

**IN THE INCOME TAX APPELLATE TRIBUNAL,  
"L" BENCH: MUMBAI**

**BEFORE SHRI J. S. REDDY, ACCOUNTANT MEMBER  
AND SHRI R. S. PADVEKAR, JUDICIAL MEMBER**

**ITA No.5420 and 5421/Mum/2006**

(Assessment years: 2002-03 and 2003-04)

CA Computer Associates Pvt. Ltd. Vs  
B-1, 2nd Floor,  
National Stock Exchange Plaza,  
Bandra Kurla Complex, Bandra(E),  
Mumbai -400 020  
PAN: **AAACC 4971 D**

DCIT -6(2),  
Mumbai-400 020

**Appellant**

**Respondent**

Appellant by: Shri Rajan R Vora & Mrs Ritika Sachade  
Respondent by: Shri S S Rana

**ORDER**

**PER R. S. PADVEKAR, JM**

The assessee has filed these appeals challenging the respective orders of Learned CIT (A)-VI Mumbai for the assessment years 2002-03 and 2003-04. As the issue as well as facts are identical hence both these appeals are disposed off by this common order.

2. The first common issue in respect of disallowance of royalty paid by the assessee to C A Management Inc USA (in short 'CAMI') for distribution of the software products in India.

3. The facts, which reveals from the record are as under. The assessee-company is a 100% subsidiary company incorporated in 1998 under the Indian Companies Act, which is one of the subsidiaries of Computer Associates International Inc USA. The assessee is primarily engaged in the

business of licensing mainframe and midrange and system infrastructure software products of CA Management Inc. of USA. The assessee has set-up a Technical Support Centre in Chennai to provide support services to end users of the software products on behalf of the CA Management Inc. The business activity of the assessee company summarily can be put as under:-

- (i) Licensing mainframe midrange and system infrastructure software products of CA Inc;
- (ii) Software that can be generally deployed "Out of box" or with customer/ industry specified adaptations;
- (iii) Development software that can allows technologies and programmes to write custom applications and create new categories of packaged applications.

The Assessee-company files the return of income for the assessment year 2002-03 declaring total loss of Rs 14,55,99,340/-. The return of income filed by the assessee was selected for scrutiny. It was seen by the Assessing Officer that the assessee had certain international transactions with Associate Enterprises / concerns (AE). So far as the issue before us is concerned, it is in respect of royalty payable to CA Management Inc, USA. Assessing Officer, therefore, referred the matter to the Transfer Pricing Officer (in short TPO) u/s 92A(1) of the Act for determining Arms Length Price (in short ALP). The assessee had valued the said transaction treating it as ALP at Rs 7,43,22,376/- as against that TPO determined the ALP at Rs 5,85,30,774/-. The assessee has written off the bad debt to the extent of Rs 13,33,44,452/-. So far as the determination of the ALP for royalty is concerned, the assessee has used comparable un-controlled price Method of transitions. The core issue before us is not method which has been adopted for determining the ALP but way it is determined by the TPO. The assessee has entered into an agreement with C A Management Inc of USA and as per the said agreement the assessee was appointed as sole distributor of the products of CAMI in India. The TPO has given the details of the agreement between the assessee and CAMI in the order pass u/s 92CA(3) of the Income Tax Act dated

25.2.2005. It appears that for determining ALP, the TPO has only considered bad debts written off during the financial year 2001-02 which were to the extent of Rs 13,33,44,452/-. The TPO has noted that as per the details given by the Assessee in respect of the bad debts written off, the same were in respect of the amount invoice during the year. The TPO was of the view that why not the ALP of royalty payable of Rs 47,09,755/- to the extent of bad debts written off be computed at 'nil'. The assessee tried to justify the bad debts written off which summary is given in the TPO's order.

4. The TPO did not agree with the contention of the assessee and so far as royalty payment to CAMI USA was concerned the same was determined at 'nil' as against the ALP of the transaction was determined by the assessee at Rs 47,09,755/-. The reasons given by the TPO are as under:-

*"The contention of the company are considered, however, the same are not acceptable for the following reasons:*

- (i) The invoices were raised during FY 2001-02, the decision of write off was taken in all the cases, in the meeting of Board of Directors of the company held on 07.03.2002 at Phuket, Thailand.*
- (ii) As mentioned in the agreement between the company and CAMGT, the company was to submit a monthly report regarding all the product licenses consummated by the distributor and the payments collected. This means that, in respect of invoices raised, the company should be intimating the collection position with regard to invoices. Due to this, the intimation regarding uncollected invoice was available with the licensor on monthly basis.*
- (iii) Once the decision of write off of bad debts for the invoices raised during the current year was taken on 07.03.2002. This amount would get reflected as amount non-receivable in the monthly reports, which would be available with the licensor. If such reports were available with the licensor for the amount of invoices raised during the year and written off during the year, the licensor should not have claimed royalty on such amounts written off, in the debit note raised on 31.03.2002.*

- (iv) *From the documents filed by the company substantiating its claim of write off for the Bad Debts, it is seen that one the customer Global E-Secure vide their letter dated 27.03.2002 addressed to the company complained regarding the non-working of the software in their environment and it contested that as per the implied condition of the agreement, the software was to work any environment. This indicated that, in some cases, there have been problem with the working of software in certain environments.*
- (v) *The invoices were raised in the same year and written off during the same year and hence no royalty amounts were payable annually.*
- (vi) *The company has informed that it does not have any document seeking the waiver /write off of royalty on amounts invoiced and written off during FY 2001-02. Any independent entity, acting as a sole distributor of the off the shelf product of a licensor, would have sought for a waiver of royalty payable, considering the huge amount of non-receivables which ultimately it is forced to write off as bad debts.*
- (vii) *CA India did not actually paid the Royalty amounts corresponding to FY 1998-99 to FY 2001-02 and as on 31.03.2002 the amounts payable was Rs 237,765, 819/-, the company paid a royalty of Rs 158,946,324/- during FY 2002-03. As the company had written off huge bad debts, the company should have asked for a waiver of royalty corresponding to such write off, any independent entity, who is just distributor of the products, could have asked for such waiver, irrespective of the agreement provisions. When the company could not realise the amounts from the clients, for the products distributed, belonging to CA Management Inc, how could a Royalty can be considered as payable. The independent entities acting independent of each other, would certainly enter into agreement for payment of Royalty, on the basis of actual collections made and not on the basis of just invoicing.*
- (viii) *The contention of the company that it paid Royalty at a lesser rate than paid in comparable uncontrolled transactions. This contention is not relevant in the present issue, because regarding the rate of royalty, there is no dispute, of being at Arm's Length but issue at hand deals with the specific issue of royalty on write off of the invoiced amount during the year, itself.*
- (ix) *The agreements entered into by the CA India with the clients are in standard agreements, as referred in the Distributor*

*agreement. As per the software license agreement entered into by CA India with clients, it is mentioned that the licensed programme belongs to Computer Associates International Inc. Had the Computer Associates licensed the products directly to the clients, it could have suffered that bad debts, as the company has suffered.*

- (x) *In view of the fact that the CA India was only acting as a Distributor, the products belonged to the licensor, these were the initial years of the business of CA India, in the country, the bad debts risks were likely to be there, these facts would certainly be considered by the Independent Parties, while entering into distributor agreement and non payment of royalty, on non realisation of the proceeds would certainly be a condition in agreement entered at arm's length.*

*In view of the above, the Arm's Length Price of Royalty corresponding to invoices raised and written off during the year is computed at NIL as against transaction value reported of Rs 4,709,755/-."*

5. Following the TPO's order, the Assessing Officer made the adjustment to the ALP to the International transactions by reducing the value of the royalty payment/payable which was of Rs 47,09,755/-. The assessee challenged the same before the Learned CIT (A) but without success. Now, the assessee is in appeal before us.

6. We have heard the rival submissions of the parties. The Learned Counsel vehemently argued that the jurisdiction of TPO is restricted to determine the ALP of any international transaction in view of the power vested in him u/s 92CA(3) of the Act. The Learned Counsel took us thorough the TPO's order passed u/s 92CA(3) and argued that write off of the bad debts cannot be the subject matter for determining the ALP so as to power of the TPO is concerned. Merely because royalty payments were relating to the product sold by the assessee to its client which payments could not be recovered cannot be the consideration before the TPO for deterring 'ALP' of any international transaction. It is argued that specific methods have been prescribed in the Act and the I. T. Rules and the T.P.O. is bound to determine

'ALP' of any international transaction within the framework of the method prescribed by statute. He also referred to the assessment order and argued and submitted that the Assessing Officer was bound to follow the order of the TPO the ALP in respect of the royalty payment to CAMI, USA was determined at 'nil'. He, therefore, pleaded that there is no base so far as the ALP determined in respect of the royalty payable to CAMI USA. We have also heard the Learned Departmental Representative who mainly relied on the order of the T.P.O.

7. We find force in the argument of Learned Counsel for the assessee. The method of computation of arms length price (in short ALP) has been given in section 92C of the Act, which reads as under:-

***Computation of arm's length price.***

**92C.** (1) *The arm's length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely:*

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- (a) *comparable uncontrolled price method;*
- (b) *resale price method;*
- (c) *cost plus method;*
- (d) *profit split method;*
- (e) *transactional net margin method;*
- (f) *such other method as may be prescribed by the Board.*

(2) *The most appropriate method referred to in sub-section (1) shall be applied, for determination of arm's length price, in the manner as may be prescribed:*

**[Provided** *that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices, or, at the option of the assessee, a price which may vary from the arithmetical mean by an amount not exceeding five per cent of such arithmetical mean.]*

(3) *Where during the course of any proceeding for the assessment of income, the Assessing Officer is, on the basis of material or information or document in his possession, of the opinion that—*

(a) the price charged or paid in an international transaction has not been determined in accordance with sub-sections (1) and (2); or

(b) any information and document relating to an international transaction have not been kept and maintained by the assessee in accordance with the provisions contained in sub-section (1) of [section 92D](#) and the rules made in this behalf; or

(c) the information or data used in computation of the arm's length price is not reliable or correct; or

(d) the assessee has failed to furnish, within the specified time, any information or document which he was required to furnish by a notice issued under sub-section (3) of [section 92D](#),

the Assessing Officer may proceed to determine the arm's length price in relation to the said international transaction in accordance with sub-sections (1) and (2), on the basis of such material or information or document available with him:

**Provided** that an opportunity shall be given by the Assessing Officer by serving a notice calling upon the assessee to show cause, on a date and time to be specified in the notice, why the arm's length price should not be so determined on the basis of material or information or document in the possession of the Assessing Officer.

(4) Where an arm's length price is determined by the Assessing Officer under sub-section (3), the Assessing Officer may compute the total income of the assessee having regard to the arm's length price so determined:

**Provided** that no deduction under [section 10A](#) or [section 10B](#) or under Chapter VI-A shall be allowed in respect of the amount of income by which the total income of the assessee is enhanced after computation of income under this sub-section:

**Provided further** that where the total income of an associated enterprise is computed under this sub-section on determination of the arm's length price paid to another associated enterprise from which tax has been deducted <sup>20</sup>[or was deductible] under the provisions of Chapter XVIIIB, the income of the other associated enterprise shall not be recomputed by reason of such determination of arm's length price in the case of the first mentioned enterprise.

8. The manner in which the A.L.P is to be determined by any of the method prescribed in Sec. 92C in provided in Rule 10B of the I. T. Rules, 1962. After examining the parameters prescribed in Rule 10B, it can be seen that bad debts written off cannot be factor to determined the arm's length price of any international transaction. In our opinion, the TPO has exceeded his limitation by following the method which is not authorised under the Act or rules. We, therefore, hold that the Arms Length Price determined by the

TPO and adopted by the Assessing Officer to the extent of royalty payable to the CA Inc Management, USA is not as per the procedure prescribed and same cannot be sustained. We, therefore, direct the Assessing Officer to adopt the Arms Length Price of the royalty payable to CA Inc Management, USA as declared by the assessee in both the years.

9. The next issue for assessment year 2003-04 is with regards to the levy of interest u/s 234D. We have heard the parties. This issue stands covered in favour of the assessee by the decision in the case of Ekata Promoters reported in 113 ITD 719 (Del)(SB). As admittedly, the assessment year involved is 2003-04 and section 234D is brought under statue book from assessment year 2004-05. We, therefore, direct the Assessing Officer not to levy the interest u/s 234D in respect of the refund granted for assessment year 2003-04. Accordingly, this issue is decided in favour of the assessee and ground 6 for assessment year 2003-04 is allowed.

10. In the result, both the appeals are allowed.  
Order pronounced on 28th day of January 2010.

**Sd/-**  
**(J. S. REDDY)**  
**ACCOUNTANT MEMBER**

**Sd/-**  
**(R. S. PADVEKAR)**  
**JUDICIAL MEMBER**

Mumbai, Date: **28th January 2010**

Copy to:-

- 1) The Appellant.
- 2) The Respondent.
- 3) The CIT (A) -II, Thane.
- 4) The CIT -IV, Thane.
- 5) The D.R. "L" Bench, ITAT, Mumbai.

// True Copy //

\*Chavan

By Order

Asstt. Registrar  
I.T.A.T., Mumbai



Sr.N.	Episode of an order	Date	Initials	Concerned
1	Draft dictated on	21.01.2010		Sr.PS
2	Draft placed before author	22.01.2010		Sr.PS
3	Draft proposed & placed before the second Member			JM/AM
4	Draft discussed/approved by Second Member			JM/AM
5	Approved Draft comes to the Sr.PS			Sr.PS
6	Kept for pronouncement on			Sr.PS
7	File sent to the Bench Clerk			Sr.PS
8	Date on which file goes to the Head Clerk			
9	Date of dispatch of Order			