the data furnished by companies to whom notice under Section 133(6) of the Act were issued.

3 Erroneous data used by the AO/TPO

- (a) The AO/TPO has erred in law in using data, which was not contemporaneous and which was not available in the public domain at the time of conducting the transfer pricing study by the Appellant or at the time of undertaking of assessment by the TPO.
- (b) The AO/TPO erred in law and on facts in disregarding the application of multiple-year data while computing the margins of comparable companies.

4 Non-allowance of appropriate adjustments to the comparable companies, by the AO/TPO

- (a) The AO/TPO erred in law and on facts in not allowing appropriate adjustments under Rule 10B to account for, *inter alia*, differences in (i) accounting practices, (ii) marketing expenditure, (iii) research and development expenditure, and (iv) risk profile between the Appellant and the comparable companies.

5 Variation of 5% from the arithmetic mean

- (a) The AO/TPO erred in law in not granting the variation as per the proviso to Section 92C(2) of the Act.

6 Grant of lower deduction under section 10A of the Income-tax Act, 1961

- (a) On the facts and in the circumstances of the case, the learned AO has erred in reducing the travel expenses incurred in foreign currency amounting to Rs. 6,669,249 from the export turnover while computing the deduction under section 10A of the Act irrespective of the fact that the Appellant is engaged in software development activity and not rendering technical services outside India.
- (b) On the facts and in the circumstances of the case, the learned AO has erred in reducing the telecommunication expenses of Rs. 2,983,358 from the export turnover irrespective of the fact that entire expenses cannot be attributable to the delivery of computer software outside India.
- (c) On the facts and in the circumstances of the case, the learned AO has erred in treating the insurance expenses of Rs 9,763,523 as incurred for delivery of computer software outside India.
- (d) Without prejudice to the above, on the facts and in the circumstances of the case, the learned AO has erred in erroneously considering Telecommunication charges as Rs 2,983,358 as against Rs 9,763,523 and Insurance charges as Rs 9,763,523 as against Rs 359,738.
- (e) Without prejudice to the above, on the facts and in the circumstances of the case, the learned AO has erred in reducing the travel expense incurred in foreign currency amounting to Rs. 6,669,249; telecommunication expenses amounting to Rs. 2,983,358; and insurance charges of Rs 9,763,523 only from the export turnover without correspondingly reducing the said expenses from the total turnover.

7 Disallowance of interest paid to Telelogic Sweden

- (a) On the facts and in circumstances of the case, the learned AO has erred in treating the proceeds from issue of convertible debenture issued to Telelogic Sweden as funds utilised for acquisition of assets and disallowing a proportionate interest of Rs 167,757 as capital in nature.
- (b) Without prejudice to the above, even if it is assumed that proceeds from issue of convertible debentures were utilised for acquisition of assets, the learned AO has erred in computing the proportionate interest.
- (c) Without prejudice to the above, the AO has erred in not providing depreciation on the aforesaid amount of proportionate interest disallowed as capital in nature.

8 Disallowance of rent equalization amount

On the facts and in the circumstances of the case, the learned AO has erred in disallowing rent equalization amount of Rs 801,624 treating the same as unascertained liability inspite of the fact that the Assessee has deducted taxes on the same.

9 Disallowance of consultancy charges paid to Telelogic Germany

On the facts and in the circumstances of the case, the learned AO has erred in disallowing Rs 1,435,960 paid towards consultancy charges to Telelogic Germany without appreciating the details submitted by the Appellant.

10 Ratio adopted for apportioning items of disallowance

On the facts and in the circumstances of the case, the learned AO has erred in considering a different ratio for apportioning the items of disallowances between STP and Non-STP Unit as against the ratio regularly adopted by the Assessee i.e. head – count basis.

11 Set off of unabsorbed depreciation of earlier years

On the facts and in the circumstances of the case, the learned AO is to be directed to allow set off of unabsorbed depreciation against the taxable income of the subject assessment year in case the additions/ disallowances made in earlier years' assessment orders are deleted by the appellate authorities.

12 Directions issued by the Honorable DRP

The Honorable DRP has erred in law and on facts in not taking cognizance of the objections filed by the Appellant in relation to the draft assessment

order issued by the AO/ TP order and confirming the draft order of the AO.

13 Interest under section 234B of the Act

The learned AO has erred in levying interest under section 234B of the Act amounting to Rs 1,173,089.

14 Penalty under section 271(1)(c)

The learned AO has erred in initiating penalty proceedings under section 271(1)(c) of the Act.

Relief

- (a) The Appellant prays that directions be given to grant all such relief arising from the above grounds and also all relief consequential thereto.
- (b) The Appellant craves leave to add to or alter, by deletion, substitution, modification or otherwise, the above grounds of appeal, either before or during the hearing of the appeal.

Further, the Appellant prays that the adjustment in relation to transfer pricing matters made by the learned AO/TPO and upheld by Honorable DRP is bad in law and liable to be deleted."

3. Ground No.1 is general in nature and does not require any specific adjudication.

4. Ground Nos.2 to 5 are regarding Transfer Pricing Adjustment made by the Transfer Pricing Officer ('TPO') by considering the various comparable companies and confirmed by the DRP. The assessee company was incorporated on 14.11.2000. The assessee is engaged in the business of selling licenses for use of software product developed by its parent and group companies. It also provides product development, after sales services, consultancy services and training services. The assessee basically operates three business segments i.e. (i) Distribution of software license (ii) Information Technology Enabled Services (ITES) and (iii) Software Development Services. The assessee has reported the financial results for the Assessment Year under consideration as well as segment results as worked out by the TPO after excluding foreign exchange loss and gains as under :

Description	Amount (Rs.)
Operating Revenues	51,77,31,084
Operating Cost	48,24,31,816
Operating Profit	3,52,99,268

OP / TC 7.32%

Description	Software Devt. Services (Rs.)	IT Enabled Service (Rs.)	Distribution of software licenses (Rs.)
Operating Revenues	220034997	160066222	142959428
Operating Cost	196354998	135965920	48494000
Operating Profit	23679999	24100302	94465428
OP/TC	12.06%	17.72%	194.80%
OP/OR	10.76%	15.06%	66.08%

The assessee has entered into international transactions during the year with its Associated Enterprises (AEs) which are reported in 3CEB as under :

Description	Amount (Rs.)
Payment of royalty for software application	4,84,94,000
Product development – Software Development Services.	21,72,52,102
Indian Global Services.	2,87,31,881
International Telemarketing	1,32,57,075
Accounting Services	19,07,807
Consultancy Fees received.	12,61,497
Consultancy Services Paid	14,35,960
Issue of debentures.	18,50,00,000
Payment of interest (paid)	23,31,506
Reimbursement of expenses (paid)	8,76,299
Recovery of expenses (received)	24,27,098

The assessee has bench marked its international transactions by adopting the TNMM as Most Appropriate Method ('MAM') for all three segments in its T.P. Analysis report. The TPO accepted the transactions in respect of distribution segment and ITES at arm's length. However, the TP Study analysis in respect of software development services was rejected by the TPO. Therefore, the only dispute before us is regarding the adjustment made by the TPO in respect of software development services segment of the assessee apart from other non-

T.P. issues. The assessee selected 17 comparables to bench mark its international transaction of software development services as under :

<i>Sl.No.</i>	<i>Name of the Company</i>	<i>NCP 2005-06 (%)</i>	<i>NCP 2006-07 (%)</i>	<i>NCP 2007-08 (%)</i>	<i>Weighted Average (%)</i>
1.	Akshay Software Technologies Ltd.	4.02	4.49	NA	4.27
2.	Birla Technologies Ltd.	11.10	-3.55	1.84	3.40
3.	Computech International Ltd.	4.52	5.88	NA	5.37
4.	Helios & Matheson Information Technology Ltd.	33.42	36.88	32.82	34.36
5.	Indium Software (India) Ltd.	27.59	2.04	NA	12.00
6.	Kaashyap Technologies Ltd.	NA	57.68	16.04	17.16
7.	Lanco Global Systems Ltd.	6.00	16.01	21.96	17.64
8.	Neilsoft Ltd.	14.71	9.67	NA	11.59
9.	PSI Data Systems Ltd.	1.64	6.52	6.75	5.48
10.	Persistent Systems Pvt. Ltd.	21.05	19.50	NA	20.14
11.	Powersoft Global Solutions Ltd.	16.19	13.19	14.30	14.40
12.	Quintegra Solutions Ltd.	14.22	15.95	31.27	23.14
13.	RS Software (India) Ltd.	14.81	12.62	10.00	12.63
14.	R Systems International Ltd.	22.35	7.35	16.87	14.72
15.	Sagarsoft (India) Ltd.	-11.62	23.08	6.17	7.92
16.	Shree Tulsi Online.Com Ltd.	3.33	15.66	NA	9.22
17.	Vama Industries Ltd.	23.05	10.99	NA	18.50
	Arithmetical Mean				13.64

The TPO rejected 12 out of the 17 comparables selected by the assessee and carried out a fresh search for including 15 more comparable companies. Accordingly, the TPO has considered 20 comparable companies to determine the ALP as under :

<i>Sl.No.</i>	<i>Name of the company</i>	<i>Operating Margin on Cost (%)</i>	<i>Adjusted Margin on Cost (%)</i>
1.	Avani Cimcon Technologies Ltd.	25.62	27.58

2.	Bodhtree Ltd.	18.72	18.12
3.	Celestial Labs Ltd.	87.94	80.42
4.	E-Zest Solutions Ltd.	29.81	28.65
5.	Flextronics Software Systems Ltd.	7.86	4.78
6.	iGate Global Solutions Ltd.	13.99	10.91
7.	Infosys Technologies Ltd.	40.37	37.25
8.	KALS Information Systems Ltd. (Seg.)	31.29	27.54
9.	LGS Global Ltd. (Lanco Global Solutions Ltd.)	27.52	25.22
10.	Mindtree Consulting (Seg.)	16.41	14.07
11.	Persistent Systems Ltd.	20.31	19.32
12.	Quintegra Solutions Ltd.	21.74	17.28
13.	R System Intl. Ltd. (Seg.)	15.30	12.09
14.	R S Software (India) Ltd.	7.41	7.41
15.	Sasken Communication Technologies Ltd. (Seg.)	7.58	5.63
16.	Tata Elxsi Ltd. (Seg.)	18.97	17.43
17.	Thirdware Solutions Ltd.	19.35	15.58
18.	Wipro Ltd. (Seg.)	28.45	28.46
19.	Soft Sol India Ltd.	17.89	14.15
20.	Lucid Software Ltd.	16.50	16.47
	Total :	23.65	21.43

Accordingly, the TPO proposed T.P. Adjustment of Rs.1,83,79,242 after allowing working capital adjustment. The assessee challenged the action of the TPO/A.O before the DRP but could not succeed.

5. Before us, the Id. AR has submitted that 13 out of 20 companies considered by the TPO for determination of ALP in respect of international transactions for providing software development services, are not comparable with the assessee. Thus, the Id. AR submitted that these 13 companies should be excluded from the set of comparables for determination of the ALP. He has contended that all these 13 companies have been considered by the coordinate Bench of this Tribunal in the series of decisions including the decision in the case

of *M/s 3DPLM Software Solutions Ltd. v. DCIT* in IT(TP)A No.1303/Bang/2012 (AY-2008-09) dated 28.11.2013. Thus, the Id. AR has pointed out that this Tribunal in various cases has held that these companies cannot be considered as comparables with the software development services as provided by the assessee. He has also invited our attention to various decisions of this Tribunal wherein these companies were rejected as comparables of software development services provider. Apart from these 12 companies selected by TPO the Id. AR is also seeking exclusion of M/s Bodhtree Consulting Ltd from the list of comparables in the additional ground raised by the assessee on the ground that in case of *M/s Mindtech (India) Ltd. v. DCIT* in IT(TP) No.70/Ban/2014 (AY-2009-10) dated 21.8.2014 this Tribunal has held that M/s Bodhtree Ltd cannot be considered as comparables. Thus, the Id. AR has submitted that after excluding these 13 companies from the list of comparables the mean margin of remaining companies selected by the TPO comes to 13.72 % and after adjustment of working capital it comes to 13.50 % in comparison the operating margin of the assessee at 11.30% which is within the range of $\pm 5\%$ and therefore no adjustment is called for.

6. On the other hand, the Id. DR submitted that TPO took segmental data in case of M/s KALS Information Systems Ltd (Seg.), M/s Tata Elxsi Ltd (Seg.) and M/s Wipro Ltd (Seg.), therefore, the objection raised by the assessee that these companies are functionally not comparable with the assessee is not sustainable. As regard M/s Quintegra Solutions Ltd, the Id. DR submitted that it is assessee's own comparable included in the TP study report and therefore, the assessee cannot ask for rejection of the said company as comparable. He has relied upon the orders of authorities below. In rejoinder, the Id. AR has submitted that though M/s Quintegra Solutions Ltd was part of the TP study of the assessee but it was found that the said company is not comparable with the function of the assessee and therefore, it cannot be included in the list of comparables for determination of ALP. He has relied upon the decision of Special Bench of ITAT of Chandigarh Bench in the case of *DCIT v. QUARK SYSTEMS (P.) LTD.* [2010] 38 SOT 307 (ITAT[Chand]). The Id. AR has further pointed out that in case of M/s KALS Information Systems Ltd (Seg.), M/s Tata Elxsi Ltd (Seg.) and M/s Wipro Ltd (Seg.), the result of software segment also includes software product and no separate data for software development segment are given by these companies, therefore, the revenue and the margin of composite segment of software product and software development service cannot be compared with the revenue and margin of the assessee from software development service alone.

7.1 The learned Authorised Representative of the assessee has submitted that these all 13 comparable companies have been considered by the coordinate bench of this Tribunal in the case of Kodiak Network vide order dt.5.5.2015 in ITA No.1540/Bang/2012 and therefore the comparability of these 13 companies have been covered by the findings of the Tribunal in the case of Kodiak Network India Pvt. Ltd. (supra).

7.2 The assessee is seeking exclusion of 2 comparable companies namely Persistent Systems Pvt. Ltd. and Quintegra Solutions Ltd. from the list of comparable companies which was also

part of the assessee's TP Analysis and therefore the assessee has filed additional grounds as under :

- "1. The learned TPO has erred in selecting Persistent Systems Limited as a comparable in the order u/s 92CA, despite that the company is functionally not comparable to the business of the Appellant.
2. The learned TPO has erred in selecting Quintegra Solutions Limited as a comparable in the order u/s 92CA, despite that the company is functionally not comparable to the business of the Appellant."

The learned Authorised Representative has however pointed out that out of these 13 comparables sought to be excluded by the assessee 2 comparable companies namely Persistent Systems Limited and Quintegra Solutions Ltd. were also part of the T.P. Analysis of the assessee. The learned Authorised Representative has submitted that the functional comparability of these companies have been examined by this Tribunal in the series of decisions and therefore the assessee has filed a petition for admission of the additional grounds along with the grounds seeking the exclusion of these two companies from the set of comparables. He has pointed out that this issue was also considered by the co-ordinate bench of this Tribunal in the case of *Kodiak Network India Pvt. Ltd. (supra)* and by following the decision of the Special Bench of the Tribunal in the case of *DCIT v. Quark Systems Pvt. Ltd.* 38 SOT 307. This Tribunal directed to exclude the companies which are not functionally comparable. Thus when these companies are not found functionally comparable with software development services provider then irrespective of the fact that the same were included by the assessee in the T.P. analysis requires exclusion from the list of comparables. The learned Authorised Representative has relied upon the decision of the co-ordinate bench if the Tribunal in the case of *Kodiak Network India Pvt. Ltd. (supra)*.

8. On the other hand, the learned Departmental Representative has relied upon the orders of authorities below and submitted that TPO as well as DRP has considered the objections raised by the assessee and found that these comparable companies included in the list of set of comparables are functionally similar to that of the software development services segment of the assessee.

9. Having considered the rival submissions as well as the relevant material on record, we note that the TPO has determined the ALP by taking into consideration a set of 20 comparables and computing the Arithmetic Mean-PLI at 23.65% and after working capital adjustment at 21.43%. Thus the TPO proposed the TP Adjustment of the differential ALP in comparison to the assessee's margin of 12.06%.

10. At the outset, we note that all the functional comparability of all these 13 comparables which are sought to be excluded by the assessee were also considered by the co-ordinate bench of this Tribunal in the case of *Kodiak Network India Pvt. Ltd. (supra)* in paras 21 to 25 as under :

"21. We have considered the rival submissions and relevant material available on record. As we have narrated the facts in the foregoing paras that the TPO has determined the ALP by taking into consideration the set of 20 comparables. The assessee has raised objection regarding 13 comparables out of 20 selected by the TPO. The companies against which the assessee raised objections are as under:

<i>S.No.</i>	<i>Name of the Company</i>
1	AvaniCimcon Technologies Ltd
2	Bodhtree Ltd
3	Celestial Biolabs Ltd
4	E-Zest Solutions Ltd
5	Infosys Technologies Ltd
6	KALS Information Systems Ltd (Seg.)
7	Lucid Software Ltd
8	Persistent Systems Ltd
9	Quintegra Solutions Ltd
10	Softsole India Ltd
11	Tata Elxsi Ltd (Seg.)
12	Thirdware Solutions Ltd (Seg.)
13	Wipro Ltd (Seg.)

22. We note that the comparability of these 13 companies have been examined by this Tribunal in series of decision as referred by the Id. AR. In the case of M/s 3DPLM Software Solutions Ltd (supra), the co-ordinate Bench of this Tribunal has considered the comparability of these companies in paras 7 to 19.3 of the order which have been reproduced below:

"7.0 Avani Cincom Technologies Ltd.

7.1 This company was selected by the TPO as a comparable. The assessee objects to the inclusion of this company as a comparable on the ground that this company is not functionally comparable to the assessee as it is into software products whereas the assessee offers software development services to its AEs. The TPO had rejected the objections of the assessee on the ground that this comparable company has categorized itself as a pure software developer, just like the assessee, and hence selected this company as a comparable. For this purpose, the TPO had relied on

information submitted by this company in response to enquiries carried out under section 133(6) of the Act for collecting information about the company directly.

7.2 Before us, the learned Authorised Representative reiterated the assessee's objections for the inclusion of this company from the list of comparable companies on the ground that this company is not functionally comparable to the assessee as it is into software products. It is also submitted that the segmental details of this company are not available and the Annual Report available in the public domain is not complete. It was further contended that the information obtained by the TPO under section 133(6) of the Act, on the basis of which the TPO included this company in the final list of comparable companies, has not been shared with the assessee. In support of this contention, the learned Authorised Representative placed reliance on the following judicial decisions:

(i) *Trilogy E-Business Software India Pvt. Ltd. v. DCIT* (ITA No.1054/Bang/2011)

(ii) *Telecordia Technologies India Pvt Ltd. v. ACIT* (ITA No.7821/Mum/2011)

It was also submitted that this company has been held to be functionally not comparable to the assessee by a co-ordinate bench of this Tribunal in the assessee's own case for Assessment Year 2007-08 in ITA No.845/Bang/2011 dt.22.2.2013.

7.3 The learned Authorised Representative further submitted that the facts pertaining to this company has not changed from the earlier year (i.e. Assessment Year 2007-08) to the period under consideration (i.e. Assessment Year 2008-09). In support of this contention, it was submitted that :—

(i) The extract from the Website of the company clearly indicates that it is primarily engaged in development of software products. The extract mentions that this company offers customised solutions and services in different areas;

(ii) The Website of this company evidences that this company develops and sells customizable software solutions like "DX Change, CARMA, etc.

7.4 The learned Authorised Representative submitted that a co-ordinate bench of the Tribunal in its order in Curram Software International Pvt. Ltd., in its order in ITA No.1280/Bang/2012 dt.31.7.2013 has remanded the matter back to the file of the Assessing Officer / TPO to examine the comparability of this company afresh, by making the following observations at paras 9.5.2 and 9.5.3 thereof :—

"9.5.2 As regards the submission of the learned Authorised Representative, we are unable to agree that this company has to be deleted from the list of comparables only because it has been deleted from the set of comparables in the case of *Trilogy E-Business Software India Pvt. Ltd.* (*supra*). No doubt this company has been deleted as a

comparable in the case of *Triology E-Business Software India Pvt. Ltd. (supra)* and this can be a good guidance to decide on the comparability in the case on hand also. This alone, however, will not suffice for the following reasons :—

(i) The assessee needs to demonstrate that the FAR analysis and other relevant facts of the Triology case are equally applicable to the facts of the assessee's case also. Unless the facts and the FAR analysis of Triology case is comparable to that of the assessee in the case on hand, comparison between the two is not tenable. (ii) After demonstrating the similarity and the comparability between the assessee and the Triology case, the assessee also needs to demonstrate that the facts applicable to the Assessment Year 2007-08, the year for which the decision in case of *Triology E-Business Software India Pvt. Ltd. (supra)* was rendered are also applicable to the year under consideration i.e. Assessment Year 2008-09.

9.5.3 It is a well settled principle that the assessee is required to perform FAR analysis for each year and it is quite possible that the FAR analysis can be different for each of the years. That being so, the principle applicable to one particular year cannot be extrapolated automatically and made applicable to subsequent years. To do that, it is necessary to first establish that the facts and attendant factors have remained the same so that the factors of comparability are the same. Viewed in that context, the assessee has not discharged the onus upon it to establish that the decision rendered in the case of *Triology E-Business Software India Pvt. Ltd. (supra)* can be applied to the facts of the case and that too of an earlier year i.e. Assessment Year 2007-08. The assessee, in our view, has not demonstrated that the facts of *Triology E-Business Software India Pvt. Ltd. (supra)* are identical to the facts of the case on hand and that the profile of the assessee for the year under consideration is similar to that of the earlier Assessment Year 2007-08. In view of facts as discussed above, we deem it fit to remand the matter back to the file of the Assessing Officer / TPO to examine the comparability of this company afresh by considering the above observations. The TPO is directed to make available to the assessee information obtained under section 133(6) of the Act and to afford the assessee adequate opportunity of being heard and to make its submissions in the matter, which shall be duly considered before passing orders thereon. It is ordered accordingly."

The learned Authorised Representative submits that this company was selected as a comparable by the TPO not by any FAR analysis or as per the search process conducted by the TPO, but only as an additional comparable for the reason that it was selected as a comparable in the earlier year i.e. Assessment Year 2007-08 on the basis of information obtained under section 133(6) of the Act. In this regard, the learned Authorised Representative took us through the relevant portions of the TP order under section 92CA of the Act and the show cause notices for both the earlier year i.e. Assessment Year 2007-08 and for this year and contended that the selection of this company as a comparable violates the principle enunciated in *Curram Software*

International Pvt. Ltd. (supra) that a company can be selected as a comparable only on the basis of FAR analysis conducted for that year and therefore pleaded for its exclusion. The learned Authorised Representative also submitted that he has brought on record sufficient evidence to show that the functional profile of this company remains unchanged from the earlier year and hence the findings rendered by the coordinate benches of the Tribunal in the assessee's own case for Assessment Year 2007-08 (*supra*) and in other cases like *Triology E-Business Software India Pvt. Ltd. (supra)* are applicable to the year under consideration as well.

7.5 Per contra, the learned Departmental Representative supported the order of the TPO / DRP for inclusion of this company Avani Cincom Technologies Ltd. in the final set of comparables.

7.6.1 We have heard both parties and perused and carefully considered the material on record. It is seen from the record that the TPO has included this company in the final set of comparables only on the basis of information obtained under section 133(6) of the Act. In these circumstances, it was the duty of the TPO to have necessarily furnished the information so gathered to the assessee and taken its submissions thereon into consideration before deciding to include this company in its final list of comparables. Nonfurnishing the information obtained under section 133(6) of the Act to the assessee has vitiated the selection of this company as a comparable.

7.6.2 We also find substantial merit in the contention of the learned Authorised Representative that this company has been selected by the TPO as an additional comparable only on the ground that this company was selected in the earlier year. Even in the earlier year, it is seen that this company was not selected IT(TP)A 1380/Bang/2012 Page 7 of 34 on the basis on any search process carried out by the TPO but only on the basis of information collected under section 133(6) of the Act. Apart from placing reliance on the judicial decision cited above, including the assessee's own case for Assessment Year 2007-08, the assessee has brought on record evidence that this company is functionally dis-similar and different from the assessee and hence is not comparable. Therefore the finding excluding it from the list of comparables rendered in the immediately preceding year is applicable in this year also. Since the functional profile and other parameters by this company have not undergone any change during the year under consideration which fact has been demonstrated by the assessee, following the decisions of the co-ordinate benches of this Tribunal in the assessee's own case for Assessment Year 2007-08 in ITA No.845/Bang/2011 dt.22.2.2013, and in the case of *Triology E-Business Software India Pvt. Ltd. (ITA No.1054/Bang/2011)*, we direct the A.O./TPO to omit this company from the list of comparables.

8.0 Bodhtree Consulting Ltd.

8.1 This company has been selected as a comparable company to the assessee by the TPO; the inclusion of which was not objected to by the assessee before both the TPO and the DRP. The assessee has not objected to the inclusion of this company in the list of comparables, as can be seen from the grounds of appeal raised in Form 36B before this Tribunal. 8.1 However in the course of proceedings before us, the learned Authorised Representative objected to the inclusion of this company as a comparable for the following reasons :

- (i) This company has reported abnormally fluctuating margins in the period from 2005 to 2011, which indicate abnormal business factors and abnormal profit margins and hence should not be considered as comparable to the assessee.
- (ii) The abnormally fluctuating margins indicate that this company bears higher risk in contrast to the assessee who has earned consistent margins over the years, indicating difference in the risk profile between this company and the assessee.
- (iii) This company has registered exponential growth of 67% in terms of revenue and 41% in terms of profits over the immediately preceding year which can be attributed to the development of a software application, MIDAS (Multi Industry Data Anomaly) which was made available for customers as SaaS (Software as a Service).

8.3 Per contra, the learned Departmental Representative opposed the exclusion of this company from the list of comparable companies. The learned Departmental Representative contended that since the assessee had accepted the TPO's proposal for inclusion of this company in the set of comparables and had not objected to its inclusion even before the DRP, the objections raised by the assessee in this regard, at this stage, ought to be rejected.

8.4.1 We have heard both parties and perused and carefully considered the material on record. Admittedly, there is no disputing the fact that the assessee had never objected to the inclusion of this company in the set of comparables in earlier proceedings before the TPO and the DRP. It is also seen that even in the grounds of appeal raised before us, the assessee has not raised any grounds challenging the inclusion of this company in the list of comparables. In fact in the assessee's own case for Assessment Year 2007-08, this company was selected as a comparable by the assessee itself. We, therefore, find no merit in the contentions raised by the learned Authorised Representative of the assessee in respect of this company at this stage of proceedings.

8.4.2 It is also seen from the submissions made before us that the assessee has only pointed out fluctuating margins in the results of this company over the years. This, in itself, cannot be reason enough to establish differences in functional profile or any

clinching factual reason warranting the exclusion of this company from the list of comparables. In this view of the matter, the contentions of the assessee are rejected and this company is held to be comparable to the assessee and its inclusion in the list of comparable companies is upheld.

9. Celestial Biolabs Ltd.

9.1 This comparable was selected by the TPO for inclusion in the final list of comparables. Before the TPO, the assessee had objected to the inclusion of this company in the list of comparables for the reasons that it is functionally different from the assessee and that it fails the employee cost filter. The TPO, however, brushed aside the objections raised by the assessee by stating that the objections of functional dissimilarity has been dealt with in detail in the T.P. order for Assessment Year 2007-08. As regards the objection raised in respect of the employee cost filter issue, the TPO rejected the objections by observing that the employee cost filter is only a trigger to know the functionality of the company.

9.2 Before us, the learned Authorised Representative contended that this company is not functionally comparable, as the company is into bio-informatics software product /services and the segmental break up is not provided. It was submitted that :—

- (i) This company is engaged in the development of products in the field of bio-technology, pharmaceuticals, etc. and therefore is not functionally comparable to the assessee;
- (ii) This company has been held to be functionally incomparable to software service providers by the decision of the co-ordinate bench of this Tribunal in the assessee's own case for Assessment Year 2007-08 (*supra*);
- (iii) The co-ordinate bench of this Tribunal in its order in the case of *Triology E-Business Software India Pvt. Ltd. (supra)* at para 43 thereof had observed about this company that –

" As explained earlier, it is a diversified company and therefore cannot be considered as comparable functionally with the assessee. There has been no attempt to identify, eliminate and make adjustment of the profit margins so that the difference in functional comparability can be eliminated. By not resorting to such a process of making adjustments, the TPO has rendered this company as not qualifying for comparability. We therefore accept the plea of the assessee in this regard."
- (iv) The rejection/exclusion of this company as a comparable for Assessment Year 2007-08 for software service providers has been upheld by the co-ordinate benches of this Tribunal in the cases of LG Soft India Pvt. Ltd. in ITA No.112/Bang/2011, CSR India Pvt. Ltd. in IT(TP)A No.1119/Bang/2011 and

by the ITAT, Delhi Bench in the case of Transwitch India Pvt. Ltd. in ITA No.6083/Del/2010.

- (v) The facts pertaining to this company has not changed from Assessment Year 2007- 08 to Assessment Year 2008-09 and therefore this company cannot be considered for the purpose of comparability in the instant case and hence ought to be rejected. In support of this contention, the assessee has also referred to and quoted from various parts of the Annual Report of the company.

9.3 Per contra, the learned Departmental Representative supported the inclusion of this company in the list of comparable companies. The learned Departmental Representative submitted that the decisions cited and relied on by the assessee are for Assessment Year 2007-08 and therefore there cannot be an assumption that it would continue to be applicable for the period under consideration i.e. Assessment Year 2008-09.

9.4.1 We have heard both the parties and perused and carefully considered the material on record. While it is true that the decisions cited and relied on by the assessee were with respect to the immediately previous assessment year, and there cannot be an assumption that it would continue to be applicable for this year as well, the same parity of reasoning is applicable to the TPO as well who seems to have selected this company as a comparable based on the reasoning given in the TPO's order for the earlier year. It is evidently clear from this, that the TPO has not carried out any independent FAR analysis for this company for this year viz. Assessment Year 2008-09. To that extent, in our considered view, the selection process adopted by the TPO for inclusion of this company in the list of comparables is defective and suffers from serious infirmity.

9.4.2 Apart from relying on the afore cited judicial decisions in the matter (supra), the assessee has brought on record IT(TP)A 1380/Bang/2012 Page 8 of 34 substantial factual evidence to establish that this company is functionally dis-similar and different from the assessee in the case on hand and is therefore not comparable and also that the findings rendered in the cited decisions for the earlier years i.e. Assessment Year 2007-08 is applicable for this year also. We agree with the submissions of the assessee that this company is functionally different from the assessee. It has also been so held by co-ordinate benches of this Tribunal in the assessee's own case for Assessment Year 2007-08 (supra) as well as in the case of *Triology E-Business Software India Pvt. Ltd.* (supra). In view of the fact that the functional profile of and other parameters of this company have not changed in this year under consideration, which fact has also been demonstrated by the assessee, following the decision of the co-ordinate benches of the Tribunal in the assessee's own case for Assessment Year 2007-08 in ITA No.845/Bang/2011 and *Triology E-Business Software India Pvt. Ltd.* in ITA

No.1054/Bang/2011, we hold that this company ought to be omitted from the list of comparables. The A.O./TPO are accordingly directed.

10. KALS Information Systems Ltd.

10.1 This is a comparable selected by the TPO. Before the TPO, the assessee had objected to the inclusion of this company in the set of comparables on grounds of functional differences and that the segmental details have not been provided in the Annual Report of the company with respect to software services revenue and software products revenue. The TPO, however, rejected the objections of the assessee observing that the software products and training constitutes only 4.24% of total revenues and the revenue from software development services constitutes more than 75% of the total operating revenues for the F.Y. 2007-08 and qualifies as a comparable by the service income filter.

10.2 Before us, the learned Authorised Representative contended that this company is not functionally comparable to the assessee and ought to be rejected /excluded from the list of comparables for the following reasons:—

- (i) This company is functionally different from the software activity of the assessee as it is into software products.
- (ii) This company has been held to be functionally not comparable to software service providers for Assessment Year 2007-08 by the co-ordinate bench of this Tribunal in the assessee's own case. This company has been held to be different from a software development company in the decision of the Tribunal in the case of Bindview India Pvt. Ltd. V DCIT in ITA No.1386/PN/2010.
- (iii) The rejection of this company as a comparable has been upheld by co-ordinate benches of the Tribunal in the case of –
 - (a) *Triology E-Business Software India Pvt. Ltd.* (ITA No.1054/Bang/2011).
 - (b) *LG Soft India Pvt. Ltd.* IT(TP)A No.112/Bang/2011)
 - (c) *CSR India Pvt. Ltd.* IT(TP)A No.1119/Bang/2011) and
 - (d) *Transwitch India Pvt. Ltd.* ITA No.6083/Del/2010)
- (iv) The facts pertaining to this company has not changed from Assessment Year 2007- 08 to Assessment Year 2008-09 and therefore this company cannot be considered for the purpose of comparability in the case on hand and hence ought to be excluded from the list of comparables. In support of this contention, the learned Authorised Representative drew our attention to

various parts of the Annual Report of this company.

- (v) This company is engaged not only in the development of software products but also in the provision of training services as can be seen from the website and the Annual Report of the company for the year ended 31.3.2008.
- (vi) This company has two segments; namely,
 - (a) Application Software Segment which includes software product revenues from two products i.e. 'Virtual Insure' and 'La-Vision' and
 - (b) The Training segment which does not have any product revenues.

10.3 Per contra, the learned Departmental Representative contended that the decision of the co-ordinate bench of the Tribunal in the case of *Triology E-Business Software India Pvt. Ltd. (supra)* was rendered with respect to F.Y.2006-07 and therefore there cannot be an assumption that it would continue to be applicable to the year under consideration i.e. A.Y. 2008-09. To this, the counter argument of the learned Authorised Representative is that the functional profile of this company continues to remain the same for the year under consideration also and the same is evident from the details culled out from the Annual Report and quoted above (supra).

10.4 We have heard both parties and perused and carefully considered the material on record. We find from the record that the TPO has drawn conclusions as to the comparability of this company to the assessee based on information obtained u/s.133(6) of the Act. This information which was not in the public domain ought not to have been used by the TPO, more so when the same is contrary to the Annual Report of the company, as pointed out by the learned Authorised Representative. We also find that the co-ordinate benches of this Tribunal in the assessee's own case for Assessment Year 2007-08 (supra) and in the case of *Triology E-Business Software India Pvt. Ltd. (supra)* have held that this company was developing software products and was not purely or mainly a software service provider. Apart from relying of the above cited decisions of coordinate benches of the Tribunal (supra), the assessee has also brought on record evidence from various portions of the company's Annual Report to establish that this company is IT(TP)A 1380/Bang/2012 Page 9 of 34 functionally dis-similar and different form the assessee and that since the findings rendered in the decisions of the coordinate benches of the Tribunal for Assessment Year 2007-08 (cited supra) are applicable for this year i.e. Assessment Year 2008-09 also, this company ought to be excluded from the list of comparables. In this view of the matter, we hold that this company i.e. KALS Information Systems Ltd., is to be omitted form the list of comparable companies. It is ordered accordingly."

"11.0 Infosys Technologies Ltd.

11.1 This was a comparable selected by the TPO. Before the TPO, the assessee objected to the inclusion of the company in the set of comparables, on the grounds of turnover and brand attributable profit margin. The TPO, however, rejected these objections raised by the assessee on the grounds that turnover IT(TP)A 1380/Bang/2012 Page 24 of 34 and brand aspects were not materially relevant in the software development segment.

11.2 Before us, the learned Authorised Representative contended that this company is not functionally comparable to the assessee in the case on hand. The learned Authorised Representative drew our attention to various parts of the Annual Report of this company to submit that this company commands substantial brand value, owns intellectual property rights and is a market leader in software development activities, whereas the assessee is merely a software service provider operating its business in India and does not possess either any brand value or own any intangible or intellectual property rights (IPRs). It was also submitted by the learned Authorised Representative that :-

- (i) the co-ordinate bench of this Tribunal in the case of 24/7 Customer.Com Pvt. Ltd. in ITA No.227/Bang/2010 has held that a company owning intangibles cannot be compared to a low risk captive service provider who does not own any intangible and hence does not have an additional advantage in the market. It is submitted that this decision is applicable to the assessee's case, as the assessee does not own any intangibles and hence Infosys Technologies Ltd. cannot be comparable to the assessee ;
- (ii) the observation of the ITAT, Delhi Bench in the case of Agnity India Technologies Pvt. Ltd. in ITA No.3856 (Del)/2010 at para 5.2 thereof, that Infosys Technologies Ltd. being a giant company and market leader assuming all risks leading to higher profits cannot be considered as comparable to captive service providers assuming limited risk ;
- (iii) the company has generated several inventions and filed for many patents in India and USA ;
- (iv) the company has substantial revenues from software products and the break up of such revenues is not available ;
- (v) the company has incurred huge expenditure for research and development;
- (vi) the company has made arrangements towards acquisition of IPRs in 'AUTOLAY', a commercial application product used in designing high performance structural systems.

In view of the above reasons, the learned Authorised Representative pleaded that, this company i.e. Infosys Technologies Ltd., be excluded from the list of comparable companies.

11.3 Per contra, opposing the contentions of the assessee, the learned Departmental Representative submitted that comparability cannot be decided merely on the basis of scale of operations and the brand attributable profit margins of this company have not been extraordinary. In view of this, the learned Departmental Representative supported the decision of the TPO to include this company in the list of comparable companies.

11.4 We have heard the rival submissions and perused and carefully considered the material on record. We find that the assessee has brought on record sufficient evidence to establish that this company is functionally dis-similar and different from the assessee and hence is not comparable and the finding rendered in the case of Trilogy E-Business Software India Pvt. Ltd. (supra) for Assessment Year 2007-08 is applicable to this year also. We are inclined to concur with the argument put forth by the assessee that Infosys Technologies Ltd is not functionally comparable since it owns significant intangible and has huge revenues from software products. It is also seen that the break up of revenue from software services and software products is not available. In this view of the matter, we hold that this company ought to be omitted from the set of comparable companies. It is ordered accordingly.

12. Wipro Ltd.

12.1 This company was selected as a comparable by the TPO. Before the TPO, the assessee had objected to the inclusion of this company in the list of comparables on several grounds like functional dis-similarity, brand value, size, etc. The TPO, IT(TP)A 1380/Bang/2012 Page 26 of 34 however, brushed aside the objections of the assessee and included this company in the set of comparables.

12.2 Before us, the learned Authorised Representative of the assessee contended that this company i.e. Wipro Ltd., is not functionally comparable to the assessee for the following reasons :—

- (i) This company owns significant intangibles in the nature of customer related intangibles and technology related intangibles, owns IPRs and has been granted 40 registered patents and has 62 pending applications and its Annual Report confirms that it owns patents and intangibles.
- (ii) the ITAT, Delhi observation in the case of *Agnity India Technologies Pvt. Ltd.* in ITA No.3856(Del)/2010 at para 5.2 thereof, that Infosys Technologies Ltd. being a giant company and a market leader assuming all risks leading to higher profits, cannot be considered as comparable to captive service

providers assuming limited risk;

- (iii) the co-ordinate bench of the ITAT, Mumbai in the case of Telecordia Technologies India Pvt. Ltd. (ITA No.7821/Mum/2011) has held that Wipro Ltd. is not functionally comparable to a software service provider.
- (iv) this company has acquired new companies pursuant to a scheme of amalgamation in the last two years.
- (v) Wipro Ltd. is engaged in both software development and product development services. No information is available on the segmental bifurcation of revenue from sale of products and software services.
- (vi) the TPO has adopted consolidated financial statements for comparability purposes and for computing the margins, which is in contradiction to the TPO's own filter of rejecting companies with consolidated financial statements.

12.3 Per contra, the learned Departmental Representative supported the action of the TPO in including this company in the list of comparables.

12.4.1 We have heard both parties and carefully perused and considered the material on record. We find merit in the contentions of the assessee for exclusion of this company from the set of comparables. It is seen that this company is engaged both in software development and product development services. There is no information on the segmental bifurcation of revenue from sale of product and software services. The TPO appears to have adopted this company as a comparable without demonstrating how the company satisfies the software development sales 75% of the total revenue filter adopted by him. Another major flaw in the comparability analysis carried out by the TPO is that he adopted comparison of the consolidated financial statements of Wipro with the stand alone financials of the assessee; which is not an appropriate comparison. 12.4.2 We also find that this company owns intellectual property in the form of registered patents and several pending applications for grant of patents. In this regard, the coordinate bench of this Tribunal in the case of *24/7 Customer.Com Pvt. Ltd.* (ITA No.227/Bang/2010) has held that a company owning intangibles cannot be compared to a low risk captive service provider who does not own any such intangible and hence does not have an additional advantage in the market. As the assessee in the case on hand does not own any intangibles, following the aforesaid decision of the co-ordinate bench of the *Tribunal i.e. 24/7 Customer.Com Pvt. Ltd. (supra)*, we hold that this company cannot be considered as a comparable to the assessee. We, therefore, direct the Assessing Officer/TPO to omit this company from the set of comparable companies in the case on hand for the year under consideration."

13. Tata Elxsi Ltd.

13.1 This company was a comparable selected by the TPO. Before the TPO, the assessee had objected to the inclusion of this company in the set of comparables on several counts like, functional dis-similarity, significant R&D activity, brand value, size, etc. The TPO, however, rejected the contention put forth by the assessee and included this company in the set of comparables.

13.2 Before us it was reiterated by the learned Authorised Representative that this company is not functionally comparable to the assessee as it performs a variety of functions under software development and services segment namely - (a) product design, (b) innovation design engineering and (c) visual computing labs as is reflected in the annual report of the company. The learned Authorised Representative submitted that,

- (i) The co-ordinate bench of the Mumbai Tribunal in the case of *Telcordia Technologies (P.) Ltd. (supra)* has held that *Tata Elxsi Ltd.* is not a functionally comparable for a software development service provider.
- (ii) The facts pertaining to *Tata Elxsi Ltd.* have not changed from the earlier year i.e. Assessment Year 2007-08 to the period under consideration i.e. Assessment Year 2008-09 and therefore this company cannot be considered as a comparable to the assessee in the case on hand.
- (iii) *Tata Elxsi Ltd.* is predominantly engaged in product designing services and is not purely a software development service provider. In the Annual Report of this company the description of the segment 'software development services' relates to design services and are not to software services provided by the assessee.
- (iv) *Tata Elxsi Ltd.* invests substantial funds in research and development activities which has resulted in the 'Embedded Product Design Services Segment' of the company to create a portfolio of reusable software components, ready to deploy frameworks, licensable IPs and products. The learned Authorised Representative pleads that in view of the above reasons, *Tata Elxsi Ltd.* is clearly functionally different/dis-similar from the assessee and therefore ought to be omitted from the list of comparables.

13.3 Per contra, the learned Departmental Representative supported the stand of the TPO in including this company in the list of comparables.

13.4 We have heard both parties and carefully perused and considered the material on record. From the details on record, we find that this company is predominantly engaged in product designing services and not purely software development services. The details in the Annual Report show that the segment "software development

services" relates to design services and are not similar to software development services performed by the assessee.

13.5 The Hon'ble Mumbai Tribunal in the case of *Telcordia Technologies India (P.) Ltd . (supra)* has held that Tata Elxsi *Ltd .* is not a software development service provider and therefore it is not functionally comparable. In this context the relevant portion of this order is extracted and reproduced below :—

" Tata Elxsi is engaged in development of niche product and development services which is entirely different from the assessee company. We agree with the contention of the learned Authorised Representative that the nature of product developed and services provided by this company are different from the assessee as have been narrated in para 6.6 above. Even the segmental details for revenue sales have not been provided by the TPO so as to consider it as a comparable party for comparing the profit ratio from product and services. Thus, on these facts, we are unable to treat this company as fit for comparability analysis for determining the arm's length price for the assessee, hence, should be excluded from the list of comparable portion."

As can be seen from the extracts of the Annual Report of this company produced before us, the facts pertaining to Tata Elxsi have not changed from Assessment Year 2007-08 to Assessment Year 2008-09. We, therefore, hold that this company is not to be considered for inclusion in the set of comparables in the case on hand. It is ordered accordingly.

14. E-Zest Solutions Ltd.

14.1 This company was selected by the TPO as a comparable. Before the TPO, the assessee had objected to the inclusion of this company as a comparable on the ground that it was functionally different from the assessee. The TPO had rejected the objections raised by the assessee on the ground that as per the information received in response to notice under section 133(6) of the Act, this company is engaged in software development services and satisfies all the filters.

14.2 Before us, the learned Authorised Representative contended that this company ought to be excluded from the list of comparables on the ground that it is functionally different to the assessee. It is submitted by the learned Authorised Representative that this company is engaged in 'e-Business Consulting Services', consisting of Web Strategy Services, I T design services and in Technology Consulting Services including product development consulting services. These services, the learned Authorised Representative contends, are high end ITES normally categorised as knowledge process Outsourcing ('KPO') services. It is further submitted that this company has not provided segmental data in its Annual Report. The learned Authorised Representative submits that since the Annual Report of the company does not contain detailed descriptive information on the business of the company, the assessee places reliance on the details

available on the company's website which should be considered while evaluating the company's functional profile. It is also submitted by the learned Authorised Representative that KPO services are not comparable to software development services and therefore companies rendering KPO services ought not to be considered as comparable to software development companies and relied on the decision of the co-ordinate bench in the case of *Capital IQ Information Systems (India) (P.) Ltd . v. Dy. CIT (International Taxation)* [2013] 32 taxmann.com 21 (Hyd. -Trib.) and prayed that in view of the above reasons, this company *i.e.* e-Zest software *Ltd.*, ought to be omitted from the list of comparables.

14.3 Per contra, the learned Departmental Representative supported the inclusion of this company in the list of comparables by the TPO.

14.4 We have heard the rival submissions and perused and carefully considered the material on record. It is seen from the record that the TPO has included this company in the list of comparables only on the basis of the statement made by the company in its reply to the notice under section 133(6) of the Act. It appears that the TPO has not examined the services rendered by the company to give a finding whether the services performed by this company are similar to the software development services performed by the assessee. From the details on record, we find that while the assessee is into software development services, this company *i.e.* e-Zest software *Ltd.*, is rendering product development services and high end technical services which come under the category of KPO services. It has been held by the co-ordinate bench of this Tribunal in the case of *Capital I-Q Information Systems (India) (P.) Ltd. (supra)* that KPO services are not comparable to software development services and are therefore not comparable. Following the aforesaid decision of the co-ordinate bench of the Hyderabad Tribunal in the aforesaid case, we hold that this company, *i.e.* e-Zest software *Ltd.* be omitted from the set of comparables for the period under consideration in the case on hand. The A.O./TPO is accordingly directed.

15. Thirdware Solutions Ltd. (Segment)

15.1 This company was proposed for inclusion in the list of comparables by the TPO. Before the TPO, the assessee objected to the inclusion of this company in the list of comparables on the ground that its turnover was in excess of Rs. 500 Crores. Before us, the assessee has objected to the inclusion of this company as a comparable for the reason that apart from software development services, it is in the business of product development and trading in software and giving licenses for use of software. In this regard, the learned Authorised Representative submitted that :—

- (i) This company is engaged in product development and earns revenue from sale of licences and subscription. It has been pointed out from the Annual Report that the company has not provided any separate segmental profit and loss account for software development services and product development

services.

- (ii) In the case of *E-Gain Communications (P.) Ltd. v. ITO* [2009] 118 ITD 243/[2008] 23 SOT 385 (Pune), the Tribunal has directed that this company be omitted as a comparable for software service providers, as its income includes income from sale of licences which has increased the margins of the company.

The learned A.R. prayed that in the light of the above facts and in view of the afore cited decision of the Tribunal (*supra*), this company ought to be omitted from the list of comparables.

15.2 Per contra, the learned Departmental Representative supported the action of the TPO in including this company in the list of comparables.

15.3 We have heard the rival submissions and perused and carefully considered the material on record. It is seen from the material on record that the company is engaged in product development and earns revenue from sale of licenses and subscription. However, the segmental profit and loss accounts for software development services and product development are not given separately. Further, as pointed out by the learned Authorised Representative, the Pune Bench of the Tribunal in the case of *E-Gain Communications (P.) Ltd. (supra)* has directed that since the income of this company includes income from sale of licenses, it ought to be rejected as a comparable for software development services. In the case on hand, the assessee is rendering software development services. In this factual view of the matter and following the afore cited decision of the *Pune Tribunal (supra)*, we direct that this company be omitted from the list of comparables for the period under consideration in the case on hand.

16. Lucid Software Ltd.

16.1 This company was selected as a comparable by the TPO. Before us, the assessee has objected to the inclusion of this company as a comparable on the grounds that it is into software product development and therefore functionally different from the assessee. In this regard, the learned Authorised Representative submitted that —

- (i) This company is engaged in the development of software products.
- (ii) This company has been held to be functionally different and therefore not comparable to software service providers by the order of a coordinate bench of the Tribunal in the assessee's own case for Assessment Year 2007-08 (IT(TP)A No.845/Bang/2011), following the decision of Mumbai Tribunal in the case of *Telcordia Technologies India (P.) Ltd.(ITA No.7821/Mum/2011)*

- (iii) The rejection of this company as a comparable to software service providers has been upheld by the co-ordinate benches of this Tribunal in the cases of *LG Soft India (P.) Ltd* and *CSR India (P.) Ltd. (supra)* and by the Delhi Bench of the Tribunal in the case of *Transwitch India (P.) Ltd. (supra)*. (ITA No.6083/Del/2010)
- (iv) The factual position and circumstances pertaining to this company has not changed from the earlier Assessment Year 2007-08 to the period under consideration i.e. Assessment Year 2008-09 and therefore on this basis, this company cannot be considered as a comparable in the case on hand.
- (v) The relevant portion of the Annual Report of this company evidences that it is in the business of product development.

The learned Authorised Representative prays that in view of the factual position as laid out above and the decisions of the co-ordinate benches of the Tribunal in the assessee's own case for Assessment Year 2007-08 and other cases cited above, it is clear that this company being into product development cannot be considered as a comparable to the assessee in the case on hand who is a software service provider and therefore this company *i.e.* Lucid software *Ltd.*, ought to be omitted from the list of comparables.

16.2 per contra, the learned Departmental Representative supported the action and finding of the TPO in including this company in the list of comparables.

16.3 We have heard the rival submissions and perused and carefully considered the material on record. It is seen from the details on record that the company *i.e.* Lucid software *Ltd.*, is engaged in the development of software products whereas the assessee, in the case on hand, is in the business of providing software development services. We also find that, co-ordinate benches of the Tribunal in the assessee's own case for Assessment Year 2007-08 (IT(TP)A No.845/Bang/2011), *LG Soft India (P.) Ltd. (supra)*, *CSR India (P.) Ltd. (supra)*; the ITAT, Mumbai Bench in the case of *Telcordia Technologies India (P.) Ltd (supra)* and the Delhi ITAT in the case of *Transwitch India (P.) Ltd. (supra)* have held, that since this company, is engaged in the software product development and not software development services, it is functionally different and dis-similar and is therefore to be omitted from the list of comparables for software development service providers. The assessee has also brought on record details to demonstrate that the factual and other circumstances pertaining to this company have not changed materially from the earlier year *i.e.* Assessment Year 2007-08 to the period under consideration *i.e.* Assessment Year 2008-09. In this factual matrix and following the afore cited decisions of the coordinate benches of this Tribunal and of the ITAT, Mumbai and *Delhi Benches (supra)*, we direct that this company be omitted from the list of comparables for the period under consideration in the case on hand.

17. Persistent Systems Ltd.

17.1 This company was selected by the TPO as a comparable. The assessee objected to the inclusion of this company as a comparable for the reasons that this company being engaged in software product designing and analytic services, it is functionally different and further that segmental results are not available. The TPO rejected the assessee's objections on the ground that as per the Annual Report for the company for Financial Year 2007-08, it is mainly a software development company and as per the details furnished in reply to the notice under section 133(6) of the Act, software development constitutes 96% of its revenues. In this view of the matter, the Assessing Officer included this company *i.e.* Persistent Systems *Ltd.*, in the list of comparables as it qualified the functionality criterion.

17.2 Before us, the assessee objected to the inclusion of this company as a comparable submitting that this company is functionally different and also that there are several other factors on which this company cannot be taken as a comparable. In this regard, the learned Authorised Representative submitted that :

- (i) This company is engaged in software designing services and analytic services and therefore it is not purely a software development service provider as is the assessee in the case on hand.
- (ii) Page 60 of the Annual Report of the company for F.Y. 2007-08 indicates that this company, is predominantly engaged in 'Outsourced software Product Development Services' for independent software vendors and enterprises.
- (iii) Website extracts indicate that this company is in the business of product design services.
- (iv) The ITAT, Mumbai Bench in the case of *Telcordia Technologies India (P.) Ltd. (supra)* while discussing the comparability of another company, namely Lucid Software Ltd. had rendered a finding that in the absence of segmental information, a company be taken into account for comparability analysis. This principle is squarely applicable to the company presently under consideration, which is into product development and product design services and for which the segmental data is not available.

The learned Authorised Representative prays that in view of the above, this company *i.e.* Persistent Systems *Ltd.* be omitted from the list of comparables.

17.2 Per contra, the learned Departmental Representative support the action of the TPO in including this company in the list of comparables.

17.3 We have heard the rival submissions and perused and carefully considered the material on record. It is seen from the details on record that this company *i.e.*

Persistent Systems *Ltd.*, is engaged in product development and product design services while the assessee is a software development services provider. We find that, as submitted by the assessee, the segmental details are not given separately. Therefore, following the principle enunciated in the decision of the Mumbai Tribunal in the case of *Telcordia Technologies India (P.) Ltd. (supra)* that in the absence of segmental details/information a company cannot be taken into account for comparability analysis, we hold that this company i.e. Persistent Systems *Ltd.* ought to be omitted from the set of comparables for the year under consideration. It is ordered accordingly.

18. Quintegra Solutions Ltd.

18.1 This case was selected by the TPO as a comparable. Before the TPO, the assessee objected to the inclusion of this company in the set of comparables on the ground that this company is functionally different and also that there were peculiar economic circumstances in the form of acquisitions made during the year. The TPO rejected the assessee's objections holding that this company qualifies all the filters applied by the TPO. On the issue of acquisitions, the TPO rejected the assessee's objections observing that the assessee has not adduced any evidence as to how this event had an any influence on the pricing or the margin earned.

18.2 Before us, the assessee objected to the inclusion of this company for the reason that it is functionally different and also that there are other factors for which this company cannot be considered as a comparable. It was submitted that,

- (i) Quintegra Solutions Ltd., the company under consideration, is engaged in product engineering services and not in purely software development services. The Annual Report of this company also states that it is engaged in preparatory software products and is therefore not similar to the assessee in the case on hand.
- (ii) In its Annual Report, the services rendered by the company are described as under :

"Leveraging its proven global model, Quintegra provides a full range of custom IT Solution (such as development, testing, maintenance, SAP, product engineering and infrastructure management services), proprietary software products and consultancy services in IT on various platforms and technologies."
- (iii) This company is also engaged in research and development activities which resulted in the creation of Intellectual Proprietary Rights (IPRs) as can be evidenced from the statements made in the Annual Report of the company for the period under consideration, which is as under :

"Quintegra has taken various measures to preserve its intellectual property. Accordingly, some of the products developed by the company have been covered by the patent rights. The company has also applied for trade mark registration for one of its products, viz. Investor Protection Index Fund (IPIF). These measures will help the company enhance its products value and also mitigate risks."

- (iv) The TPO has applied the filter of excluding companies having peculiar economic circumstances. Quintegra fails the TPO's own filter since there have been acquisitions in this case, as is evidenced from the company's Annual Report for F.Y. 2007-08, the period under consideration.

The learned Authorised Representative prays that in view of the submissions made above, it is clear that *inter alia*, this company i.e. Quintegra Solution Ltd. being functionally different and possessing its own intangibles/IPRs, it cannot be considered as a comparable to the assessee in the case on hand and therefore ought to be excluded from the list of comparables for the period under consideration.

18.3 Per contra, the learned Departmental Representative supported the action of the TPO in including this company in the set of comparables to the assessee for the period under consideration.

18.4 We have heard the rival submissions and perused and carefully considered the material on record. It is seen from the details brought on record that this company i.e. Quintegra Solutions Ltd. is engaged in product engineering services and is not purely a software development service provider as is the assessee in the case on hand. It is also seen that this company is also engaged in proprietary software products and has substantial R&D activity which has resulted in creation of its IPRs. Having applied for trade mark registration of its products, it evidences the fact that this company owns intangible assets. The co-ordinate bench of this Tribunal in the case of 24/7 Customer.Com (P.) Ltd. (*supra*) has held that if a company possesses or owns intangibles or IPRs, then it cannot be considered as a comparable company to one that does not own intangibles and requires to be omitted from the list of comparables, as in the case on hand.

18.5 We also find from the Annual Report of Quintegra Solution Ltd. that there have been acquisitions made by it in the period under consideration. It is settled principle that where extraordinary events have taken place, which has an effect on the performance of the company, then that company shall be removed from the list of comparables.

18.6 Respectfully following the decision of the co-ordinate bench of the Tribunal in the case of 24/7 Customer.Com (P.) Ltd. (*supra*), we direct that this company i.e. Quintegra Solution Ltd. be excluded from the list of comparables in the case on hand since it is

engaged in proprietary software products and owns its own intangibles unlike the assessee in the case on hand who is a software service provider.

19. Softsol India Ltd.

19.1 This company was selected by the TPO as a comparable. The assessee objected to the inclusion of this company as a comparable on the grounds that this company is functionally different and dis-similar from it. The TPO rejected the assessee's objections on the ground that as per the company's reply to the notice under section 133(6) of the Act, the company has categorized itself as a pure software developer and therefore included this company as a comparable as the assessee was also a provider of software development services. Before us, in addition to the plea that the company was functionally different, the assessee submitted that this company was excluded from the list of comparables by the order of the co-ordinate bench of this Tribunal in the assessee's own case for Assessment Year 2007-08 (ITA No. 845/Bang./2011) on the ground that the 'Related Party Transactions ('RPT') is in excess of 15%. The learned Authorised Representative submitted that for the current period under consideration, the RPT is 18.3% and therefore this company requires to be omitted from the list of comparables.

19.2 Per contra, the learned Departmental Representative supported the action of the TPO in including this company in the list of comparables as this company was a pure software development service provider like the assessee.

19.3 We have heard both parties and perused and carefully considered the material on record. We find that the co-ordinate bench of this Tribunal in the assessee's own case for Assessment Year 2007-08 in ITA No.845/Bang/2011 has excluded this company from the set of comparables for the reason that RPT is in excess of 15% following the decision of another bench of this Tribunal in the case of *24/7 Customer.Com (P.) Ltd. (supra)*. As the facts for this year are similar and material on record also indicates that RPT is 18.3%, following the afore cited decisions of the co-ordinate benches (*supra*), we hold that this company is to be omitted from the list of comparables to the assessee in the case on hand.

23. Thus, it is clear from the findings of the Co-ordinate Bench of the Tribunal in the case of *M/s 3DPLM Software Solutions Ltd (supra)* that except Bodhtree Ltd all other 12 companies were found to be not good comparables of the software development services as provided by assessee.

24. As regard the objection of the Id. DR that Quintegra Solution *Ltd.* has been selected by the assessee itself, we notice that the functional comparability of this company has been examined by the Tribunal in the case of *M/s 3DPLM Software Solutions Ltd (supra)* and it was found that the said company is engaged in the different field of services i.e. product designing and analytic services as well as in proprietary of software product

and are in research and development activity which has resulted in creation of its intellectual property rights. Therefore, the said company is not functionally comparable with pure software development service activity. Once the company is found to be a non-comparable company with the assessee, the same is required to be excluded from the set of comparables even if the said company is selected by the assessee itself. This view was taken by the decision of the Special Bench of Chandigarh Tribunal in the case *QUARK SYSTEMS (P.) LTD (supra)*.

25. Thus, out of 20 comparables 12 companies are required to be excluded from the list of comparables for determining the ALP. Accordingly, we direct the TPO/AO to exclude the following companies from the set of comparables and recomputed the ALP after considering the claim of risk adjustment as well as working capital adjustment:

<i>S.No.</i>	<i>Name of the Company</i>
1	Avani Cimcon Technologies Ltd
2	Celestial Biolabs Ltd
3	E-Zest Solutions Ltd
4	Infosys Technologies Ltd
5	KALS Information Systems Ltd (Seg.)
6	Lucid Software Ltd
7	Persistent Systems Ltd
8	Quintegra Solutions Ltd
9	Softsole India Ltd
10	Tata Elxsi Ltd (Seg.)
11	Thirdware Solutions Ltd (Seg.)
12	Wipro Ltd (Seg.) "

As regards the additional grounds raised by the assessee, the co-ordinate bench of the Tribunal also dealt with an identical issue in para 24 (*supra*) and therefore when the functional comparability of these two companies have been examined by the Tribunal and it was found that these companies are not comparable with the software development services provider because of different activities as well as engaged in the software products, R&D activities and resulting in creation of Intellectual Property Rights (IPRs) then, even if these companies are selected by the assessee in its T.P. Analysis the same shall be excluded from the comparables. The comparability of these companies was already tested by this Tribunal, then the same cannot be included in the list of comparables. Accordingly, by following the earlier order of the Tribunal as well as Special Bench decision in the case of

Quark Systems Pvt. Ltd. (supra). We admit the additional grounds raised by the assessee. In view of the findings of the co-ordinate bench of the Tribunal in the case of *Kodiak Network India Pvt. Ltd. (supra)*, we hold that 12 companies out of 13 sought by the assessee are required to be excluded from the list of comparables where as the company Bodhtree Consulting Ltd. is accepted as a good comparable of software development services provided by the assessee. Accordingly, we direct the TPO/A.O to exclude 12 companies as mentioned in para 25 of the order of the co-ordinate bench (*supra*) from the set of comparables and recomputed the ALP after considering the claim of risk adjustment as well as the benefit of tolerance range of + / - 5% as per the proviso to section 92C(2).

11. Ground No.6 is regarding the rejection of travel expenses incurred in foreign currency from the export turnover.

12. We have heard the rival submissions as well as considered the relevant material on record. At the outset, we note that this issue is covered by the decision of the Hon'ble jurisdictional High Court of Karnataka in the case of *CIT v. Tata Elxsi Ltd & Others* [2011] 247 CTR 334 (Karnataka) wherein it has been held that while computing the exemption u/s 10A, if the export turnover in the numerator is to be arrived at after excluding certain expenses, the same should also be excluded from the total turnover in the denominator. The relevant finding of the Hon'ble jurisdictional High Court reads as follows:—

".....Section 10A is enacted as an incentive to exporters to enable their products to be competitive in the global market and consequently earn precious foreign exchange for the country. This aspect has to be borne in mind. While computing the consideration received from such export turnover, the expenses incurred towards freight, telecommunication charges, or insurance attributable to the delivery of the articles or things or computer software outside India, or expenses if any incurred in foreign exchange, in providing the technical services outside India should not be included. However, the word total turnover is not defined for the purpose of this section. It is because of this omission to define 'total turnover', the word 'total turnover' falls for interpretation by this Court;

...In section 10A, not only the word 'total turnover' is not defined, there is no clue regarding what is to be excluded while arriving at the total turnover. However, while interpreting the provisions of section 80HHC, the courts have laid down various principles, which are independent of the statutory provisions. There should be uniformity in the ingredients of both the numerator and the denominator of the formula, since otherwise it would produce anomalies or absurd results. Section 10A is a beneficial section which intends to provide incentives to promote exports. In the case of combined business of an assessee, having export business and domestic business, the legislature intended to have a formula to ascertain the profits from export business by apportioning the total profits of the business on the basis of turnovers. Apportionment of profits on the basis of turnover was accepted as a method of arriving

at export profits. In the case of section 80HHC, the export profit is to be derived from the total business income of the assessee, whereas in section 10-A, the export profit is to be derived from the total business of the undertaking. Even in the case of business of an undertaking, it may include export business and domestic business, in other words, export turnover and domestic turnover. To the extent of export turnover, there would be a commonality between the numerator and the denominator of the formula. If the export turnover in the numerator is to be arrived at after excluding certain expenses, the same should also be excluded in computing the export turnover as a component of total turnover in the denominator. The reason being the total turnover includes export turnover. The components of the export turnover in the numerator and the denominator cannot be different. Therefore, though there is no definition of the term 'total turnover' in section 10A, there is nothing in the said section to mandate that, what is excluded from the numerator that is export turnover would nevertheless form part of the denominator. When the statute prescribed a formula and in the said formula, 'export turnover' is defined, and when the 'total turnover' includes export turnover, the very same meaning given to the export turnover by the legislature is to be adopted while understanding the meaning of the total turnover, when the total turnover includes export turnover. If what is excluded in computing the export turnover is included while arriving at the total turnover, when the export turnover is a component of total turnover, such an interpretation would run counter to the legislative intent and impermissible. Thus, there is no error committed by the Tribunal in following the judgments rendered in the context of section 80HHC in interpreting section 10A when the principle underlying both these provisions is one and the same".

Respectfully following the judgment of Hon'ble jurisdictional High Court, we direct the A.O. to exclude travel expenses incurred in foreign currency from the total turnover as well.

13. Ground No.7 is regarding disallowance of interest paid to Telelogic Sweden (AE). The Assessing Officer noted that the assessee has acquired fixed asset to the tune of Rs.1,31,52,489 during the financial year relevant to the Assessment Year under consideration. The Assessing Officer held that the assessee does not have required funds for acquiring the fixed asset. Accordingly, the Assessing Officer disallowed proportionate interest by applying the SBI prime lending rate of 12.75% on the amount invested for the purchase of asset. Accordingly, the A.O. has computed the disallowance at Rs.1,67,757 as capital in nature. The DRP has confirmed the action of the Assessing Officer.

14. Before us, the learned Authorised Representative of the assessee has submitted that the assessee has issued convertible debentures to Telelogic Germany and the proceeds from the issue are utilized for working capital purpose and no fixed assets have been acquired by utilizing the borrowed fund. Thus the Assessing Officer is not justified in disallowing the proportionate interest on account of purchase of fixed asset. He has further submitted that the assessee has an equity capital of Rs.4,94,170 and reserves and surpluses of Rs.2,48,84,256. Therefore these reserves were sufficient to cover the funds for acquisition

of fixed asset. Alternatively, the learned Authorised Representative has submitted that the disallowance if any on account of purchase of fixed asset should be restricted only in respect of the fixed assets acquired after issue of convertible debentures as there is no scope of utilizing the borrowed fund prior to the issue of convertible debenture. Thus the learned Authorised Representative has submitted that the disallowance if any on account of interest expenditure to be made only in respect of the fixed assets added after the issuance of convertible debentures.

15. On the other hand, the learned Departmental Representative has submitted that the assessee has failed to produce the relevant evidence and details to show that the assessee has not utilized the borrowed fund prior to acquisition of fixed assets.

16. We have heard the rival submissions as well as considered the relevant material on record. The learned Authorised Representative has submitted that the addition to fixed assets after issuance of convertible debentures in July, 2007 is only of Rs.53,96,000 out of the total addition of Rs.1,31,52,489 which was considered by the Assessing Officer for disallowance of interest.

17. Though the assessee has failed to establish that the acquisition of fixed assets was made out of its own free reserves, however we find that there is a substance in the alternate plea of the assessee that the addition if any can be made only in respect of addition to the fixed assets post issuance of debentures because prior to the receipt of the debenture proceeds the borrowed fund cannot be utilized for the purpose of purchasing the asset. Accordingly, we direct the Assessing Officer to verify the exact date of acquisition of the fixed assets and then to decide the issue of disallowance of interest only in respect of the fixed assets acquired post issuance of debentures or payment of which is made post issuance of debentures.

18.1 Ground No.8 is regarding disallowance of rent equilisation amount. The Assessing Officer has noted that the assessee has debited an amount of Rs.5,47,46,191 towards rent expenditure. On verification of record, it was found that an amount of Rs.8,01,624 is a provision which has not been added back to the total income of the assessee. The Assessing Officer disallowed a sum of Rs.5,21,056 pertaining to STPI and Rs.2,80,568 to non-STPI unit on the ground that it is an uncertain liability. The assessee raised the objection before the DRP and relied upon the judgment of Hon'ble jurisdictional High Court in the case of M/s. Prakash Leasing Limited as well as the decision of Hon'ble Delhi High Court in the case of Virtualsoft System Ltd. The DRP rejected the objection of the assessee on the ground that the department has not accepted the decision of the Hon'ble jurisdictional High Court in the case of *Prakash Leasing Limited (supra)*. Before us, the learned Authorised Representative of the assessee has submitted that the DRP has rejected the claim of the assessee only because the department has not accepted the decision of the Hon'ble jurisdictional High Court where as the decision of the Hon'ble jurisdictional High Court is binding on the appellate authorities.

18.2 On the other hand, the learned Departmental Representative has relied upon the orders of authorities below.

19. Having considered the rival submissions as well as the relevant material on record, we note that the DRP has rejected this objection of the assessee in para 22.4 as under :

"22.4 The Panel has examined the issue and has also taken on record the arguments made by the assessee in the course of assessment proceedings as also in the course of DRP proceedings. The Panel also notes that the assessee places strong reliance in the ratio upheld by the Hon'ble Karnataka High Court in its order dt.27.2.2012 in the case of M/s. Prakash Leasing Ltd. (ITA No.301, 302 & 491 of 2007) as also Hon'ble Delhi High Court decision dt.7.2.2012 in Virtual Soft System Ltd. (ITA Nos.216, 398, 403, 404 & 680 of 2011) both are holding the allowability of such a claim. It is in this context the Panel notes that the Department has not accepted the decision of the Hon'ble High Court of Karnataka and is agitating the issue by way of an appeal before the Hon'ble Supreme Court and hence the Panel confirms to such a stand and holds that the view taken by the A.O. calls for no interference and as such this ground of appeal is rejected."

20. It is clear that the DRP has not disputed that this is covered by the judgment of Hon'ble jurisdictional High Court as well as Hon'ble Delhi High Court wherein this issue has been decided in favour of the assessee. The only ground for not accepting the claim of the assessee is that the department has not accepted the judgment of Hon'ble jurisdictional High Court and filed an appeal before the Hon'ble Supreme Court. Since nothing has brought before us to show that these judgments of Hon'ble jurisdictional High Court and Hon'ble Delhi High Court have either been reversed or the same has been stayed by the Hon'ble Supreme Court therefore, in the absence of any contrary judgment of the Hon'ble Supreme Court, the judgment of Hon'ble jurisdictional High Court is binding on this Tribunal as well as on the DRP. Accordingly, we allow the claim of the assessee on this issue regarding rent equilisation amount.

21. Ground No.9 is regarding disallowance of consultancy charges. We note that the TPO has found this payment of consultancy charges at arm's length however, the Assessing Officer disallowed the consultancy charges on the ground that the assessee has failed to prove that the service was rendered by the AE. The DRP has directed the Assessing Officer to decide this issue afresh after affording an opportunity to the assessee in para 23.4 as under :

"23.4 The Panel has carefully considered the issue in dispute and the facts relating thereto. It observes that the facts as given by the Assessing Officer with regard to furnishing of evidence, bills, etc. are contested by the assessee. The Panel has also taken into account a further report in the matter furnished by the Assessing Officer on the issue dt.1.5.2012. The Assessing Officer in his report has reiterated the facts mentioned in the draft assessment order and has asserted that despite as many as four opportunities, the requisite information required has not been filed by the assessee.

What has merely been filed was a copy of e-mail communication which does not substantiate the services rendered as required by the Assessing Officer. The Assessing Officer has further asserted that the assessee was afforded as many as 15 opportunities to substantiate its claim to which it has not complied with. In view of the same the Panel therefore deems it appropriate to direct the Assessing Officer to afford a final opportunity in the interest of justice and come to a conclusion thereon relating to the disallowance of impugned amount. This ground is disposed off subject to the above direction."

Thus when the DRP has already directed the Assessing Officer to afford an opportunity to the assessee to present its case and relevant evidence, then we do not find any reason to interfere with the finding of the DRP. The learned Authorised Representative has submitted that the Assessing Officer has not given effect to the directions of the DRP. Accordingly, we direct the Assessing Officer to reconsider this issue after giving an opportunity of hearing to the assessee.

22. Ground No.10 is regarding disallowance of the ratio adopted by the assessee for apportionment of the common expenses. The assessee has allocated the common expenses on the basis of head count to both STPI and non-STPI units. Based on the head counts for STPI and non-STPI the assessee has adopted apportionment of common expenses in the ratio of 222 and 42 respectively. The Assessing Officer did not accept the ratio adopted by the assessee and applied the turnover ratio for the purpose of apportionment of common expenses. The assessee challenged the action of the Assessing Officer before the DRP but could not succeed. However, the DRP directed the Assessing Officer to revisit the issue and come to a conclusion on the claim of the assessee.

23. Before us, the learned A.R. of the assessee submitted that it has been consistently allocating the common expenses on the basis of head counts which has been accepted by the Assessing Officer in the past. However, for the year under consideration, the Assessing Officer has decided to change the basis of apportionment and allocated the expenses on the basis of turnover. He has thus contended that the action of the Assessing Officer is against the rule of consistency. In support of his contention he has relied upon the judgment of Hon'ble Delhi High Court in the case of *CIT v. EHPT India Pvt. Ltd.* in ITA No.1172/Bang/2008 and submitted that the Hon'ble High Court has held that allocation method consistently accepted by both the tax payer and tax department in the past and having regard to the nature of the business and other relevant factor. If it is reasonable method and the allocation does not distort the profits then it should not be disturbed.

24. On the other hand, the learned Departmental Representative has relied upon the orders of authorities below and submitted that the turnover basis is more reasonable than the head count.

25. Having considered the rival submissions and the relevant material on record, we find that the common expenses are invariably in the nature of head office expenses and on

account of salary of the office staff and other expenses relating to head office. Therefore these common expenses have no direct or proximate relation with the ratio of the turnover. When the assessee has been consistently following the apportionment of common expenses on the basis of head count ratio then without giving any finding that this method of apportionment resulting in distortion of profits, the Assessing Officer is not justified in rejecting the same and applying some other method. In view of the above facts and circumstances and following the rule of consistency, we decide this issue in favour of the assessee and delete the addition made by the Assessing Officer.

26.1 Ground No.11 is regarding set off of unabsorbed depreciation of earlier year for computation of deduction under Section 10A.

26.2 We have heard the rival submissions as well as considered the relevant material on record. At the outset, we note that this issue is now covered by the judgment of Hon'ble jurisdictional High Court in the case of *CIT v. Yokogawa India Ltd. & others* (341 ITR 385). The co-ordinate bench of this Tribunal in the case of *Flextronics Technologies India Pvt. Ltd. v. DCIT in IT(TP)A No.1219/Bang/2011 Dt.23.11.2015* has considered an identical issue in paras 10.1 to 10.5 as under :

"10.1 The learned AR of the assessee has relied upon the decision of the Hon'ble jurisdictional High Court in the case of *CIT v. Yokogawa India Ltd. & others* (341 ITR 385) as well as the decision in the case of *CIT v. M/s.Auringene Discovery Technologies Ltd.* in ITA No.549/2013 dated 05/09/2014 and submitted that the Hon'ble High Court has reiterated the view taken in the case of *Yokogawa India Ltd.(supra)*. He has also relied upon the decision of this Tribunal dated 30/4/2014 in the case of *CIT v. M/s.Biocon Ltd.* in ITA Nos.248, 368 to 371 & 1206/2010.

10.2 On the other hand, learned Departmental Representative has relied upon the decision of the Hon'ble jurisdictional High Court in the case of *CIT v. Himatsinghika Seide Ltd.* (156 Taxman 151) and submitted that that the decision of the jurisdictional High Court has been confirmed by the Hon'ble Supreme Court and the SLP filed by the assessee has been dismissed.

10.3 We have considered the rival submissions as well as the relevant material on record. There is no dispute that the Hon'ble jurisdictional High Court in the case of *Himatsinghika Seide Ltd. (supra)* had decided this issue in favour of the revenue and against the assessee. However, it is pertinent to note that the said decision of the Hon'ble jurisdictional High Court was in respect of the dispute for the assessment year 1994-95 and there is an amendment in the provisions of sec.10A and 10B of the Act vide Finance Act, 2000 w.e.f. 1/4/2001. By virtue of the amendment and substitution of provisions of sec.10A and 10B, the incentive u/s 10A and 10B was no longer in the nature of exemption but it is in the nature of deduction. By considering the amendment/substitution of sec. 10A and 10B vide Finance Act, 2000 w.e.f. 1/4/2001,

Hon'ble jurisdictional High Court vide judgment in the case of *Yokogawa India Ltd.(supra)* has held in paras.16 to 23 as under:

"16. The substituted s. 10A continues to remain in Chapter III. It is titled as "Incomes which do not form part of the total income". It may be noted that when s. 10A was recast by the Finance Act, 2001 (sic-2000), the Parliament was aware of the character of relief given in Chapter III. Chapter III deals with incomes which do not form part of total income. If the Parliament intended that the relief under s. 10A should be by way of deduction in the normal course of computation of total income, it could have placed the same in Chapter VI-A which houses the sections like 80HHC, 80-IA, etc. The Parliament was aware of the various restricting and limiting provisions like s. 80A and s. 80AB which were in Chapter VI-A which do not appear in Chapter III. The fact that even after its recast, the relief has been retained in Chapter III indicates the intention of Parliament that it is to be regarded as an exemption and not a deduction. The Act of the Parliament in consciously retaining this section in Chapter III indicates its intention that the nature of relief continues to be an exemption. Chapter VII deals with the incomes forming part of the total income on which no income-tax is payable. These are the incomes which are exempted from charge, but are included in the total income of the assessee. The Parliament despite being conversant with the implications of this chapter, has consciously chosen to retain s. 10A in Chapter III.

17.If s. 10A is to be given effect to as a deduction from the total income as defined in s. 2(45), it would mean that s. 10A is to be considered after Chapter VI-A deductions have been exhausted. The deductions under Chapter VI-A are to be given from out of the gross total income. The term "gross total income" is defined in s. 80B(5) to mean the total income computed in accordance with the provisions of this Act, before making any deduction under this chapter. As per the definition of gross total income, the other provisions of the Act will have to be first given effect to. There is no reason why reference to the provisions of the Act should not include s. 10A. In other words, the gross total income would be arrived at after considering s. 10A deduction also. Therefore, it would be inappropriate to conclude that s. 10A deduction is to be given effect to after Chapter VI-A deductions are exhausted.

18.It is after the deduction under Chapter VI-A that the total income of an assessee is arrived at. Chapter VI-A deductions are the last stage of giving effect to all types of deductions permissible under the Act. At the end of this exercise, the total income is arrived at. Total income is thus, a figure arrived at after giving effect to all deductions under the Act. There cannot be any further deduction from the total income as the total income is itself arrived at after all deductions.

19.From the aforesaid discussion it is clear that the income of 10A unit has to be excluded before arriving at the gross total income of the assessee. The income of 10A unit has to be deducted at source itself and not after computing the gross total income.

The total income used in the provisions of s. 10A in this context means the global income of the assessee and not the total income as defined in s. 2(45). Hence, the income eligible for exemption under s. 10A would not enter into computation as the same has to be deducted at source level.

2nd substantial question of law

20. Prior to the introduction of sub-s. (6) of s. 10A and s. 10B by the Finance Act, 2000, which came into effect from 1st April, 2001, in computing the total income of the assessee of the previous year relevant to the assessment year immediately succeeding the last of the relevant assessment years, or of any previous year, relevant to any subsequent assessment year, sub-s. (2) of s. 32, cl. (ii) of sub-s. (iii), s. 32A cl. (ii) of sub-s. (3) of s. 32A, cl. (ii) of sub-s. (2) of s. 33 and sub-s. (4) of s. 35 of the Act or the second proviso to cl. (ix) of sub-s. (1) of s. 36 shall not be applicable in relation to any such allowance or deduction. Similarly no loss as referred to in sub-s. (1) or in s. 72 or sub-s. (1) or sub-s. (3) of s. 74 insofar as such loss relates to the business of the undertaking was permitted to be carried forward or set off where such loss relates to any of the relevant assessment years.

21. It is in this background the Finance Act, 2003 was introduced by inserting the words "the year ending upto the first day of April, 2001", for that in cls. (1) and (2) of sub-s. (6) restricting the disallowance only upto the first day of April, 2001 and granting the benefit, of those provisions even in respect of units to which ss. 10A and 10B are applicable. The Finance Act, 2003, amended this sub-section with retrospective effect from 1st April, 2001 by lifting the embargo in the aforesaid clauses in respect of depreciation and business loss relating to the asst. yr. 2001-02 onwards. The amendment indicates the legislative intention of providing the benefit of carry forward of depreciation and business loss relating to any year of the tax holiday period to be set off against income of any year post tax holiday. This is supported by Circular No. 7 of 2003 [(2003) 184 CTR (St) 33] wherein the board has stated that the purpose of amendment is to entitle an assessee to the benefit of carry forward of depreciation and loss suffered during the tax holiday period. The circular dt. 5th Sept., 2003 reads as under :

"20. Providing for carry forward of business losses and unabsorbed depreciation to units in Special Economic Zones and 100 per cent export oriented units.

20.1 Under the existing provisions of ss. 10A and 10B, the undertakings operating in a Special Economic Zone (under s. 10A) and 100 per cent export oriented units (under s. 10B) are not permitted to carry forward their business losses and unabsorbed depreciation.

20.2 With a view to rationalize the existing tax incentives in respect of such units sub-s. (6) in ss. 10A and 10B has been amended to do away with the restrictions on the carry forward of business losses and unabsorbed depreciation.

The amendments have been brought into effect retrospectively from 1st April, 2001 and have been made applicable to business losses or unabsorbed depreciation arising in the asst. yr. 2001-02 and subsequent years."

22.It is interesting to note that such relaxation has not been made in s. 10C which provides for exemption in respect of profits of certain undertakings in north eastern region. This makes clear the legislative intention of providing relaxation wherever it deems fit and in the present case, such relaxation has been made in s. 10A but not in s. 10C.

23.It is to be noted that the aforesaid amendment read with the Board circular does not militate against the proposition that the benefit of relief under this section is in the nature of exemption with reference to the commercial profits. However, in order to give effect to the legislative intention of allowing the carry forward of depreciation and loss suffered in respect of any year during the tax holiday for being set off against income post tax holiday, it is necessary that the notional computation of business income and the depreciation as per the provisions of the Act should be made for each year of the tax holiday period. While so computing, attention will have to be given to provisions of ss. 70, 71, 72 and s. 32(2). The amount of depreciation and business loss remaining unabsorbed at the end of the tax holiday period should be determined so that the same may be set off against the income post tax holiday period.

10.4 We further note that this view has been reiterated by the Hon'ble jurisdictional High Court in the case of M/s.Aurigene Discovery Technologies Ltd., in ITA No.549/13. A similar view was considered by the co-ordinate bench of this Tribunal in the case *M/s.Biocon Ltd. (supra)* and held in para.23 to 26 as under:

"23. We have given a very careful consideration to the rival submissions. The issue raised by the assessee in ground no.21 is identical to the ground raised by the assessee in *Biocon (supra)*. The facts of the case before the Tribunal in the case of *Biocon (supra)* were that the assessee during the previous year had four units which were entitled to claim deduction u/s. 10B of the Act viz., CMZ Unit, SAP Unit, RHI Unit and IFP Unit. The assessee had claimed deduction u/s. 10B of the Act in respect of the aforesaid units totaling Rs.157,22,33,066 which is the sum total of deduction u/s. 10B for the four units as follows:—

(1) CMZ Unit	:	6,87,70,229
(2) SAP Unit	:	76,60,29,880
(3) RHI Unit	:	52,42,56,278

(4) IFP Unit	:	21,31,76,679
Total		157,22,33,06

The assessee had non-10B units as well. In those non-10B units, there was a loss of Rs.105,92,19,172. In the return of income filed by the assessee, the assessee sought to carry forward the loss of non-10B units for set off against the profits of non-10B units in the subsequent assessment years. The AO firstly noticed that there was income from other sources to the extent of Rs.4,71,15,896 and such had to be set off against the loss of the non-10B units. Accordingly, the AO held that the loss of the non-10B units that had to be considered for carry forward would be Rs.101,21,03,280. Thereafter, the AO was of the view that income of the 10B units had to be set off against the loss of the non-10B units and if it is so set off, there will be no loss that needs to be carried forward. In coming to the aforesaid conclusion, the AO expressed the opinion that provisions of section 10B are deduction provisions and therefore effect will have to be given to the provisions of section 72 of the Act, even in respect of profits of the 10B unit. Accordingly, the claim of the assessee for carry forward of loss of non-10B unit was not allowed by the AO. On appeal by the assessee, it was contended that the provisions of section 10A and section 10B are exemption provisions and therefore the profit of 10A and 10B units will not enter the computation of total income at all and therefore the profits of these units need not be set off against the loss of non-10B unit by invoking the provisions of section 72 of the Act. The CIT(Appeals) did not agree with the contention of the assessee and in doing so, he placed reliance on the decision of the Hon'ble Karnataka High Court in the case of *CIT v. Himatsingike Seide Ltd.*, 286 ITR 255 (Kar). In the aforesaid decision, the Hon'ble High Court has taken the view that deduction u/s. 10B has to be allowed after set off of unabsorbed depreciation and unabsorbed investment allowance. The Hon'ble Court took the view that the aforesaid provision was only an exemption provision. The CIT(Appeals) noticed that the aforesaid decision was followed by the ITAT Bangalore Bench in the case of *Intelnet Technologies India Pvt. Ltd. v. ITO*, ITA No.1021/Bang/2009 dated 12.3.2010. Similar view expressed by the Delhi Bench of the Tribunal in the case of *Global Vantage Pvt. Ltd. v. DCIT*, 2010 TIOL 24 ITAT (DEL) was also referred to by the CIT(A). A contrary view was expressed by the Bangalore Bench of the Tribunal in the case of *KPIT Cummins Info Systems (Bangalore) Pvt. Ltd. v. ACIT*, 120 TTJ 956. The CIT(A) found that in the case of *Global Vantage Pvt. Ltd. (supra)* decided by the Delhi Tribunal this decision has been held to be not in tune with the decision of the Hon'ble High Court of Karnataka in the case of *Himatsingike Seide Ltd. (supra)*. The CIT(A) also referred to the decision of the Chennai Bench of the Tribunal in the case of *Sword Global India Pvt. Ltd. v. ITO*, 306 ITR 286 (AT), wherein the provisions of section 10A and 10B have been held to be deduction provisions and not exemption provisions. For all the above reasons, the CIT(Appeals)

confirmed the order of the Assessing Officer. Against the order of the CIT(A), the Assessee was in appeal before the Tribunal.

25. This Tribunal dealt with the issue in the following words :

63. We have given a careful consideration to the rival submissions. The issue as to whether the provisions of Sec.10B of the Act are deduction provisions or exemption provisions will assume great importance. The reason is that if the provisions are considered as exemption provisions then they will not enter the computation of total income and therefore the loss of the eligible unit cannot be set off against the profits of the non-eligible unit. This issue has already been settled by the Hon'ble Karnataka High Court in the case of *Yokogawa India Ltd. (supra)*. The Hon'ble Karnataka High Court in the case of *Yokogawa (supra)* had to deal with two substantial question of law. The first substantial question of law was on the right of set off of loss of non-eligible unit against the profit of the eligible unit on which deduction u/s.10B was to be allowed. The Hon'ble Court in para 10 to 20 of its judgment dealt with the issue. The Hon'ble Court noticed that Sec.10-A(1) of the Act (which is in pari materia with Sec.10-B of the Act) read as follows:

"10B. Special provisions in respect of newly established undertaking in free trade zone etc.,-(1) Subject to the provisions of this section, a deduction of such profits and gains as are derived by undertaking from the export of articles or things or computer software for a period of ten consecutive assessment years beginning with the assessment year relevant to the Previous-year in which the undertaking begins to manufacture or produce articles or things or computer software, as the case may be, shall be allowed from the total income of the assessee :"

(emphasis supplied)

64. The expression "Deduction" and "shall be allowed from the total income of the Assessee" used in the aforesaid provisions was considered by the Hon'ble High Court and it held in para 13 to 15 of its judgment that the expression " shall be allowed from the total income of the Assessee" does not mean total income as defined u/s.2(45) of the Act but that expression means "profits and gains of the STP undertaking as understood in its commercial sense or the total income of the STP unit. Thus the view expressed is that income of the STP undertaking gets quarantined and will not be allowed to be set off against loss of either another STP undertaking or a non STP undertaking. The Hon'ble Court thereafter held that though the expression used in Sec.10A was "Deduction" but in effect it was only an exemption section. These conclusions clearly emanate from para 17 of the Hon'ble Court's judgment.

65. The situation with which we are concerned in the present case is a situation where there is positive income of the eligible unit then the same should be allowed deduction u/s.10B of the Act without setting of the loss of non-eligible unit. The Hon'ble

Karnataka High Court in the case of *Yokogawa (supra)* was concerned with similar situation as set out above. In view of the aforesaid decision of the Hon'ble Karnataka High Court, we are of the view that the claim as made by the Assessee for carry forward of loss of the non-eligible unit had to be allowed without set off of profits of the 10A/10B unit. We hold accordingly and allow the relevant grounds of appeal of the Assessee.

66. We may also observe that the Hon'ble Karnataka High Court's decision in the case of *Himatasingike Seide (supra)* has held that unabsorbed depreciation (and business loss) of same (s. 10A/10B) unit brought forward from earlier years have to be set off against the profits before computing exempt profits. The assessee in that case set up a 100% EOU in AY 1988-89. For want of profits it did not claim benefits u/s 10B in AYs 1988-89 to 1990-91. From AY 1992-93 it claimed the said benefits for a connective period of 5 years. In AY 1994-95, the assessee computed the profits of the EOU without adjusting the brought forward unabsorbed depreciation of AY 1988-89. It claimed that as s. 10B conferred "exemption" for the profits of the EOU, the said brought forward depreciation could not be set-off from the profits of the EOU but was available to be set off against income from other sources. It was also claimed that the profits had to be computed on a "commercial" basis. The AO accepted the claim though the CIT revised his order u/s 263 and directed that the exemption be computed after set-off. On appeal by the assessee, the Tribunal reversed the order of the CIT. On appeal by the department, the High Court in *CIT v. Himatasingike Seide Ltd.* 286 ITR 255 (Kar) reversed the order of the Tribunal and held that the brought forward depreciation had to be adjusted against the profits of the EOU before computing the exemption allowable u/s 10B. In Civil Appeal No.1501 of 2008 dated 19.9.2013 against the aforesaid decision of the Hon'ble Karnataka High Court, the Hon'ble Supreme Court observed as follows while dismissing the appeal:—

"Having perused the records and in view of the facts and circumstances of the case, we are of opinion that the civil appeal being devoid of any merit deserves to be dismissed and is dismissed accordingly."

67. Thus the ratio has to be confined to the facts and circumstances of the case. The aforesaid observations have to be confined to the facts of that case and as applicable to a case where brought forward losses and depreciation of the very same STP undertaking are not adjusted while arriving at the profits of the 10B unit for allowing deduction u/s.10A/10B of the Act and not in respect of brought forward losses and depreciation of other undertakings/non-10A/10B units. S. 10A/10B(6) as amended by the FA 2003 w.r.e.f. 1.4.2001 provides that depreciation and business loss of the eligible unit relating to the AY 2001-02 & onwards is eligible for set-off & carry forward for set-off against income post tax holiday which means that they need not be so set off as mandated in the decision of the Hon'ble Karnataka High Court in the case of *Himatasingike Seide Ltd. (supra)*. As we have already seen, in *Yokogawa India Ltd.* 341

ITR 385 (Kar), it was held that even after s. 10A/10B were converted into a "deduction" provision w.e.f 1.4.2001, the benefit of relief u/s 10A/10B is in the nature of "exemption" with reference to "commercial profits" and that as the income of the s. 10A unit has to be excluded at source itself before arriving at the gross total income, the question of setting off the loss of the current year's or the brought forward business loss (and unabsorbed depreciation) against the s. 10A profits does not arise. Therefore the decision of the Hon'ble Karnataka High Court in the case of *Himatasingike Seide (supra)* will not apply to the facts of the present case."

26. In view of the aforesaid decision, we are of the view that the claim made by the assessee deserves to be accepted. We may also observe that CBDT circular No.7 dated 16.07.2013, on the facts and circumstances of the present case is not a benevolent circular vis-à-vis, the assessee, and therefore the decision to the contrary of the Hon'ble Karnataka High Court in the case of *Yokogawa India (supra)* will continue to apply. For the reasons given above, we direct the Assessing Officer to accept the claim of the assessee, as raised in ground no.21."

10.5 Accordingly by following the latest judgment of the Hon'ble jurisdictional High Court based on the substituted/amended provisions of sec.10A/10B which are applicable in the case of the assessee as well as the decision of the Tribunal in case of *Biocon (supra)*, we decide this issue in favour of the assessee and direct the AO to allow deduction u/s 10A without setting off the domestic losses."

For the above said reasons, we decide this issue in favour of the assessee and direct the Assessing Officer to allow deduction under Section 10A without setting off the unabsorbed depreciation.

27. Another ground raised by the assessee is regarding levy of interest under Section 234B which is mandatory and consequential in nature.

28. The assessee has also raised a ground of initiation of penalty proceedings under Section 271(1)(c) of the Act which is premature at this stage.

29. In the result, the appeal of the assessee is partly allowed.

■ ■

IN THE ITAT MUMBAI BENCH 'F'

Vasant J. Khetani

v.

Joint Commissioner of Income-tax-17(3), Mumbai

SAKTIJIT DEY, JUDICIAL MEMBER
AND RAMIT KOCHAR, ACCOUNTANT MEMBER

IT APPEAL NO. 3340 (MUM.) OF 2012
[ASSESSMENT YEAR 2007-08]

MARCH 16, 2016

Nishit Gandhi *for the Appellant.* **Satya Pal Kumar** *for the Respondent.*

ORDER

Ramit Kochar, Accountant Member - This appeal, filed by the assessee, being ITA No. 3340/Mum/2012, is directed against the order dated 20-02-2012 passed by learned Commissioner of Income Tax (Appeals) (hereinafter called "the CIT(A)") and the appeal before the CIT(A) arose from the assessment order dated 23.12.2009 passed by the learned assessing officer (Hereinafter called "the AO") u/s 143(3) of the Income Tax Act, 1961 (Hereinafter called "the Act"), for the assessment year 2007-08.

2. The grounds raised by the assessee in the memo of appeal filed with the Tribunal read as under:—

"1.1 The learned Commissioner of Income - tax (Appeals) - 19, Mumbai ("the Id. CIT (A)") erred in confirming the action of the assessing officer ("A.O.") of making disallowance of Rs. 12,00,000/-under section 43B of the Income tax Act, 1961 ("the Act").

1.2 While doing so, the CIT (A) failed to appreciate that the amount payable to Brahnamumbai Municipal Corporation ("BMC") was not covered by the provisions of section 43 B of the Act so as to call for the disallowance.

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

2.1 The Id. CIT (A) erred in confirming the action of the A.O. in disallowing the claim of deduction amounting to Rs. 3,02,575/- on account of labour charges paid, by invoking the provisions of section 40 (a) (ia) of the Act.

2.2 While doing so, the Id. CIT (A) failed to appreciate that the provisions of section 40(a) (ia) were not at all applicable in the facts of the Appellant's case.

3. The brief facts of the case are that the assessee is engaged in the business of development and construction of buildings. During the course of assessment proceedings u/s 143(3) read with Section 143(2) of the Act, it was observed by the A.O. that in Profit & Loss account, the assessee has debited a sum of Rs. 12 lacs as provision for BMC payment which is shown as payable under the head current liabilities. The assessee was asked to explain the same as to why this provision being an unascertained liability should not be disallowed. In reply, the assessee submitted that the original lessor is BMC and Mr. Sylvester & Others are original lessee. When a lessee transfer his lease-hold rights to other party, the said other party has to pay to lessor (i.e. BMC) transfer fee. Transfer fee was 7% of agreement value, when the assessee has started construction of the building. But at the time of completion of the building, transfer fee was increased to 50% & considering that it will be settled to say 10% of the agreement value, the assessee has made provision for 10% of Agreement value i.e. Rs. 12,00,000/- being lease transfer fee payable. The assessee submitted that if there was accrued liability, then estimated expenditure which could be incurred in discharging that liability could be deducted from the profits and gains of the business. The assessee is following mercantile system of accounting and is entitled to deduct from profits and gains of business such liability which had accrued during the period for which profits and gains were being computed, therefore, the assessee was entitled to deduction of confirmed and accrued contingent liability. The assessee relied upon the decisions in the case of *CIT v. Southern Estates (P) Ltd.* [1982] 136 ITR 846 (Cal.), *CIT v. B&A Plantations & Industries Ltd.* [2002] 257 ITR 694 (Gau.), *South Eastern Coalfields Ltd. v. Joint CIT* [2002] 77 TTJ (Nag-Trib) 401, *CIT v. Indian Metal & Metallurgical Corporation*, [1964] 51 ITR 240 (Mad) and *Sirsa Industries v. CIT* [1989] 178 ITR 437 (P & H), *Calcutta Co. Ltd. v. CIT* [1959] 37 ITR 1 (SC), *Addl. CIT v. T Nagireddy & Co.* [1976] 105 ITR 669 (AP) and *Metal Box Co. of India Ltd. v. Their Workmen* [1969] 73 ITR 53 (SC). The A.O. observed that there is a dispute between BMC and the assessee regarding payment of certain dues and the matter is pending before the Hon'ble jurisdictional High Court. In the meanwhile, assessee made a provision for transfer fee payable to BMC @ 10% of agreement value, as against earlier transfer fee rate of 7% of agreement value and as against BMC's demand of increased transfer fee @ 50%. However, the same is also not paid yet as BMC has not agreed upon. The A.O. held that firstly, the transfer fees due to BMC is covered by section 43B of the Act being a Government due. As per the provisions of section 43B of the Act, this transfer fee payable to BMC can be allowable only when it is actually paid. As per the submissions of the assessee, the same is still payable. Hence, the said fee cannot be allowed in the relevant assessment year due to provisions of Section 43B of the Act. Secondly, it is very much clear that in the previous year relating to this assessment year, the liability has not been crystallized being a disputed contractual liability. In mercantile system of accounting, the income & expenditure accrues when there is a right to receipt and right to payment is established and once the right is withheld by way of a dispute, then the accrual of income &

expenditure is postponed till the final settlement of the dispute. It is a settled law that the disputed liability accrues only in the year of final settlement, therefore, the claim made by the assessee is not deductible. The A.O. observed that the case laws relied upon by the assessee, none of them is applicable to the present case as the facts are different. The AO held that in the present case the issue is allowability of liability which is disputed and also covered by section 43B of the Act , whereas the issues in all the case laws cited by the assessee are on different footings . The A.O. relied upon the following decisions:—

1. *CIT v. Purushottam Gokuldas* (Ker.) 237 ITR 115
2. *CIT v. Oriental Motor Car Co.(P.) Ltd.* (All.) 124 ITR 74
3. *Acentric Chemical Works Ltd. v. DCIT* (Guj.) 266 ITR 47
4. *CIT v. Highway Construction Co. P. Limited* 223 ITR 32
5. *N Sundereswaran v. DCIT* 226 ITR 142(Ker.)
6. *CIT v. Bharat Fire Bricks and Potteryware Private Limited* 202 ITR 821(Cal.)
7. *. Navjivan Roner Flom Pulses Mills Limited v. DCIT* 73 ITD 265(Ahd. Trib.)

On the basis of facts and circumstances and the judicial pronouncements, the A.O. disallowed the sum of Rs. 12 lacs and added the same to the total income of the assessee , vide assessment orders dated 23.12.2009 passed by the AO u/s 143(3) of the Act.

4. Aggrieved by the assessment order dated 23.12.2009 passed by the A.O. u/s 143(3) of the Act , the assessee has preferred an appeal before the CIT(A).

5. Before the CIT(A), the assessee contended that the plot of land which was purchased by the assessee is a leasehold land and the said lease is for a period of 999 years. The original lessor is BMC and Mr. Sylvester & Others are original lessee. The assessee submitted that when the lessee transfer his right to other party, the said party to whom the lease hold rights are transferred by the lessee has to pay the transfer charges to the BMC. The BMC has suddenly increased its transfer charges from 7% of agreement value to 50%. The assessee had made provision of transfer charges of Rs.12,00,000/- @10% of agreement value as against 50% demanded by BMC, to be payable in due course assuming that it will be settled @10% of the agreement value. The matter has gone in dispute and the said transfer charges were not paid by the assessee to BMC.

The CIT(A) considered the submission of the assessee and held that since the amount has not been paid to BMC, provisions of Section 43B(a) of the Act is not complied with and in view of this the expenses will not be allowed and the CIT(A) upheld the order of the A.O. , vide orders dated 20.02.2012

6. Aggrieved by the orders dated 20.02.2012 of the CIT(A), the assessee is in appeal before the Tribunal.

7. The Id. Counsel for the assessee submitted that the assessee has to pay transfer fee to BMC and accordingly the assessee has made provision of Rs. 12 lacs with respect to the plot of land which was purchased by the assessee which was a leasehold land for 999 years. The original lessor is BMC and Mr. Sylvester & Others are original lessee. The assessee has to pay transfer charges to the BMC @ 7% of agreement value and the BMC has suddenly increased the transfer charges from 7% of agreement value to 50% of value of land as per ready reckoner rate, however, the assessee has made provision of Rs.12,00,000/- @10% of agreement value as against 50% of value of land as per ready reckoner rate to be payable in due course and the assessee has claimed expenses in the year under consideration. The Id. Counsel submitted that in view of this dispute with respect to payment of transfer fee/premium to BMC on transfer of lease-hold rights, Writ Petitions vide No. 166 of 1997, 2370 of 2006, writ petition no 1262 of 2010 and 718 of 2010 were filed by various aggrieved petitioners before the Hon'ble Bombay High Court and the said Writ Petitions were disposed of and allowed by the Hon'ble Bombay High Court, vide common judgment dated 15-02-2011, by holding as under:—

"12. The Supreme Court has thus held that whenever there is compulsory exaction of money, there should be specific provision for the same. In the present case, we have not been pointed out any provision permitting the Corporation to recover premium from the assignee of lease. We have also not been pointed out any recital in the Lease Deed permitting the Corporation to do so. Therefore, the Corporation obviously was not entitled to claim premium for taking entry about assignment of the lease hold rights. We also found that neither there is any provision in any law nor there is any term in the Lease Deed with which we are concerned in these petitions requiring the lessee to seek prior permission of the Corporation before assigning his lease hold rights. As prior permission itself is not contemplated, there is no question of the Corporation levying any penalty for assigning the lease hold rights without prior permission of the Corporation. The demand made by the Corporation in that regard, therefore, is without authority of law.

13. In these circumstances, therefore in our opinion, all these Petitions will have to be allowed. They are accordingly allowed. It is held that in the absence of any stipulation in the Lease Deed permitting the Corporation to charge any premium or any provision in law authorizing the Corporation to claim such a premium on transfer of lease hold rights, the Corporation cannot claim any premium like it has been done in this case from the assignee. Similarly in the absence of any stipulation in the Lease Deed for not obtaining prior permission of the Corporation for assignment of lease hold rights the Corporation cannot demand any transfer fees from the assignee. The amount that might have been collected by the Corporation pursuant to the demand notice which has been made in these Petitions are directed to be refunded by the Corporation after

adjusting any legal demands that may be due to the Corporation from the Petitioners within a period of eight weeks from today."

The Id. Counsel submitted that the Municipal Corporation of Greater Bombay (also known as BMC) has filed SLP(C) No. 16197/2011 with the Hon'ble Supreme Court challenging the afore-stated judgment dated 15-02-2011 delivered by the Hon'ble Bombay High Court, copy of the SLP is placed vide page No. 31 to 33 of the paper book filed by the assessee with the Tribunal. The Id. Counsel contended that these demands were raised by BMC without any authority of law and nor these are contractual liabilities as per the terms of lease deed entered by and between the lessor and the lessee. The Id. Counsel also relied on the decision of the Hon'ble Supreme Court in the case of *Bharat Earth Movers Limited*, [2000] 245 ITR 428 (SC) and *Taparia Tools Private Limited*, [2015] 372 ITR 605(SC).

8. The Id. D.R., on the other hand, relied on the orders of authorities below and submitted that the demand has not been paid by the assessee to the BMC and there is thus non compliance of provisions of Section 43B(a) of the Act and the authorities below has rightly made the disallowance.

9. We have heard the rival contentions and also perused the material available on record including the case laws relied upon by both the sides. We have observed that the assessee has purchased a plot of land of which the original lessor is 'Brihanmumbai Municipal Corporation'(in short 'BMC') also known as 'Municipal Corporation of Greater Mumbai' (in short 'MCGM') and Mr. Sylvestor & Others are the original lessee. When the lessee transfers his lease-hold rights in the land owned by BMC, to other party, the said party has to pay the premium to BMC. The prevailing premium was 7% of the agreement value since 1993 (earlier it was 5%) but suddenly the premium has been increased from 7% of agreement value to 50% of value of land as per ready reckoner rate by Resolution of the Improvement committee/corporation in March/April 2008 for which the proposal was moved by BMC in July 2007. The assessee has made provision of 10% i.e. Rs. 12,00,000/- in the books for accounts for the previous year relevant to the assessment year 2007-08 assuming that it is finally settled at 10% , as the matter relating to legality and validity of chargeability by BMC of the said premium has been challenged in writ petitions filed with the Hon'ble Bombay High Court vide Writ Petitions bearing No. 166 of 1997, 2370 of 2006, 1262 of 2010 and 718 of 2010 by the Petitioners , although no writ petition has been filed by the assessee before the Hon'ble Bombay High Court. We have observed that in view of this legal dispute with respect to challenge to the legality and validity of premium charged by BMC on transfer of lease-hold rights of the land owned by BMC from lessee's to purchasers/assignees , Writ Petitions bearing No. 166 of 1997, 2370 of 2006, 1262 of 2010 and 718 of 2010 were filed by various aggrieved petitioners before the Hon'ble Bombay High Court and the said Writ Petitions were disposed of and allowed by the Hon'ble Bombay High Court , vide common judgment dated 15-02-2011 , by holding as under:—

"12. The Supreme Court has thus held that whenever there is compulsory exaction of money, there should be specific provision for the same. In the present case, we have not been pointed out any provision permitting the Corporation to recover premium from the assignee of lease. We have also not been pointed out any recital in the Lease Deed permitting the Corporation to do so. Therefore, the Corporation obviously was not entitled to claim premium for taking entry about assignment of the lease hold rights. We also found that neither there is any provision in any law nor there is any term in the Lease Deed with which we are concerned in these petitions requiring the lessee to seek prior permission of the Corporation before assigning his lease hold rights. As prior permission itself is not contemplated, there is no question of the Corporation levying any penalty for assigning the lease hold rights without prior permission of the Corporation. The demand made by the Corporation in that regard, therefore, is without authority of law.

13. In these circumstances, therefore in our opinion, all these Petitions will have to be allowed. They are accordingly allowed. It is held that in the absence of any stipulation in the Lease Deed permitting the Corporation to charge any premium or any provision in law authorizing the Corporation to claim such a premium on transfer of lease hold rights, the Corporation cannot claim any premium like it has been done in this case from the assignee. Similarly in the absence of any stipulation in the Lease Deed for not obtaining prior permission of the Corporation for assignment of lease hold rights the Corporation cannot demand any transfer fees from the assignee. The amount that might have been collected by the Corporation pursuant to the demand notice which has been made in these Petitions are directed to be refunded by the Corporation after adjusting any legal demands that may be due to the Corporation from the Petitioners within a period of eight weeks from today."

We have observed that the 'Brihanmumbai Municipal Corporation' (in short 'BMC') also known as 'Municipal Corporation of Greater Mumbai' (in short 'MCGM') is the civic body that governs the capital city of Mumbai in Maharashtra . BMC was established under the Bombay Municipal Corporation Act, 1888 and is responsible for the civic infrastructure and administration of the Mumbai city and some suburbs of Mumbai. As per the BMC's Commissioner letter No. AC/Estates/5077/LB dtd. 27th July, 2007 (placed by the assessee in paper book , page-4 filed with the Tribunal) , it was proposed to recover premium in respect of transfer of leased plot at the rate of 50% of the unearned income taking into account the value of land as per Ready Reckoner rates prevailing on the first day of the year in which these cases are decided by Municipal Corporation of Greater Mumbai instead of prevailing rate of 7% of the total consideration amount mentioned in the documents submitted for transfer of lease plot as premium . The prevailing rate of 7% was approved vide Resolution no 658 of 23.03.1993 and CR no. 240 of 22.06.1993 (earlier rate was 5%). The said proposal to hike rate to 50% of value of land as per ready reckoner rate was moved to bring in parity and adopt similar policy keeping in view the circular u/no.

Land/10/2002/Case no 387/J-1 of 29.05.2006 and LCS/10/2005/P K 35/J-1 of 31.10.2006 of Revenue and Forest Department of Government of Maharashtra that in case of transfer of Government Plot, a transfer fee @50% of the unearned income calculated by taking into account value of the land as per ready reckoner rate prevailing on the first day of the year in which a transfer case is decided is recovered. Thereafter , the proposals were recommended for approval and it is stated by the assessee counsel before us that the same was finally approved in March /April 2008 hiking the premium to 50% of the unearned income taking into account the value of land as per Ready Reckoner rates. The Hon'ble Bombay High Court in its judgment dated 15-02-2011 while disposing of afore-stated writ petitions has held that there is no stipulation in lease deed nor there is any provision in any law in force, permitting Municipal Corporation of Greater Mumbai(BMC) to charge and collect premium on transfer of lease-hold rights from the purchaser/assignees in the plots of land of which BMC is the owner and the BMC cannot claim any premium from the purchaser's/ assignee's. We have observed that the Hon'ble Bombay High court vide its judgment dated 15th February, 2011 held that the amount that might have been collected by the Corporation pursuant to the demand notice which has been made in these Writ Petitions filed with the Hon'ble Bombay High Court are directed to be refunded by the BMC after adjusting any legal demands that may be due to the BMC from the Petitioners within a period of eight weeks from the date of judgment. Against this judgment of the Hon'ble Bombay High Court, the Municipal Corporation of the Greater Mumbai also known as BMC has filed Special Leave Petition (SLP) under Article 136 of The Constitution of India before the Hon'ble Supreme Court vide SLP(C)No. 16197/2011 challenging the afore-stated judgment dated 15-02-2011 of the Hon'ble Bombay High Court. Thus, in nut-shell it has been held by the Hon'ble Bombay High Court vide its judgment dated 15-02-2011 that these premium on transfer of lease hold rights in the land is neither a statutory due arising from provisions of any statute in force in India as the same is not collected under authority of any law in force whether Central Act or State Act or any other law in force in India nor is the said premium charged by BMC is a contractual liability as per lease deed executed between lessor and lessee as no such clause exists in the lease deed allowing chargeability of said premium by BMC and the BMC has no authority to collect such premium from purchaser/assignees of the lease-hold rights in the land of which BMC is owner neither being as a statutory liability nor as a contractual liability. It is pertinent to note that writ petitions were filed with the Hon'ble Bombay High Court vide WP no. 166 of 1997 and WP no. 2370 of 2006 which challenged the legality and validity of charging of premium by BMC @7% on consideration amount being agreement value on transfer of lease-hold rights , whereby writ petitions were filed before the Hon'ble Bombay High Court in the year 1997 and 2006 much before the introduction of increased premium on transfer of lease deed @ 50% of value of land as per ready reckoner rate by resolution of the Improvement committee/Corporation in March/April 2008 , and said increase to 50% was also subject to dispute and challenge before the Hon'ble Bombay High Court vide writ petition no 718 of 2010 filed by the Techno Realtors Private Limited in the year 2010, there was a challenge to legality and validity of said increased rate of 50% of value of land as per

ready reckoner rate . It is also pertinent to mention that writ petition no. 2594 of 1994 was also filed by Novel Properties Private Limited with the Hon'ble Bombay High Court as the BMC (earlier Bombay Municipal Corporation) was not effecting the mutation without deposit of premium on transfer of leasehold rights and the Hon'ble Bombay High Court disposed of the petition by directing the Corporation to mutate the name of the petitioner as lessee keeping the question of entitlement of Corporation to demand premium from petitioner open. The said Novel Properties Private Limited later filed writ petition no 1262 of 2010 which is disposed of by the Hon'ble Bombay High Court vide the common judgment dated 15-02-2011 allowing the said writ petition. Thus, the dispute with respect to charging of premium on transfer of lease hold rights in the plots of the land owned by BMC was with the Hon'ble Bombay High Court since 1994. Thus, the assessee was well aware of the on-going legal dispute with respect to challenge to legality and validity of the charging of the premium by BMC on transfer of lease-hold rights in the land owned by BMC in favour of the purchaser/assignee's, both as a statutory liability as well as contractual liability.

The issue is to be decided on the undisputed and admitted fact that the assessee was fully aware of the on-going legal dispute prevailing with respect to challenge of legality and validity of the premium on transfer of lease-hold rights claimed and collected by BMC being subject of challenge on legal grounds that the said premium on transfer of lease-hold rights is collected without any authority of law in force in India and hence not a statutory liability nor the said premium charged is a contractual liability in the absence of provisions/clause in the lease deed executed by and between the lessor and the lessee authorizing charging of said premium on transfer of lease-hold rights in the land owned by BMC in favour of purchasers/assignees. The assessee was aware of the legal dispute pending at the Hon'ble Bombay High Court challenging the legality and validity of the said premium@7% of agreement value on the grounds that it is neither a statutory liability nor is a contractual liability. The assessee was also aware when he made provisions in the books for accounts for the impugned financial year 2006-07 that the said premium is likely to be increased to 50% of value of land as per ready reckoner rate due to the proposal being moved by BMC although the same was not approved by BMC till the assessee filed its return of income with the Revenue in the month of October 2007 as the said hike was accepted by BMC only in March/April 2008 and there was no specific on-going litigation with respect to this proposed hike to 50% pending with any legal forum at the time of filing return of income by the assessee with the Revenue in October 2007. The assessee made provision of Rs.12,00,000/- @10% of agreement value making an estimate that the liability would be ultimately settled around this amount. The assessee contends that this is an ascertained liability and the provision was correctly made which is allowable under law. The revenue has contended that first of all this payment was not made to BMC and is hit by Section 43B(a) of the Act, as premium on transfer of lease-hold rights , payable to BMC is a 'fee' and hit by the provisions of Section 43B(a) of the Act. We are afraid that this contention of the Revenue cannot be accepted in view of the finding by the Hon'ble Bombay High Court in judgment dated 15-02-2011 that this premium on transfer of lease-hold rights collected by BMC is not collected

under any provisions of any law in force in India be it a Central Act or State Act or any other law in force in India. Section 43B(a) of the Act clearly stipulates that to be covered under the provisions of Section 43B(a) of the Act the 'fee' must have been payable under any law for the time being in force. The Section 43B(a) of the Act is reproduced here-in-below :

"[Certain deductions to be only on actual payment.

43B. Notwithstanding anything contained in any other provision of this Act, a deduction otherwise allowable under this Act in respect of—

[(a) any sum payable by the assessee by way of tax, duty, cess or fee, by whatever name called, under any law for the time being in force, or]

**

**

**11

The Hon'ble Bombay High court has clearly laid down that the said premium on transfer of lease-hold right is not collected under any provisions of any law in force in India, we hold that said premium on transfer of lease-hold rights of land owned by BMC is not a 'fee' as defined u/s 43B(a) of the Act and is not hit by Section 43B(a) of the Act and the same cannot be disallowed for non-compliance of provisions of Section 43B of the Act.

The second contention of the Revenue is that the liability has not crystallized during the assessment year being a disputed and contingent liability as the same being un-ascertained liability and the said liability will crystallize in the year of final settlement once the legal disputes are resolved by judgments of the Courts. It is stated in the judgment of the Hon'ble Bombay High Court dated 15-02-2011 that the Writ petition bearing number 2370 of 2006 was filed by Maharashtra Chamber of Housing Industry in representative capacity and the assessee has also produced letter dated 20-09-2011 in the paper book placed at page 9 whereby the said Maharashtra Chamber of Housing Industry has updated to all their members about the recent legal development on this issue vide letter no. MCHI/SEC/11-12/107 dated 20-09-2011. The Hon'ble Bombay High Court has finally vide judgment dated 15-02-2011 held that premium on transfer of lease hold property owned by BMC is not a statutory liability being without authority of any law in force in India nor a contractual liability as there is no stipulation in lease deed executed between lessor and lessee about the chargeability of said premium. The matter is still sub-judice with the Hon'ble Supreme Court as BMC has filed Special Leave Petition(SLP) under Article 136 of The Constitution of India challenging the judgment dated 15-02-2011 of the Hon'ble Bombay High Court. The assessee has relied upon the decision of the Hon'ble Supreme Court in the case of *Bharat Earth Movers Limited*, [2000] 245 ITR 428 (SC) and *Taparia Tools Private Limited*, [2015] 372 ITR 605(SC). In our considered view, both the cases are distinguishable as they deal with the business liability which has definitely arisen during the previous year shall be allowed as deduction although the quantification and discharge of the liability may be done at a later stage. Here, in the impugned appeal we are concerned with a liability whose levability both being as a statutory liability as well as being a contractual liability per-se was subject of legal

dispute and challenge before the Hon'ble Bombay High Court on the grounds that neither it is statutorily valid as being without authority of any law in force in India be it a Central Act or State Act or any other law in force in India nor is contractually valid liability as there is no provisions in the lease deed authorizing BMC to collect the premium per-se , which was subject matter of challenge and dispute vide writ petitions filed in the year 1997 and 2006 with the Hon'ble Bombay High Court , both of which were pending for disposal before the Hon'ble Bombay High Court, at the time of filing of return of income by the assessee for the impugned assessment year , in October 2007 . With the above facts and background , in our considered view, when the assessee was fully aware of the legal dispute going on in the Hon'ble Bombay High Court with respect to challenge as to the legality and validity of charging per-se of the said premium by BMC on transfer of lease-hold rights on the land owned by BMC, both as a statutory as well as a contractual liability, it could not be said that the liability has arisen or accrued against the assessee being an ascertained liability rather it is a contingent liability being an un-ascertained liability , of which ascertainment and quantification is dependent and contingent on the pronouncement and decisions of the Courts on legal challenge raised by the Petitioners with respect to said chargeability of premium both as a statutory liability as well as contractual liability . The cue for this is to be found in the CBDT Notification No. SO 69(E) dated 25th January 1996 issued under Section 145(2) of the Act, which states that provisions should be made for "all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information." Accounting Standard AS-29 issued by The Institute of Chartered Accountants of India (ICAI) deals with "Provisions, Contingent Liabilities and Contingent Assets". The purpose of the accounting standards is to ensure that the balance sheet and P&L Account of an enterprise should present a true and fair view of its business affairs. Under AS 29 a 'provision' is defined to mean "a liability which could be measured only by using a substantial degree of estimation." The word 'liability' is defined as "a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits." 'Contingent Liability' is defined as under:

- "(a) a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or
- (b) a present obligation that arises from past events but is not recognised because:
 - (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation;

Or

(ii) a reliable estimate of the amount of the obligation cannot be made."

AS 29 further states that 'provisions' are distinguishable from other liabilities such as trade payables and accruals "because in the measurement of provisions substantial degree of estimation is involved with regard to the future expenditure required in settlement." However a 'provision' is recognised only where:

- "(a) an enterprise has a present obligation as a result of a past event:
- (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- (c) a reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision should be recognised."

Appendix A to AS-29 sets out in a tabular the summary of the AS. The provisions which are recognised and those that are not are set out in separate columns. What is not recognised is a provision for a liability which arises from 'a possible obligation' that may, but probably will not, require an outflow of resources.

Under the mercantile system of accounting, an assessee gets deduction when liability to pay an expense arises, notwithstanding its actual quantification and discharge taking place subsequently. The relevant criteria for the grant of a deduction is that the incurring of liability must be certain. If the liability itself is uncertain, it assumes the character of a contingent liability and ceases to be deductible. In the instant case the said chargeability of premium on transfer of lease-hold rights in land owned by BMC in favour of purchaser/ assignees was also subject to challenge before the Hon'ble Bombay High Court that it is neither a statutory liability as being levied without any provisions in any statute in force in India be it a Central Act or State Act or any other law in force in India and also subject to challenge that it is also not a contractual liability as there is no provision / clause in the lease deed entered into by and between lessor and lessee which enforces and crystallizes the said charge .

Thus, we hold that the liability to pay the premium to BMC on transfer of lease-hold rights of the land owned by the BMC in favour of purchaser/assignees was an un-ascertained liability being a contingent liability during the impugned assessment year as the said premium per-se both as a statutory and as well as being a contractual liability were subject matter of legal dispute and challenge before the Hon'ble Bombay High Court of which the assessee was fully aware . The assessee was also not making payment to BMC knowingly fully well that it is an unascertained and contingent liability as the matter as to legality and validity of the said premium both as statutory and contractual liability were under challenge and legal dispute being sub-judice with the Hon'ble Bombay High Court, when the assessee filed his return of income in October 2007 with the Revenue claiming the said expenditure

of Rs.12,00,000/- as deduction u/s 37(1) of the Act in the computation of income filed along with return of income with the Revenue. Thus, in our considered view, the said expenses of Rs.12,00,000/- claimed by the assessee as an expenditure in the return of income filed with Revenue is not deductible as revenue expenditure u/s 37(1) of the Act, while computing income of the assessee being disputed , un-ascertained liability and contingent liability which was subject to challenge and dispute before the Hon'ble Bombay High Court both with respect and regard to being classified as statutory as well as contractual liability at the time of filing of return of income with the Revenue by the assessee in October 2007 . Thus, based on our above discussion and reasoning, the grounds of the appeal raised by the assessee are rejected and are dismissed. We order accordingly.

10. Now, coming to the next grievance of the assessee, the assessee challenged the confirmation of A.O.'s assessment order dated 23.12.2009 passed u/s 143(3) of the Act by the CIT(A) vide orders dated 20-02-2012 in disallowing the claim of deduction amounting to Rs. 3,02,575/- on account of labour charges paid by invoking the provisions of section 40(a)(ia) of the Act. The A.O. observed that the assessee has not deducted tax at source u/s 194C of the Act on following payments:—

<i>Name of the person to whom Payment is made</i>	<i>Nature</i>	<i>Amount(Rs)</i>
1. Ramesh Solanki	Labour charges	55,255
2. Kanubhai Solanki	Labour charges	87,320
3. R-Lite Electricals	Labour charges (Electrical work)	1,60,000
4. Reliable Security & New India Security Agency	Security charges	14,081
		3,16,656

The assessee submitted that as per the list of person as specified in Section 194C(1) of the Act who are liable to deduct tax at source as per the law as applicable for the assessment year 2007-08 , individuals have not been specified and the assessee being individual is not liable to deduct tax at source u/s 194C(1) of the Act . The assessee submitted that Section 194C(2) of the Act is not applicable to the assessee as the said sub-section is applicable if the payment is made by contractor to sub-contractor and this being not the case here , the provisions of Section 194C(2) of the Act cannot be made applicable to the assessee.

The A.O held that the assessee has deducted tax at source on labour payments except with respect to above-mentioned parties and hence the assessee plea cannot be accepted. Secondly, in view of the provisions of section 40(a)(ia) read with section 194C (2) of the Act , the AO disallowed the expenditure. While doing so, the A.O. observed that the assessee is engaged in the business of developing and construction wherein he executes contract which is entered between the buyer and himself, hence, the provisions of section 194C(2) of the Act would be applicable instead of section 194C(1) of the Act. As per the above said section 194C(2) of the Act which is applicable in the assessee's case, it is very clear that for any

payment made by any person to any resident for carrying out of any work is subjected to deduction of tax at source except in the case of any individual or HUF who is not liable to the tax audit as per clause (a) or clause (b) of section 44AB of the Act, during the immediately preceding financial year in which the such sum is credited or paid to the contractor. The AO disallowed the expenditure of Rs.3,16,656/- and added the same to the income of the assessee vide assessment order dated 23.12.2009 passed u/s 143(3) of the Act.

9. Aggrieved by the assessment orders dated 23.12.2009 passed by the A.O. u/s 143(3) of the Act, the assessee preferred an appeal before the CIT(A) and submitted that during the previous year relevant to the assessment year, the assessee had made payment to contractors of the labour job/service charges to the extent of Rs.3,16,656/- to four different parties. The A.O. had misinterpreted Section 194C(2) of the Act in a different way and disallowed all the payment to contractors. The AO wrongly considered the assessee as a "Contractor" and applied Section 194C(2) of the Act where as the assessee is a builder and developers and he employed others as contractors and contractors appointed sub-contractors to get the work done. The CIT(A) after considering the facts of the case and the submissions of the assessee held that assessee has deducted tax at source where-ever applicable except for these 3 parties as mentioned in the assessment order. He held that to cover its lapses to deduct tax at source, the assessee has deliberately tried to play with the words mentioned in the Section. The CIT(A) held that the moment a contract is given a person is liable to deduct tax at source if the transaction is above the said monetary limit as envisaged in the Act. i.e. 1% where the payment is being made or credit is being given to an individual or HUF or 2% where the payment is being made or credit is being given to a person other than individual or HUF. The CIT(A) also observed that the assessee for the first time has taken the plea that he is a developer and not a contractor and therefore he is not required to deduct tax at source with respect to these payment. Accordingly, addition of Rs.3,16,656/- made u/s 40(a)(ia) of the Act was confirmed by the CIT(A) vide orders dated 20-02-2012 .

11. Aggrieved by the orders dated 20-02-2012 of the CIT(A), the assessee is in appeal before the Tribunal.

12. The Id. Counsel for the assessee submitted that assessee is a builder and developer and payment to certain contractors were made during the assessment year, but no tax was deducted at source. The Id. Counsel submitted that there was no provision in the Act which obliges the assessee for such deduction of tax at source as per the then applicable laws if the payments were made by an individual who is a builder and developer to the contractor. The Id counsel for the assessee drew our attention to the then prevailing Section 194C of the Act which was later amended w.e.f. 01-06-2007. The assessment year under consideration is 2007-08 and the law has been amended w.e.f. 1st June, 2007 whereby section 194C of the Act was amended and individual were also being made liable for deducting tax at source for payment being made to contractors as stipulated in amended

Section 194C(1) of the Act. The assessee submitted that the said plea being legal plea was taken before the CIT(A) for the first time but was not adjudicated by the CIT(A) nor any remand report was called by the CIT(A). The Id counsel for the assessee relied on the decision of the Hon'ble Calcutta High Court in the case of CIT v. Shri Rinku Mallick (ITAT No. 96 of 2012, GA No. 1368 of 2012).

13. The Id. D.R., on the other hand, relied upon the orders of authorities below.

14. We have considered the rival contention and also perused the material available on record. We have observed that the assessee is engaged in the business of builder and developer. The assessee has made payment of Rs. 3,16,656/- to four parties towards labour payments and service charges. No tax have been deducted at source under the provision of section 194C of the Act and disallowance of Rs. 3,16,656/- has been made u/s 40a(ia) of the Act. The assessee has taken a plea before the CIT(A) as well before us that he is builder and developer whereby he appoints contractors for carrying out the work for him and he is not a contractor. However, we find that the assessee has deducted tax at source with respect to other payments which is covered under Act. No tax has been deducted at source with respect to these three parties to whom payment of Rs.3,02,575/- was made which is subject matter of challenge in this appeal. The assessee has taken a plea that the assessee being individual there was no liability to deduct the tax at source u/s 194C of the Act as per the then prevailing section 194C of the Act as the assessee is builder and developer and appoints contractor to work for it. The assessee has also submitted that Section 194C was amended w.e.f. 01-06-2007 whereby individuals who are under ambit of tax-audit u/s 44AB of the Act as stipulated vide amendments in the Section itself were also brought into the mischief of Section 194C(1) of the Act w.e.f 01-06-2007 but the impugned assessment year being 2007-08, there was no liability on the assessee to deduct tax at source on these payment . The CIT(A) has not adjudicated this plea of the assessee raised for the first time by the assessee before the CIT(A) that provisions of Section 194C of the Act was not applicable on the assessee being an individual as being builder and developer himself and not a contractor . In our considered view, the matter needs to be set aside and restored to the file of the A.O. for determination of issue de-novo , after verification of the facts as to whether the payments made by the assessee to the said parties were made by the assessee in the capacity of the builder and developer and not as contractor to come out of mischief of the un-amended Section 194C of the Act as was existing in the statute during the assessment year 2007-08. Needless to say, that proper and adequate opportunity of hearing will be granted by the AO to the assessee in accordance with the principles of natural justice in accordance with law and the assessee will be allowed to produce evidence to support his contentions in his defense .We order accordingly.

15. In the result, the appeal filed by the assessee in ITA NO. 3340/Mum/2012 for the assessment year 2007-08 is partly allowed for statistical purposes.

■ ■

IN THE ITAT HYDERABAD BENCH 'B'

Virtusa (India) (P.) Ltd.

v.

Deputy Commissioner of Income-tax, Circle -17(2), Hyderabad

**SMT. P. MADHAVI DEVI, JUDICIAL MEMBER
AND S. RIFAUR RAHMAN, ACCOUNTANT MEMBER**

**IT APPEAL NO. 146 (HYD.) OF 2015
[ASSESSMENT YEAR 2012-13]**

MARCH 4, 2016

A.V. Raghuram and Ravi Bharadwaj for the Appellant. Y. Ratnakar for the Respondent.

ORDER

S. Rifaur Rahman, Accountant Member - This appeal is filed by the assessee against the order of CIT(A)IV, Hyderabad dated 07/11/2014 relates to the AY 2012-13.

2. Briefly the facts of the case are, the assessee filed its return of income on 30/11/2012 admitting total income of Rs. 42,87,89,690 under the normal provisions of the Income-tax Act, 1961 (in short 'Act'). The return of income was processed by the Central Processing Centre (CPC), Bangalore and assessed u/s 143(1) raising demand of Rs. 32,06,700/-. The main difference in the computation of tax by the assessee and the AO was as under:

Particulars	Ref	As per original return	As per the intimation u/s 143(1)
Business income		38,51,78,940	38,51,78,940
Interest income		4,36,10,747	4,36,10,747
Total income		42,87,89,687	42,87,89,687
Tax under normal provisions @ 30%		12,86,36,907	12,86,36,907
Add: Surcharge – 5%		64,31,845	
Add: Education cess – 3%		40,52,063	
	A	13,91,20,815	12,86,36,907
Book profits as per section 115JB		48,41,87,422	48,41,87,422

Tax on book profits @ 18.5%		8,95,74,673	8,95,74,673
Add: Surcharge – 5%		44,78,734	
Add: Education cess – 5%		28,21,602	
Total tax liability under MAT provisions (including surcharge and cess)	B	9,68,75,009	8,95,74,673
Tax liability (higher of A&B)		13,91,20,815	12,86,36,907
Less: MAT credit set off	A-B	4,22,45,806	3,90,62,234
Tax payable		9,68,75,009	8,95,74,673
Add: Surcharge 5%			64,31,845
Add: Education cess – 3%			40,52,063
Total tax liability		9,68,75,009	10,00,58,581

3. Aggrieved with assessment made u/s 143(1), the assessee filed appeal before the CIT(A) and has raised two grounds in this regard, which are as under:

1. That on the facts and circumstances of the case, the Id.

Assessing officer has erred in law and on facts in computation of the eligible MAT credit available of Rs. 3,90,62,234 without including surcharge and education cess while arriving at the amount of total tax payable under the normal provisions of the Income Tax Act, 1961 and under sec. 115JB of the Act.

2. Without prejudice to the Ground 1 above, that on the facts and circumstances of the case, the Id. Assessing officer has erred in computation of the tax liability (excluding interest u/s 234C of the Act) by increasing the tax liability with surcharge and education cess and then granting the MAT credit instead of granting the MAT credit and then increasing the balance tax liability with surcharge and education cess.

4. The CIT(A) has rejected ground No. 1 of the assessee by observing as under:

"4.5 The decision of the ITAT is squarely applicable to the issue in appeal. Following the decision of the ITAT in the case of Richa Global Exports Pvt. Ltd., it is held that surcharge and education cannot be taken into account for the purpose of set off of brought forward MAT credit."

5. The CIT(A) also dismissed ground No. 2 of assessee by making following observations:

5.5 The term 'income-tax' used in the Finance Act as the basis for levy of surcharge and education cess is defined in the Finance Act under Paragraph E as 30 per cent of the total income' and does not refer to any deductions there from. Though the provisions of sec.115JB apply to the appellant, in view of the fact that tax under the regular provisions was higher than the tax u/s 115JB, the income-tax was levied under the regular provisions of the Act. The income-tax payable was, accordingly, as per Paragraph E of the First Schedule of the Finance Act, 30 per cent of the total income, amounting to Rs. 12,86,36,907. As per the Finance Act, it was 'the income-tax', i.e. this sum of Rs. 12,86,36,907 on which the surcharge of 5 per cent was to be levied. Similarly, u/s 11 of the Finance Act, the basis for computation of education cess was also the income-tax.

5.6 Further, MAT credit is treated under the Act on par with prepaid taxes. This is clear from sec.140A where the self- assessment tax is required to be determined after deducting advance tax, TDS and other relief u/s 90, 90A and 91. It follows that surcharge and education cess are levied on the gross amount of income tax and not the net figure after deducting advance tax, TDS etc. In fact, though the appellant had claimed credit for TDS of ~2.36 crores and advance tax of Rs. 6.95 crores, these sums were not deducted for the purpose of levy of surcharge and education cess. For the same reason, deduction of MAT credit is not warranted before calculating surcharge and education cess.

5.7 In view of the above, it is held that computation of tax liability by increasing the tax liability with surcharge and education cess and then granting MAT credit is in order and correct. The second ground of appeal is accordingly dismissed."

6. Aggrieved by the order of the CIT(A), the assessee is in appeal before us raising the following grounds of appeal:

Based on the facts and circumstances of the case and in law the Learned ('Ld.') AO and the Ld. CIT (A), Hyderabad have:

1. Erred in computing the eligible Minimum Alternate Tax ('MAT') credit u/s 115JAA of the Act at Rs. 3,90,62,234/- by not including surcharge and education cess while arriving at the amount of total tax payable under the normal provisions of the Act and under section 115JB of the Act.
2. Without prejudice to the Ground 1 above, the Ld. CIT(A) has erred in computation of the tax liability (excluding interest under section 234C of the Act) by increasing the tax liability with surcharge and education cess and then granting the MAT credit instead of granting the MAT credit and then increasing the balance tax liability with surcharge and education cess.
3. Erred in disregarding the judicial precedent in the case of *K. Srinivasan v.*

CIT [1972] 83 ITR 346 (SC) submitted by the Appellant which has held that the term 'tax' includes surcharge and education cess.

4. Having accepted the income returned by the Appellant, the Ld. Assessing Officer/ Ld. CIT (A) erred in levying interest under section 234C of the Act at Rs. 68,878 as against the correct amount of interest under section 234C of the Act of Rs. 37,042 returned by the Appellant.
5. The Ld. CIT(A) has erred in confirming the tax demand of Rs. 32,06,697 raised on the Appellant under section 156 of the Act, hence, the same is unjustified, bad in law and should be completely vacated.

The Appellant also submits that each of the above grounds is independent and without prejudice to the other grounds of appeal preferred by the Appellant.

The Appellant craves leave to add, alter, vary, omit, substitute, amend or withdraw the above grounds of appeal, at any time before or at, the time of hearing, of the appeal, so as to enable the Hon'ble Income Tax Appellate Tribunal, Hyderabad to decide this appeal in accordance with law and on the facts and circumstances of the case."

7. With regard to Ground Nos. 1, 2 & 3: Ld. AR submitted that it is clear from the return of income filed by the assessee that the difference between the tax payable under normal provisions and as per MAT provisions is Rs 4,22,45,804 (i.e. Rs. 13,91,20,812 less Rs 9,68,75,009). On the other hand, as per intimation u/s 143(1) of the Act, it is Rs. 3,90,62,234 (i.e. Rs 12,86,36,907 less Rs 8,95,74,673). Hence, in the intimation, the eligible MAT credit considered for set off has been erroneously calculated, exclusive of surcharge and education cess at Rs. 3,90,62,234 as against the correct eligible MAT credit available for set off of Rs. 4,22,45,803, inclusive of surcharge and education cess as considered in the return of income filed by the Company.

7.1 The Id. AR further submitted that the brought forward MAT credit for A Y 2008-09 is Rs 3,86,45,182/- and for A Y 2009-10 is Rs. 5,07,73,030. Hence, assessee would be eligible to set off the difference between the tax liability as per normal provisions and tax liability as per MAT amounting to Rs 4,22,45,803.

7.2 He submitted that as per section 115JAA(5) of the Act, set off in respect of brought forward tax credit shall be allowed for any assessment year to the extent of the difference between the tax on its total income and the tax which would have been payable under the provisions of Section 115JB of the Act for that assessment year. Accordingly, the eligible MAT credit available to setoff for the Company during the captioned A Y, needs to be arrived at by comparing the difference between the tax liability (inclusive of surcharge and cess) computed under the normal provisions of the Act and the tax liability (inclusive of surcharge and cess) computed under the provisions of section 115JB of the Act.

(b) Calculation of Surcharge

7.3 Ld. AR submitted that as per intimation, the surcharge has been calculated at Rs. 64,31,845 as against the surcharge of Rs. 44,78,734. Ld. AR also submitted that the assessed tax liability (excluding surcharge and education cess) arrived at in the intimation is the same as the returned tax liability (excluding surcharge and education cess). Therefore, as there has been no change in the assessed tax liability, the surcharge calculated in the intimation suffers from error and needs rectification.

(c) Calculation of Education cess

7.4 Ld. AR submitted that as per intimation, the education cess has been calculated at Rs. 40,52,063 as against the education cess of Rs. 28,21,602. Ld. AR also submitted that the assessed tax liability (excluding surcharge and education cess) arrived at in the intimation is the same as the returned tax liability (excluding surcharge and education cess). Therefore, as there has been no change in the assessed tax liability, the education cess calculated in the intimation suffers from error and needs rectification.

(d) Interest under section 234C of the Act

7.5 Ld. AR submitted that in the intimation issued under section 143(1) of the Act, interest under section 234C of the Act is levied at Rs. 68,878 as against Rs 37,042 computed by assessee. This deviation in interest is due to consideration of the MAT credit before surcharge & education cess.

7.6 He submitted that the MAT credit is arrived at by the assessee based on the ITR 6 form, which is being followed universally by all the assesseees under the Act. He, therefore, submitted that the AO also bound to follow the same. He also submitted that CIT(A) has not considered the judicial precedent in the case of K. Srinivasan Vs. CIT, [1972] 83 ITR 346 (SC), on which reliance placed by the assessee, to bring to the knowledge of CIT(A) that in the above judgment, the Apex Court has held that the term 'tax' includes surcharge. Ld. AR also referred to the section 115JAA (2A) of the Act and the provisions of such Act describes the tax credit to be allowed shall be the difference of the tax 'paid' for any AY under subsection (1) of section 115JB and the amount of tax payable by the assessee on total income computed in accordance with the other provisions of the Act. From the above, it is important that the assessee has paid the tax which includes surcharge and education cess, hence, the MAT credit should include surcharge and education cess. Ld. AR also submitted alternate MAT credit calculation before us to demonstrate that the method adopted by the assessee and the AO will give the same tax liability irrespective of the method adopted.

8. Ld. DR, on the other hand, relied on the orders of Id. CIT(A).

9. Considered the submissions of both the counsels and material facts on the record. The provisions of section 115JB in brief are: every assessment year, two parallel computations are contemplated. One computation of total income in accordance with the normal provisions of the I.T. Act and another is the computation of book profit as stipulated u/s 115JB. If the income tax payable on the total income is less than 18.5% of the book profit

computed u/s 115JB, then the book profit so computed shall be deemed to be the total income, then the book profit so computed shall be deemed to be the total income and the company shall pay tax @ 18.5% thereon. The amount so paid as the MAT shall be available to the credit of the company to be set off as contemplated u/s 115JAA within a period of 10 AYs. Surcharge at 5% shall be levied if book profit exceeds 1 crore. Education cess @ 3% shall be added on the aggregate of income tax and surcharge. At the same time, section 115JAA provides that where any amount of tax is paid under section 115JB(l) by a company for any assessment year, credit in respect of the taxes so paid for such assessment year shall be allowed on the difference of the tax paid under section 115JB and the amount of tax payable by the company on its total income computed in accordance with the other provisions of the Act. In other words, MAT credit shall be computed as under:

MAT credit available = Tax paid u/s 115JB - Tax payable on the total income under normal provisions of the Act.

9.1 The amount of tax credit so determined shall be allowed to be carried forward and set off in a year when the tax becomes payable on the total income computed under the regular provisions. However, no carry forward shall be allowed beyond the tenth assessment year immediately succeeding the assessment year in which the tax credit becomes allowable. The set off in respect of the brought forward tax credit shall be allowed for any assessment year to the extent of the difference between the tax on the total income and the tax which would have been payable under section 115JB for that assessment year.

9.2 In other words, MAT credit will be allowed only in that previous year in which tax payable on the total income as per normal provisions of the income tax Act is more than tax payable under section 115JB and it shall be allowed to the extent of the following:

Tax payable on total income under the normal provisions of the Act – tax payable under section 115JB = MAT credit to be allowed.

9.3 On careful reading, the sub-section 2A, the tax credit to be allowed shall be the difference of tax paid for any AY under sub-section (1) of 115JB and the amount of tax payable on his total income computed in accordance with the other provisions of this Act. The important word used is tax paid and as per the Hon'ble Apex Court decision in the case of *K. Srinivasan (supra)*, the term 'tax' includes surcharge.

9.4 It is also important to evaluate sub-section (5) of section 115JAA. "Set off" in respect of brought forward tax credit shall be allowed for any AY to the extent of difference between tax on his total income and the tax which would have been payable u/s 115JB, as the case may be for that AY. On careful reading, the term used are tax not income tax or any other term. Needless to say the term tax includes surcharge.

9.5 The sub-section (5) of section 115JAA are applied as it is in the ITR '6'. The ITR-6 form is designed and approved by the apex body CBDT and this form is universally used by all the company assesseees. In Part A of the ITR-6, the assesseees are required to fill the balance

sheet and P&L A/c. From the data of Part A, all the related calculations are carried out in other parts of the ITR-6 i.e. Part – B and other related schedules. None of the columns in the Part 'B' are manually entered, these are auto fills, and the data is extracted from Part "A". It is pertinent to analyse the total tax liability calculations designed by the CBDT for the AY 2012-13. They are as below:

image

9.6 The tax liabilities for normal provisions as well as MAT are calculated with surcharge and cess. The MAT credit in row "7" are calculated automatically using the prescribed algorithm, this is nothing but balancing figure i.e., the difference between tax liability as per normal provisions and MAT provisions. Both the above tax liabilities are calculated with surcharge and cess. These are the standard format, which are expected to be followed by all the assessees and also important to note that the above format of ITR 6 was amended w.e.f. AY 2012-13 by CBDT. Moreover, this is more relevant for the department also. These formats are regulated by CBDT. Assessing Officer cannot overlook these formats and (interpret it in his own method of calculating tax credit while making assessment u/s 143(1) of the Act.) proceed to calculate the MAT credit to compute assessment u/s 143(1) applying different methods when the proper and correct method as proposed by CBDT in ITR-6. The Assessing Officer is expected to follow the ITR-6 format to complete the assessment u/s 143(1) or 143(3) of the Act.

9.5 Let us also analyse the case law of Richa Global Exports Pvt. Ltd. which was applied by CIT(A), the Delhi ITAT opined that section 115JAA applied only to income tax, not of income tax as increased by surcharge and education cess. We are of the view that the Apex court decision in the case of *K. Srinivasan (supra)* may not have been brought to the knowledge of the ITAT, Delhi. Moreover, the explanation 2 of section 115JB is applicable to calculate tax liability u/s 115JB and the same explanation should also be applied for giving credit u/s 115JAA. The tax liabilities calculated u/s 115JB by applying the explanation 2, the tax liability so computed are remitted by the assessee and then the same was carried forward for future MAT credit. In our view, while calculating the MAT credit u/s 115JAA, the same explanation '2' in section 115JB must be applied.

9.6 The earlier judgments in the cases of Universal Medicare, Valmet India and Wyeth Limited are decided relying on the ITR – 6 as applicable in those AYs. Similarly, we also apply the ITR 6 format as applicable to AY 2012-13 as stated above. Assessee has relied on the ITR – 6 format to arrive at the total liability as well as the MAT credit calculations and paid tax accordingly. In our view, the assessee had followed the procedure properly and the Assessing Officer had made the calculations applying his own interpretation or relied on the programme, we are not sure whether it is programme hitch or the interpretation of Assessing Officer was not in line with the calculations proposed in ITR-6. Therefore, we delete the addition made.

10. With regard to other grounds of appeal, they become infructuous and are dismissed as such.

11. In the result, appeal of the assessee is allowed.

■ ■

Vodafone Essar Mobile Services Ltd.

v.

Union of India

S. MURALIDHAR AND VIBHU BAKHRU, JJ.

W.P.(C) NOS. 8535 TO 8537, 8641 TO 8644 AND 8647 OF 2011
CM APPL. NOS. 19305, 19307, 19309, 19537, 19541, 19545, 19549, 19557 OF
2011,
9776, 9778, 9781 OF 2012 AND 10666 OF 2013

MARCH 9, 2016

M.S. Syali, Senior Advocate **Ms. Sonia Mathur**, **Aseem Mowar**, **Mayank Nagi**, **Rakshit Thakur**, **Husnal Syali** and **Tarun Singh**, Advocates *for the Petitioner*. **Anuj Aggarwal**, **Subhanshu Gupta**, Advocates **Dileep Shivpuri** and **Zoheb Hossain** *for the Respondent*.

JUDGMENT

S. Muralidhar, J. - The common question that arises for consideration in these writ petitions concerns the validity of the action initiated by the Respondent Income Tax Department ('Department') against the Petitioners under Sections 201(1) and 201(1A) of the Income Tax Act, 1961 ('the Act') for non-deduction of tax at source ('TDS') for periods earlier than four years prior to 31st March, 2011. These petitions in turn involve the interpretation of the proviso to sub-section (3) of Section 201 of the Act, which was inserted with effect from 1st April, 2010.

2. Although the facts of these cases are more or less similar, the facts pertaining to Tata Teleservices Limited ('TTSL'), the Petitioner in WP (C) No. 8642/2011, are first discussed. TTSL is a company registered under the Companies Act, 1956, engaged in the business of providing telecommunication services across the country. TTSL has a central office in New Delhi. It provides post-paid and pre-paid telecommunication services for which it entered into agreements with various channel partners (distributors). In the pre-paid segment, TTSL sells products such as Recharge Coupon Vouchers (RCVs) and Starter Kits to channel partners. The RCVs are the pre-paid vouchers used for selling validity and talk time to the pre-paid subscribers. The Starter Kits are the new connections containing Removable User Identity Module (RUIM) cards for providing telecommunication connection.

3. The products are sold by TTSL to the channel partners under valid tax invoices. TTSL recovers sales tax and service tax for the said transactions. The channel partner thereafter sells these products to the retailers. It is stated that there is no remuneration/consideration that flow from TTSL to the channel partners for effecting sale of such products. TTSL proceeded on the basis that in terms of the above arrangement that the retailers cannot

charge to the consumer an amount exceeding the Maximum Retail Price ('MRP'). The difference between MRP charged from consumers and price charged to channel partners by TTSL is nothing but the maximum amount of business income available for channel partners and retailers taken together. Further, the amount that is realised by channel partners or retailers separately is not known to TTSL at any point of time.

4. According to TTSL, the transaction between it and the channel partner is on a principal to principal basis. It is explained that under a principal and agent relationship, commission is paid subsequent to the happening of the incident, i.e. post the recovery of the MRP price, and thus it is termed as commission. However, under a principal to principal relationship as that is followed in the prepaid business, the discount allowed flowing out from the MRP price, which happens before the happening of the incident, i.e. recovery of the price from customers.

5. Accordingly to TTSL, in terms of the above arrangement, Section 194H of the Act concerning deduction of TDS towards commission or brokerages does not apply to the above transaction with the channel partners. TTSL filed its TDS return/statement under Section 200 of the Act in each of the relevant Assessment Years (AYs) [for WP (C) No. 8642/2011 the relevant AY being 2001-2002]. It may be noticed at this stage that the Karnataka High Court in a decision *Bharti Airtel Ltd. v. Deputy Commissioner of Income-Tax* [2015] 372 ITR 33 (Kar) held that no TDS is recoverable from the payments made by cell phone companies to the distributors where the products sold were pre-paid cards.

6. Section 201 as it stood prior to the amendment [which introduced sub-section (3) with effect from 1st April, 2010] did not contain a provision stipulating a time limit for initiation of the proceedings thereunder. The said provision reads as under:

"Consequences of failure to deduct or pay.

201. (1) Where any person, including the principal officer of a company, —

(a) who is required to deduct any sum in accordance with the provisions of this Act; or

(b) referred to in sub-section (1A) of section 192 , being an employer,

does not deduct, or does not pay, or after so deducting fails to pay, the whole or any part of the tax, as required by or under this Act, then, such person, shall, without prejudice to any other consequences which he may incur, be deemed to be an assessee in default in respect of such tax:

Provided that no penalty shall be charged under section 221 from such person, unless the Assessing Officer is satisfied that such person, without good and sufficient reasons, has failed to deduct and pay such tax.

(1A) Without prejudice to the provisions of sub-section (1), if any such person, principal officer or company as is referred to in that sub-section does not deduct the whole or

any part of the tax or after deducting fails to pay the tax as required by or under this Act, he or it shall be liable to pay simple interest at [one per cent for every month or part of a month] on the amount of such tax from the date on which such tax was deductible to the date on which such tax is actually paid and such interest shall be paid before furnishing the quarterly statement for each quarter in accordance with the provisions of sub-section (3) of section 200.

(2) Where the tax has not been paid as aforesaid after it is deducted, the amount of the tax together with the amount of simple interest thereon referred to in subsection (1A) shall be a charge upon all the assets of the person, or the company, as the case may be, referred to in sub-section (1)."

7. In *CIT v. NHK Japan Broadcasting Corporation* [2008] 305 ITR 137 (Del.) the question that arose was whether the Department could seek to initiate proceedings under Sections 201(1) and 201(1A) of the Act for a period beyond four years after the end of the relevant AY. In that case the relevant AY was 1990-91. The Assessee there was a Government Company of Japan, which was carrying on business in India. It paid salary in Indian Rupees to its employees in India. It also paid 'global salary' to its employees in Japan. While it deducted TDS from the salaries paid to the employees in India, it did not deduct TDS from the 'global salary'. These facts came to light when the Department undertook a survey on 19th November, 1998. In December, 1999, the Assessee was asked to explain why it should not be treated as an Assessee in default. After the reply was filed by the Assessee, the AO passed an order treating the said Assessee as an Assessee in default for the purposes of Section 201 of the Act and this was upheld by the Commissioner of Income Tax (Appeals) [CIT(A)]. However, the Income Tax Appellate Tribunal ('ITAT') came to the conclusion that the proceedings against the Assessee for treating it as an Assessee in default under Section 201 of the Act were not initiated within a reasonable period of time.

8. The Court in *CIT v. NHK Japan Broadcasting Corporation (supra)* noted that there was no provision in the Act, which stipulated a time limit regarding initiation of the proceedings under Section 201 of the Act. It referred to Section 153(1)(a) of the Act, which required an assessment to be completed within two years from the end of the AY in which income was first assessable. It also noted that the ITAT had in a series of decisions taken the view that four years would be a reasonable time for initiating action, in case where no limitation is prescribed. In *CIT v. NHK Japan Broadcasting Corporation (supra)*, the ITAT had applied the same aspect and reversed the decision of the CIT(A). This Court then held as under:

"21. We are not inclined to disturb the time limit of four years prescribed by the Tribunal and are of the view that in terms of the decision of the Supreme Court in *Bhatinda District Co-op. Milk Producers Union Ltd.* [2007] 9 RC 637; 11 SCC 363 action must be initiated by the competent authority under the Income Tax Act, where no limitation is prescribed as in Section 201 of the Act within that period of four years."

9. It was further observed in *CIT v. NHK Japan Broadcasting Corporation (supra)* as under:

"25. We may also note that under Section 191 of the Act, the primary liability to pay tax is on the person whose income it is that is the deductee. Of course, a duty is cast upon the deductor, that is the person who is making the payment to the deductee, to deduct tax at source but if he fails to do so, it does not wash away the liability of the deductee. It is still the liability of the deductee to pay the tax. In that sense, the liability of the deductor is a vicarious liability and, therefore, he cannot be put in a situation which would prejudice him to such an extent that the liability would remain hanging on his head for all times to come in the event the Income Tax Department decides not to take any action to recover the tax either by passing an order under Section 201 of the Act or through making an assessment of the income of the deductee."

10. The decision in *CIT v. NHK Japan Broadcasting Corporation (supra)* was followed by this Court in *Commissioner of Income Tax v. Hutchison Essar Telecom Ltd.* [2010] 323 ITR 230 (Del.). There the Court held that proceedings under Section 201(1) and 201(1A) of the Act "can be initiated only within three years from the end of the Assessment Year or within four years from the end of the relevant Financial Year."

11. In the meanwhile, by way of Finance (No. 2) Act, 2009 with effect from 1st April, 2010 sub-sections (3) & (4) along with provisos were inserted, the relevant extract of which read as under:

"(3) No order shall be made under sub-section (1) deeming a person "to be an assessee in default for failure to deduct the whole or any part of the tax from a person resident in India, at any time after the expiry of—

- (i) two years from the end of the financial year in which the statement is filed in a case where the statement referred to in section 200 has been filed;
- (ii) four years from the end of the financial year in which payment is made or credit is given, in any other case: Provided that such order for a financial year commencing on or before the 1st day of April, 2007 may be passed at any time on or before the 31st day of March, 2011.

(4) The provisions of sub-clause (ii) of sub-section (3) of section 153 and of Explanation 1 to section 153 shall, so far as may, apply 'to the time limit prescribed in sub-section (3)."

12. The Statement of Objects and Reasons of the Finance (No. 2) Bill, 2009 in relation to the amendment to Section 201 of the Act read as under:

"Sub-clause (b) of clause 65 seeks to provide time limit for passing of order under sub-section (1) of section 201 in case of resident tax payers. It provides that no order shall be made under sub-section (1) of section 201, deeming a person to be an assessee in default for failure to deduct the whole or any part of the tax in the case of a person resident in India, at any time after the expiry of two years from the end of the financial

year in which the statement is filed in a case where the statement referred to in section 200 has been filed. It further provides that in any other case such order shall not be made at any time after four years from the end of the financial year in which payment is made or credit is given. It further provides that such order for a financial year commencing on or before 1st day of April, 2007 may be passed at any time on or before the 31st day of March, 2011. The sub-clause also provides that the provisions of sub-clause (ii) of sub-section (3) of section 153 and of Explanation 1 to section 153 shall, so far as may apply to the time limit prescribed in proposed sub-section (3) of section 201."

13. There was a memorandum explaining the provisions of Finance (2) Bill, 2009, which was in the form of a circular issued by the Central Board of Direct Taxes (CBDT), which reads as under:

"f. Providing time limits for passing of orders u/s 201(1) holding a person to be an assessee in default

Currently, the Income Tax Act does not provide for any limitation of time for passing an order u/s 201(1) holding a person to be an assessee in default. In the absence of such a time limit, disputes arise when these proceedings are taken up or completed after substantial time has elapsed.

In order to bring certainty on this issue, it is proposed to provide for express time limits in the Act within which specified order u/s 201(1) will be passed.

It is proposed that an order u/s 201(1) for failure to deduct the whole or any part of the tax as required under this Act, if the deductee is a resident taxpayer shall be passed within two years from the end of the financial year in which the statement of tax deduction at source is filed by the deductor. Where no such statement is filed, such order can be passed up till four years from the end of the financial year in which the payment is made or credit is given. To provide sufficient time for pending cases, it is proposed to provide that such proceedings for a financial year beginning from 1st April, 2007 and earlier years can be completed by the 31st March, 2011.

However, no time-limits have been prescribed for order under sub-section(1) of section 201 where—

- (a) the deductor has deducted but not deposited the tax deducted at source, as this would be a case of defalcation of government dues,
- (b) the employer has failed to pay the tax wholly or partly, under sub-section (1A) of section 192, as the employee would not have paid tax on such perquisites,
- (c) the deductee is a non-resident as it may not be administratively possible to recover the tax from the non resident.

It is proposed to make these amendments effective from 1st April, 2010. Accordingly it will apply to such orders passed on or after the 1st April, 2010."

14. It is claimed that, therefore, as far as the Department was concerned it understood the insertion of the proviso to Section 201(3) as providing "sufficient time for pending cases" in respect of which the proceedings were to be completed by 31st March, 2011.

15. However, it appears that contrary to the above understanding by the Department itself depicted in the above circular issued by the CBDT, the Department understood the above amendment as permitting it to initiate proceedings under Section 201 of the Act for treating an Assessee as an Assessee in default even in respect of alleged failure to deduct TDS for a period more than four years earlier to 31st March, 2011.

16. This question, after the amendment to Section 201 of the Act brought about by the Finance (No. 2) Act, 2009 with effect from 1st April, 2010 came up for consideration by this Court in ITA No.57/2015 [CIT (TDS)-I v. CJ International Hotels Pvt. Ltd.]. One of the questions addressed by the Court in the said case in its judgement dated 9th February, 2015 concerned the initiation of proceedings against the Assessee for declaring an Assessee to be an Assessee in default. The discussion in the said judgement on this issue is contained in paras 6 to 10, which read as under:

"6. It is evident from the above discussion that the assessee was sought to be proceeded against Section 201 as one in default, after the period of four years. This Court is conscious that the text of the provision nowhere limits the exercise of powers. Equally, there are several provisions of enactment, i.e., Sections 143 (2), 147, 148 and 263, and even through introduction of specific provisions in Section 153 of the Act, where the time limit is specifically prescribed. At the same time, this Court in NHK Japan (supra) was of the opinion that the power to treat someone as assessee in default is too drastic, vague and oppressive since it is conditioned by some measure of limitation. In these circumstances, the Court had insisted that for the purpose of initiation of proceedings under Section 201, the AO has to act within four years. In NHK Japan, the Court did take note of the judgment in *State of Punjab v. Bhatinda District Co-op Milk Producers Union Ltd.* [2007] 9 RC 637.

7. The judgment in NHK Japan to a certain extent was limited by the amendment to Section 201 by substitution of Section 201 (3) w.e.f. 1.4.2010 by Finance Act No.2/2009. This substitution was in turn amended w.e.f. 1.10.2014 – by Finance Act No.2/2014. As a result, the provision which exists as on date is as follows: —

"201. (3) No order shall be made under sub-section (1) deeming a person to be an assessee in default for failure to deduct the whole or any part of the tax from a person resident in India, at any time after the expiry of seven years from the end of the financial year in which payment is made or credit is given."

8. Secondly, Section 201 itself was amended by introduction of sub-section 1 (A) - with retrospective effect, from 1.4.1966. The provision underwent legislative changes on different occasions. The decision in *NHK Japan* was rendered on 23.04.2008. The Revenue's appeal was rejected on 3.7.2014. Although, the Supreme Court had granted special leave and has apparently stated in its final order rejecting the Revenue's appeal that the question is left open, the mere circumstance that the Parliament did not spell out any time limit before it did eventually in 2009 - and subsequently in 2014 – would not lead to the sequitur that this Court's ruling in *NHK Japan* requires consideration. In that judgment, the Division Bench had given various reasons, including the application of the rationale in *Bhatinda District (supra)*. In *NHK Japan*, the Court had noticed that the facts in *Bhatinda District (supra)* judgment concern exercise of jurisdiction by a statutory authority in the absence of specific period of limitation. The Court in *Bhatinda District (supra)* held as follows:

"17. It is trite that if no period of limitation has been prescribed, statutory authority must exercise its jurisdiction within a reasonable period. What, however, shall be the reasonable period would depend upon the nature of the statute, rights and liabilities thereunder and other relevant factors.

18. Revisional jurisdiction, in our opinion, should ordinarily be exercised within a period of three years having regard to the purport in terms of the said Act. In any event, the same should not exceed the period of five years. The view of the High Court, thus, cannot be said to be unreasonable. Reasonable period, keeping in view the discussions made hereinbefore, must be found out from the statutory scheme. As indicated hereinbefore, maximum period of limitation provided for in Sub-section (6) of Section 11 of the Act is five years."

9. More recently in *Commissioner of Income Tax-III v. Calcutta Knitwears, Ludhiana* [2014] 362 ITR 673 (SC), the Supreme Court had the occasion to deal with the correct position in law as to the initiation of income tax proceedings. Although, the context of the dispute was in respect of recording of a satisfaction note as to the initiation of proceedings against third parties under erstwhile Section 158BD of the Act which did not prescribe the period of limitation and left it to the discretion of the AO to decide on being satisfied that such proceedings were required to be initiated, the Court limited such discretion in the following terms:

"44. In the result, we hold that for the purpose of Section 158BD of the Act a satisfaction note is sine qua non and must be prepared by the assessing officer before he transmits the records to the other assessing officer who has jurisdiction over such other person. The satisfaction note could be prepared at either of the following stages: (a) at the time of or along with the initiation of proceedings against the searched person under Section 158BC of the Act; (b) along with the assessment proceedings

under Section 158BC of the Act; and (c) immediately after the assessment proceedings are completed under Section 158BC of the Act of the searched person."

10. An added reason why the submission of the Revenue is unacceptable is that had the Parliament indeed intended to overrule or set aside the reasoning in *NHK Japan* (supra), it would have, like other instances and more specifically in the case of Section 201 (1A), brought in a retrospective amendment, nullifying the precedent itself. That it chose to bring Section 201 (3) in the first instance in 2010 and later in 2014 fortifies the reasoning of the Court. Accordingly, the issue is answered against the Revenue."

17. It appears to the Court that the above decision settles the question whether to declare an Assessee to be an Assessee in default under Section 201 of the Act could be initiated for a period earlier than four years prior to 31st March, 2011.

18. Mr. M.S. Syali, the learned Senior Advocate for the Petitioners states that although the challenge in these petitions is also to the vires of the proviso to Section 201(3) of the Act as inserted by the Finance (No. 2) Act, 2009, the Petitioners would be satisfied if the interpretation sought to be advanced by them on the scope and ambit of proviso to sub-section (3) of Section 201 of the Act is accepted by the Court. In other words what has been canvassed on behalf of the Petitioners is that the proviso to Section 201(3) of the Act has to be read consistent with the law explained by the Court in *CIT v. NHK Japan Broadcasting Corporation* (supra) and should be held not to permit the Department to initiate proceedings for declaring Assessee to be Assessee in default for a period more than four years prior to 31st March, 2011.

19. Mr. Dileep Shivpuri, the learned Senior Standing Counsel for the Revenue, however, seeks to advance a different line of argument. According to him the action taken by the Department was pursuant to a decision in *CIT v. Idea Cellular Ltd.* [2010] 325 ITR 148 (Del) where the amounts paid to the channel partners for the pre-paid cards and other products was held to be 'commission' by the Court within the meaning of Section 194H of the Act. It is stated that it is consequent upon the said decision that the Department issued the impugned notices to these Petitioners and that this was permissible in terms of Section 153(3)(ii) of the Act.

20. The above submission of Mr. Shivpuri cannot be accepted if Section 153 is perused carefully. It reads as under:

"153. Time limit for completion of assessments and reassessments

(3) The provisions of sub- sections (1), (1A), (1B) and (2) shall not apply to the following classes of assessments, reassessments and recomputations which may, subject to the provisions of sub section (2A), be completed at any time

(ii) where the assessment, reassessment or recomputation is made on the assessee or any person in consequence of or to give effect to any finding or direction contained in an order under section 250, 254, 260, 262, 263 or 264 or in an order of any court in a proceeding otherwise than by way of appeal or reference under this Act."

21. In the first place, what the said provision does is to not apply the time limit of two years for completing the assessment from the end of the financial year "where the assessment, reassessment or recomputation is made on the assessee or any person in consequence of or to give effect to any finding or direction contained in an order or in an order of any court in a proceeding otherwise than by way of appeal or reference under this Act." This can apply only to the Assessee in whose case such an order is made by a Court. For instance, if the above decision was qua Idea Cellular Ltd. then it certainly cannot form the basis for initiating proceedings qua other Assesseees.

22. Secondly there has to be a finding or directions as regards the issue in question viz., the non-deduction of TDS resulting in an Assessee having to be declared an Assessee in default under Section 201 of the Act. In *Rajender Nath v. CIT* [1979] 120 ITR 14 (SC), it was held that the existence of an order disposing of a case qua an Assessee containing specific directions of the Court was a sine qua non for invoking the powers under Section 153(3)(ii) of the Act. Even in the case relied upon by Mr. Shivpuri, i.e., *CIT v. Idea Cellular Ltd. (supra)*, there is no such finding or direction to the Department by the Court requiring it to initiate proceedings for declaring the Assessee to be an Assessee in default. The Court is, therefore, of the view that the reliance by the Department on Section 153(3)(ii) of the Act and the decision in *CIT v. Idea Cellular Ltd. (supra)* to justify initiation of the proceedings in the present case against the Petitioner is misconceived.

23. It was then contended by Mr. Shivpuri, that the decision in *CIT v. NHK Japan Broadcasting Corporation (supra)* would not hold good after 1st April, 2010 and that the decision of this Court in *CIT (TDS)-I v. CJ International Hotels Pvt. Ltd. (supra)* was not correctly understood by the Petitioners herein. In his reading of the decision in *CIT (TDS)-I v. CJ International Hotels Pvt. Ltd. (supra)*, the Court did not categorically state therein that the Department was prohibited from initiating proceedings in declaring an Assessee to be an Assessee in default for a period earlier than 31st March, 2011.

24. The Court is unable to agree with the above submission of Mr. Shivpuri. As the Court sees it, its decision in *NHK Japan Broadcasting Corporation (supra)* deals precisely with the situation where proceedings were sought to be initiated more than four years prior to 31st March, 2011. That law explained in *NHK Japan Broadcasting Corporation (supra)* has not changed by the introduction of proviso to sub-section (3) to Section 201 by the Finance (No. 2) Act, 2009. Mr. Shivpuri was unable to explain how the Circular No.5 of 2010 issued by the CBDT is not favourable to the Petitioners. With reference to the expression "pending cases",

in respect of which orders have to be passed in terms of the proviso to Section 201(3) before 31st March 2011, Mr. Shivpuri sought to suggest that the Circular has to be harmoniously construed with Section 201(3) of the Act to glean an intention to permit the Department to initiate cases four years earlier than 31st March, 2011. The only requirement was that orders had to be passed by 31st March, 2011.

25. The Court is unable to agree with this approach of the Department either. There is no question of 'harmonious construction' of a CBDT Circular issued by the CBDT. At best, it is an external aid of construction of Section 201(3) and the proviso thereto. The Circular also gives an instance of contrary understanding of the legal position by the Department itself. It is well settled that if a Circular issued by the Department favours an Assessee then it should be so done even where such interpretation goes contrary to the legislative intent.

26. In this regard reference may be made to the decision in *K.P. Verghese v. Income Tax Officer* AIR 1981 SC 1922. There the Supreme Court was considering the correctness of the stand of the Department that for the purpose of Section 52 (2) of the Act it was not necessary that the Assessee should have under-stated the sale consideration and that to attract Section 52 (2) it was sufficient if, as on the date of the transfer, the fair market value of the property exceeded the full value of the consideration declared by the Assessee by an amount of not less than 15% of the value so declared. The Supreme Court held in favour of the Assessee, and in doing so referred to the fact that there were two CBDT circulars on the interpretation of Section 52 (2) of the Act that supported the case of the Assessee. The Court observed:

"These two circulars of the Central Board of Direct Taxes are, as we shall presently point out, binding on the Tax Department in administering or executing the provision enacted in sub-section (2), but quite apart from their binding character, they are clearly in the nature of contemporanea expositio furnishing legitimate aid in the construction of sub-section (2). The rule of construction by reference to contemporanea expositio is a well established rule for interpreting a statute by reference to the exposition it has received from contemporary authority, though it must give way where the language of the statute is plain and unambiguous. This rule has been succinctly and felicitously expressed in Crawford on Statutory Construction (1940 ed) where it is stated in paragraph 219 that "administrative construction (i. e. contemporaneous construction placed by administrative or executive officers charged with executing a statute) generally should be clearly wrong before it is overturned; such a construction, commonly referred to as practical construction, although non-controlling, is nevertheless entitled to considerable weight; it is highly persuasive." The validity of this rule was also recognised in *Baleshwar Bagarti v. Bhagirathi Dass* [1914] ILR 41 Cal 69 where Mookerjee, J. stated the rule in these terms:

"It is a well-settled principle of interpretation that courts in construing a statute will give much weight to the interpretation put upon it, at the time of its enactment and since, by those whose duty it has been to construe, execute and apply it."

and this statement of the rule was quoted with approval by this Court in *Deshbandhu Gupta & Co. v. Delhi Stock Exchange Association Ltd.* [1979] 3 SCR 373. It is clear from these two circulars that the Central Board of Direct Taxes, which is the highest authority entrusted with the execution of the provisions of the Act, understood subsection (2) as limited to cases where the consideration for the transfer has been understated by the assessee and this must be regarded as a strong circumstance supporting the construction which we are placing on that subsection.

But the construction which is commending itself to us does not rest merely on the principle of *contemporanea expositio*. The two circulars of the Central Board of Direct Taxes to which we have just referred are legally binding on the Revenue and this binding character attaches to the two circulars even if they be found not in accordance with the correct interpretation of subsection (2) and they depart or deviate from such construction. It is now well-settled as a result of two decisions of this Court, one in *Navnitlal C. Jhaveri v. K. K. Sen* AIR 1965 SC 1922 and the other in *Ellerman Lines Ltd. v. Commissioner of Income-tax, West Bengal* AIR 1972 SC 524 that circulars issued by the Central Board of Direct Taxes under section 119 of the Act are binding on all officers and persons employed in the execution of the Act even if they deviate from the provisions of the Act."

27. Recently in a decision in *Spentex Industries Ltd. v. Commissioner of Central Excise* [2016] 1 SCC 780, the Supreme Court explained the maxim *contemporanea expositio*. In the said decision, the Court referred to its earlier decision in *Desh Bandhu Gupta & Co. And Ors. v. Delhi Stock Exchange Association Ltd.* [1979] 4 SCC 565 in which it was observed as under:

"It may be stated that it was not disputed before us that these two documents which came into existence almost simultaneously with the issuance of the notification could be looked at for finding out the true intention of the Government in issuing the notification in question, particularly in regard to the manner in which outstanding transactions were to be closed or liquidated. The principle of *contemporanea expositio* (interpreting a statute or any other document by reference to the exposition it has received from contemporary authority) can be invoked though the same will not always be decisive of the question of construction. (Maxwell 12th Edn. p.268). In Crawford on Statutory Construction (1940 Edn.) in para 219 (at pp. 393-395) it has been stated that administrative construction (i.e. contemporaneous construction placed by administrative or executive officers charged with executing a statute) generally should be clearly wrong before it is overturned; such a construction, commonly referred to as practical construction, although not controlling, is nevertheless entitled to considerable weight; it is highly persuasive. In *Baleshwar Bagarti v. Bhagirathi Dass* (*supra*) the

principle, which was reiterated in *Mathura Mohan Saha y. Ram Kumar Saha* 35 Ind Cas 305 has been stated by Mukerjee J. thus:

'It is a well-settled principle of construction that courts in construing a statute will give much weight to the interpretation put upon it, at the time of its enactment and since, by those whose duty it has been to construe, execute and apply it. I do not suggest for a moment that such interpretation has by any means a controlling effect upon the Courts; such interpretation may, if occasion arises, have to be disregarded for cogent and persuasive reasons, and in a clear case of error, a Court would without hesitation refuse to follow such construction.'

Of course, even without the aid of these two documents which contain a contemporaneous exposition of the Government's intention, we have come to the conclusion that on a plain construction of the notification the proviso permitted the closing out or liquidation of all outstanding transactions by entering into a forward contract in accordance with the rules, bye-laws and regulations of the respondent.'"

28. Circular 5 of 2010 of CBDT clarifying that the proviso to Section 201(3) of the Act was meant to expand the time limit for completing the proceedings and passing orders in relation to 'pending cases'. The said proviso cannot be interpreted, as is sought to be done by the Department, to enable it to initiate proceedings for declaring an Assessee to be an Assessee in default under Section 201 of the Act for a period earlier than four years prior to 31st March, 2011.

29. With respect to Vodafone Essar Mobile Services Limited (VEMSL), Mr. Shivpuri sought to contend that in these cases the initiation of the proceedings was triggered by the order dated 12th August 2010 passed by the Supreme Court in Civil Appeal No. 6692 of 2010 which pertained to the AY 2002-2003.

30. As rightly pointed out by Mr. Syali while the Supreme Court had sent the matter back for further proceedings for AY 2002-2003, as far as the orders under challenge in these writ petitions are concerned, they pertain to AYs 2003-2004, 2004-2005 and 2005-2006 in respect of which no orders have been passed by the Supreme Court. These notices, therefore, sought to initiate proceedings for declaring VEMSL to be an Assessee in default earlier than four years prior to 31st March, 2011.

31. The Court agrees that the notices issued to VEMSL for the aforementioned AYs are not covered by the order of the Supreme Court for AY 2002-2003. Accordingly, insofar as the notices for AYs 2003- 2004, 2004-2005 and 2005-2006 are concerned, they are held to be unsustainable in law on the interpretation of Section 201(3) of the Act by the Court.

32. In view of the above conclusion, the Court does not consider it necessary to address the question of constitutional validity of Section 201(3) of the Act or the proviso thereto. In any event, the Petitioners also did not press for that relief in view of the acceptance of their submission on the interpretation of the said provision by the Court.

33. Consequently, the notices impugned in the present petitions issued by the Department seeking to initiate proceedings against the Petitioners for declaring them to be Assesseees in default under Section 201(3) of the Act are hereby quashed.

34. The writ petitions are allowed but in the circumstances no orders as to costs. All pending applications also stand disposed of.

■ ■