आयकर अपीलीय अधिकरण, अहमदाबाद न्यायपीठ 'ए'' अहमदाबाद ।

IN THE INCOME TAX APPELLATE TRIBUNAL
" A " BENCH, AHMEDABAD

सर्वश्री मुकुल कुमार श्रावत, न्यायिक सदस्य **एवं** श्री ए.मोहन अलंकामोनी,लेखा सदस्य के समक्ष ।

BEFORE SHRI MUKUL Kr.SHRAWAT, JUDICIAL MEMBER AND SHRI A. MOHAN ALANKAMONY, ACCOUNTANT MEMBER

आयकर अपील सं./I.T.A. No.3120/Ahd/2010
(**निर्धारण वर्ष** / Assessment Year : 2006-07)

Mastek Limited 804/805, President House Opp.C.N. Vidyalaya Near Ambawadi Circle Ambawadi, Ahmedabad-380 006	**बनाम**/ Vs.	The Addl.CIT Range-4 Ahmedabad
स्थायी लेखा सं./जीआइआर सं./PAN/GIR No. : AAACM 9908 Q		
(अपीलार्थी /**Appellant**)	..	(प्रत्यर्थी/**Respondent**)

अपीलार्थी ओर से/**Appellant by** :	Shri S.N. Soparkar, A.R.
प्रत्यर्थी की ओर से/ **Respondent by** :	Shri V.K. Gupta with Shri Kartar Singh

सुनवाई की तारीख/**Date of Hearing** : **21/12/2011**
घोषणा की तारीख /**Date of Pronouncement** : **29/02/2012**

आदेश/O R D E R

PER SHRI MUKUL Kr. SHRAWAT, JUDICIAL MEMBER :

This appeal has been filed on 24/11/2010 by the Assessee on Form No.36B, i.e. "appeal memorandum" u/s. 253(1)(d) of the IT Act directly against the assessment order dated 26/10/2010 passed u/s.143(3) r.w.s. 144C of the I.T.Act. To decide several issues raised before us; certain orders of the Revenue authorities were involved, passed for the year under consideration, chronologically as follows:-

(1) An order of 92CA(3) of IT Act dated 12/10/2009 by ACIT (TPO)-I, Ahmedabad.

(2) An order u/s.143(3) (a draft order u/s.144-C) dated 11.12.2009 / 24.12.2009 by the ACIT Range-4, Ahmedabad.

(3) An order u/s.144C(5) dated 28/09/2010 passed by Dispute Resolution Panel, Ahmedabad.

(4) An order u/s.144C r.w.s. 143(3) dated 26.10.2010 by ACIT, Range-4, Ahmedabad.

A) <u>FACTS : -</u>

2. The appellant is a Domestic Limited Company incorporated in India on 14th May-1982. As informed the appellant is a Software Development Company and worked as a global information Technology Services Provider. The services were "off-shore" as well as "on site" services; hence operated through its subsidiaries at other countries, viz. USA, UK, Germany, Singapore, Malaysia. It is informed that the assessee-company provides composite deliverables to the clients One of its Associate Enterprise (in short A.E.) is Mastek U.K.Ltd. (in short MUK) is a 100% subsidiary; established in the year 1992. This said A.E. is contributing substantial revenue and for the year under consideration stated to be 60% of the total Revenue of the Mastek group.

2.1. The assessee-company has filed the return for A.Y. 2006-07 on 31.10.2006 declaring total income at Rs.61,28,140/-, however the assessment was made u/s.144C r.w.s. 143(3) vide an order dated 26.10.2010 on assessed income of Rs.22,46,55,290/-; hence challenged in this appeal. It was found by the Revenue Department that

International Transaction was involved with an Associate Enterprise (A.E.) , therefore referred to Transfer Pricing Officer u/s.92CA on 30/09/2008. The order u/s.92CA(3) of DIT (Transfer Pricing) is dated 12.10.2009. A draft assessment u/s.144C dated 11/12/009 was also forwarded to the assessee. And finally the directions of the Dispute Resolution Panel u/s.144C(5) dated 28/09/2010 has also been received by the Assessing Officer to make an assessment accordingly, i.e. the impugned assessment now before us under appeal.

2.2. Reason given in the impugned orders for making reference u/s.92CA to TPO was that as per 3 CEB Audit Report, the assessee had "International Transaction" with its Associate Enterprises and the details of those enterprises and the amount of the transaction involved were stated to be as under:-

Sr.No.	*Name & Address of AEs*	*Description of transaction with AEs*	*Amount paid/recd as per books (Rs.)*
1	*Mastek UK Ltd.*	*i) Software Services,* *ii) Common Infrastructure costs* *iii) Reimbursement of travel & other costs*	*299,33,35,552* *1,15,79,429* *1,45,24,952*
2	*Majesco Mastek New jersey*	*i) Software services* *ii) Reimbursement of travel & other costs*	*35,17,44,575* *2,16,23,772*
3	*Mastek GMBH Germany*	*i) Software services* *ii) Reimbursement of travel & other costs*	*4,01,61,499* *6,24,149*
4.	*Mastek Asia Pacific Pte Ltd. Singapore*	*i) Software services* *ii) Reimbursement of personal and other costs*	*2,52,66,475* *9,49,748*
5.	*Mastek Msc Sdn Bhd, Malaysia*	*i) Software services* *ii) Reimbursement of travel & other costs*	*2,25,45,120* *17,04,627*

6.	*Carretek LLC, USA*	*i) Provision of information technology enabled services* *ii) Reimbursement of actual costs for data lines travel & others costs*	*5,04,84,337* *2,33,04,757*
		Total :	***355,78,48,992/-***

2.3. The TPO had picked up **Function Asset Risk Analysis (FAR)** of M/s.Mastek UK (MUK) and thereafter suggested following three adjustments:-

(a)International Transaction with Mastek UK (MUK) for Software Services – upward adjustment required of	Rs.18,62,45,100/-
(b) Human Resources Management Services With Mastek UK – adjustment required	Rs. 2,92,22,683/-
(c) Excess Credit period granted to the A.E.	11,22,281/-
Total adjustment suggested by T.P.O.	Rs.21,65,90,064

All the three adjustments and other additions made in the impugned assessment order are now under appeal, therefore, the ground-wise adjudication is as under:-

On the facts and circumstances of the case and in law, the Additional Commissioner of Income-tax Range-4, Ahmedabad ('Ld. AO') erred in concluding the assessment under section 143(3) of the Income tax Act, 1961 ('the Act') read with section 144C of the Act on the basis of directions issued under section 144C(5) of the Act by the Hon'ble Dispute Resolution Panel, as follows:

1. GROUND NO. 1 - Re-computation of the Arm's Length Price ('ALP') of the international transactions of software services distributed by Mastek (UK) Limited ('MUK')

i. The Ld. AO has erred in law and on facts in relation to the re-computation of the ALP of the international transactions of software services distributed by MUK (associated enterprise) by making an adjustment of Rs.18,62,45,100.

ii. The Ld. AO has erred in law and on facts in disregarding the distribution operations of MUK and considering the operations of MUK as that of a marketing service provider, without giving weight-age to inter alia the key selling functions involving negotiating and concluding customer contracts and the key risks viz. market and credit, assumed by MUK.

iii. The Ld. AO has erred in law and on facts in rejecting the distribution comparables, provided in the TP study and in adopting the comparable set which comprises of companies carrying out marketing support activities in US Region. Further, the Ld. AO ought to have considered the differences in functions, assets and risks performed and also the geographical differences while selecting the comparables and thereafter provided the benefit of necessary adjustments in accordance with Rule 10B(3) of the Income-tax Rules, 1962.

iv. Without prejudice to the above, the Ld. AO erred in law and on facts in making an adjustment to the arm's length price of the said international transactions without giving benefit of the proviso to Section 92C(2) of the Act.

B) ORDER OF TPO:

3. From the order of the TPO, it is evident and undisputed that Mastek Ltd. i.e. is the appellant (in short hereinafter referred to as "MIL") was incorporated on 14/05/1982. The appellant is a global information technology services provider. The appellant is offering software development and its related services. The appellant has overseas subsidiaries or Associated Enterprises (AE). For overseas clients, the appellant provides services through its AEs situated outside India. The services includes offshore services and onsite services. One of the subsidiary is Mastek UK Ltd. (in short MUK). At this juncture, our attention was drawn that MUK has worked as a 'Distributor' of the software services to the customers in the country UK, and this is one of

the controversy raised by the TPO. Our attention has also been drawn that for the year under consideration the Revenue generated by MUK was more than 60% of the total revenue of the assessee.

3.1. The start point for the controversy in hand is because of an observation of the TPO that on the operative turnover of Rs.355.82 crores the assessee had shown operating profit on cost at 12.62% as against the operating profit on cost at 26.02% in the immediate preceding assessment year. An enquiry was raised to explain the reason of fall in operating profit. In this regard, the preliminary explanation of the assessee was that there was a new profit sharing agreement with MUK. That agreement has been referred to as **"Master Agreement" dated 30/03/2005.** From the side of the assessee, FAR analysis was furnished. That analysis shall be discussed in the later part of this order. Meanwhile it is worth to mention that on the basis of the said FAR analysis the contention of the assessee before the TPO was that the MUK has functioned as a "distributor". The distribution activities of MUK were, such as, identifying the customers, establishing contacts, soliciting enquiries, managing of relationship. All these activities were performed in UK and MUK was appointing advertising agencies for advertisement of software services in newspaper journals, etc. It was informed that the MUK has entered into contracts and negotiated with the customers in UK. On signing of the contract, MUK has provided all requisite details, time limit of completion, warranty period and other specific commitments. The assessee has also furnished the details of all other functions performed by MUK on one hand ,and on the other hand, the functions performed by MIL. On the basis of the FAR analysis the TPO had summarized the functions performed by MUK as below:-

1) Identifying customers
2) Establishing contacts
3) Soliciting enquiries
4) Managing customer relationships
5) Appointment of agencies or engaging into advertisement and sales promotion.
6) Negotiation of contracts and signing of contracts on concluding.
7) Agreeing the scope deliverables and time schedules with the customers.

3.2. According to TPO, first five functions, i.e. identifying the customers, establishing the contracts, solicitation of the enquiries, management of relationship and appointment of agencies were purely **"marketing activities".** Further, as per TPO, certain functions, such as, negotiation of contracts, signing of contracts, fixation of time schedule, etc. as listed in (6) & (7) above, were nothing but **"Front Office Activities".**

3.3. The TPO has also discussed the **"Risk Profile of MUK".** According to TPO, the market risk, service liability risk, technology risk, credit risk, man-power risk and foreign exchange risk, were remained with MIL. TPO had even stated that normal distributor's risk like inventory risk, foreign exchange risk and profit risk were not existed with MUK. According to TPO, MUK did not receive the delivery of services or the delivery of product but those were directly delivered to the third party, i.e. clients.

3.4. We have also noted that the TPO had made a comment that the agreement between the assessee and MUK were in respect of fixation of arm's length price. The profits or returns on the transactions were alleged to have given the risk coverage to MUK and it was fixed after the

charging of expenses incurred by MUK. The assessee MIL has agreed upon to transfer the money accordingly. Hence, as per TPO the MUK was like a **captive office** of the assessee-company. Further, it was alleged that MUK had **no non-recurring expenses.** The MUK has received admittedly 5.5% net profit. Because of the said fixed percentage of profit, the TPO has stated that the MUK has not functioned like an independent distribution company. As per TPO, an independent distribution company earns fluctuating profit. The TPO has discussed the method of preparation of bill and noted that the bills raised by the assessee-company to MUK were based upon the Revenue collected from the clients and after reducing the front office cost of MUK, a net profit of 5.5% was given. As per TPO the assessee(MIL) was raising bills on the basis of the third party receipts after considering MUK as a front office. Lastly, according to him, expenses would have been borne by the MUK, had it functioned as an independent distributor.

3.5. Thereafter, the TPO has discussed one of the clause of the agreement with MUK through which it was agreed upon that MUK shall be entitled to retain an arm's length return on the revenues received from customers in UK. At the end of each month, Mastek India used to determine the total transfer price due from MUK for services rendered during that month and then issue an invoice in Great Britain Pounds. On the basis of information, the TPO has cited an example of the compensation for MUK and the related transfer price of Mastek India in the following manner:-

	£
Revenue from UK Client	*1000*
Less:	

Front office cost of MUK	*200*
Arm's length percentage of Revenues as determined from time to time	*55*
Transfer price for Mastek	*745*

Note : Front Office Costs shall include Personal cost Travel, lodging, Local conveyance Sales promotion PR & Mktg Consulting Seminar & Conveyance Insurance Rent, rates, taxes Legal & Prof fees Audit fees Doubtful debts Others."

3.6. An another point has also been raised that the tangible and intangible assets have belonged to the assessee-company. The TPO has drawn a conclusion that on the basis of the FAR analysis and the activities performed by MUK the said AE has acted as a front office of the parent company as also merely a marketing entity. Thereafter, a conclusion was drawn that the profit has been attributed to MUK on the basis of value added expenses incurred by it. Since the basis of attribution of profit was considered by the TPO as a value addition on expenses, hence the said method was held as **"Cost Plus"** basis.

3.7. The TPO has also discussed the comparables chosen by the assessee. He has mentioned the defects in those comparables. The TPO, thereupon, has drawn a conclusion that the referred comparable companies were in product-distribution and not in service-delivery-activity. Those companies were stated to be dealers of patented softwares and, therefore, it was treated by the TPO that FAR did not match with MUK. A show cause was issued and in compliance the assessee has taken the following issues; reproduced by the TPO as follows:-

"(a) As a distributor, assessee takes normal risk related to business risk except risk related to inventory.

(b) The assessee enters into negotiation with the buyer and strikes a deal and signs the contract, it is carrying out selling functions.

(c) The compensation to a distributor should be reimbursement of operating cost plus volume related commission.

(d) Employee's qualification and strength and in this regard the assessee submits case studies saying involvement of MUK employees related to third party account.

(e) Provision regarding reward relating to selling function in UK Tax Laws.

(f) Relying on the ruling of Hon'ble ITAT Kolkata in the case of Development Consultant Pvt.Ltd. vs. DCIT, Circle-11(ITA Nos.79 & 80/Kol/2008), stating that model similar to it was accepted as distribution of services."

3.8. The TPO has given his reasoning as under:-

"(a) The assessee has stated that ***MUK is assuming market risk and credit risk with regard to key functions of selling.*** *In fact exposure to these risks is more to the assessee company as compared to MUK as any reduction in revenue will hurt huge set up and infrastructure created by the assessee company as compared to MUK which is merely customer facing entity and marketing assessee's business using goodwill and name of the assessee company. It is the assessee company which is more involved in getting a contract in fixing competitive pricing and taking profit risk. It can be seen from the financial statement of the assessee company that it is receiving fluctuating margins on each contract whereas MUK has been assured of a fixed return irrespective of the fact whether the assessee is earning profit or incurring losses on a particular contract. In addition to the above, it is the assessee company which bears product/service liability risk, technology risk, manpower risk and foreign exchange risk. Further Assessee Company assumes all credit risk of the MUK even credit risk lies with Assessee Company. Under the*

circumstances, MUK cannot be said to be an entity having normal business risk as of independent distributor and can be said as captive office customer facing entity of the assessee.

As discussed earlier, the Assessee Company has entered into an agreement with MUK by agreement dated 30/3/2005 called as 'Master Agreement' where it can be seen that all the risk and consequently all the expenses have been taken up by the assessee company. In fact by doing so all the marketing intangibles and other intangible developed during the course of business have to be treated as assets of the assessee company only. Further, by providing comfort letters to third parties and guarantees to bank, assessee has assumed all the risk of the MUK. The assessee company is reimbursing besides all other expenses, expense related to insurance taken for various purposes/risk, doubtful debts and others are also being paid by the assessee company.

(b) The ***assessee has stated that MUK enters into negotiations with the buyer and strikes a sale i.e. concludes the contract and further signs contract as its functions.*** *Merely doing this function without assuming related risk does not mean carrying out those functions independently which are required to be remuneratd as such. It is clear from Annexure A & B that final price for any contract to the third party is decided by assessee company in consultation with MUK and MUK merely signs those contract on assessee's behalf. Merely stating that these contract6s have been entered into by MUK is not the substance of all those contracts but merely the form in which they are entered. All the sales specification and terms of delivery and time scale for delivery are to be first provided by the assessee which is incorporated in the agreement as per the direction of the assessee company.*

(c) ***The assessee has stated that a distributor should be compensated for reimbursement of its operating cost plus volume related commission is not normal system of compensation.*** *There may be reimbursement of certain expenses which a principal may reimburse to the distributor for certain specific work which it wants to be carried out. However, reimbursement of all expenses and risk and further payment of commission that too @ 5.5% on*

basis of sales is not a prevalent system. The more prevalent system is paying commission on sales and not reimbursement of day to day expenses of the commission agent. There cannot be any distributor which is to be paid for all its expenses and risk and in addition above, volume related commission as same would promote inefficiencies in expenses and further remuneration to the distributor on intangibles of the principal.

(d) ***The assessee has further stated that it has employed highly qualified full fledged strategy business team*** *which was not only selling and promoting items but also taking strategic decision in respect of the sales. The assessee has not submitted what strategic decisions or whether all strategic decisions required in respect of sale was being taken by that team only. Providing a very highly qualified team is merely a marketing exercise which provides comfort to third party clients and presence of the assessee company in the UK. Any marketing strategy requires providing comfort to the clients and showing to others including clients that the assessee company is competent in carrying out all technical projects and has support services near to it. Signing of contract in UK and presence of competent team is clearly marketing exercise for software service business.*

(e) ***The assessee has further relied on Transfer Pricing Guidelines of UK Revenue authorities*** *which also supports under sign's contention that remuneration should be based on risk taken by the entity.*

(f) The assessee has relied upon decision of honorable Kolkata ITAT in the case of Development Consultant Pvt Ltd that model, similar to the distribution of services was accepted by the Tribunal and it was agreed that distributor need to be compensated on gross margin basis.

3.9. Finally, the TPO has computed the arm's length price as under:-

*"**8. <u>Computation of Arm's Length Price</u>** :*

8.1. The assessee company has submitted arm's length mark up for US market on similar activities using PLI of value added expenses/total cost (VAE/TC). The arithmetic mean of the company found out by the assessee is 6.02%. A similar comparable set based on similar PLI was found out in another case using following data:

i) Standard & Poor's Compustat
ii) Mergent's Vs Public Companies and
iii) Disclosure

The following industrial classification codes were used for economic criteria, advertising agencies; advertising not classified elsewhere, business consulting services and business consulting services not classified elsewhere. The companies which were classified inactive and closed and similar companies having less that US $ 1.5 mn were excluded and manual qualitative screening were carried out rejecting the companies having non-comparable functions, non comparable services, persistent loss makers and merger/inactive were excluded. This data base resulted in arithmetic mean of comparables at 5.6% on cost. However, arithmetic mean of the comparable companies found out by the assessee company at 6.02% has been used for computation of arm's length price for marketing/front end office activities of the MUK.

Total expenses of MUK (in pounds)	*82,11,483*
Mark up 6.02% as discussed above	*4,94,331*
Operating profit added to sales price of assessee (2860974 – 4984 331)	*23,66,643*

Converted into INR @ Rs.78,6959/- per pound = Rs.18,62,45,100/-

(Upward adjustment of Rs.18,62,45,100/-)"

3.10. We have also gone through the order of the Ld.DRP, Ahmedabad dated 28/09/2010. A major portion of this order simply contains the order of the TPO and the submissions of the assessee. The proposed addition/adjustment was affirmed and the reasons assigned in short are as follows. DRP was of the view that the said AE, i.e.MUK

situated in UK has performed the functions, such as, identification of customers, establishment of contacts, solicitation of enquiries, maintenance of customer relationship, appointment of advertisement agencies, etc. were the functions in the nature of "marketing activities". Even the signing of contracts, agreement on price, scope of deliverables or the time schedule were the functions though undertaken by the MUK but only with reference to the feedback received by the Mastek India Ltd. They have endorsed the view of the TPO that the MUK had functioned as a front office of the assessee. According to DRP, only a fixed profit was settled as per the terms of the agreement between the assessee-company and MUK. The MUK was admittedly remunerated at 5.5% of the revenue received as a third party sale price. According to DRP if MUK was working as a distributor, then there should not be a fixed profit but the profit should kept on changing. They have stated that the selling price could not be fixed by MUK and, therefore, MUK could not be considered as an independent entrepreneur. The assessee had made contentions in respect of the adjustment made by the TPO with reference to Rule 10B(1)(e), 10B(2) and 10B(3) of the Income-tax Rules. However, the contention of the assessee connected in this regard were negated in the following manner:-

> *"a) From the plain reading of the aforesaid rule, it is crystal clear that profit level indicator (PLI) prescribed under TNMM is the net operating margins computed in relation to the prescribed base as mentioned in sub-section (i) above. The choice with the tax payer is regarding selection of base i.e. cost incurred or sale effected or assets employed or any other relevant base, but not in the selection of margins.*
>
> *b) Net profit margins have not been defined in the I.T. Act or Rules made therein. When the statues have not provided the*

definition of a term used in it then general meaning of the term has to be taken into consideration. It has been held by the Kerala High Court in the case reported in 190 ITR 32 (Ker) "While interpreting the meaning of a word, the court in the absence of the statutory definition will have to consider its meaning in the manner in which it is understood generally by those who deal with the subject in question"

Thus, the net profit normally means profit before tax, computed in accordance with the accounting principles. However, any item of income or expenditure which has no bearing on the amount of the transactions under examination have to be excluded or included as the case may be. Some of these items may be as dividend income and interest income, which are not directly related to the transactions.

c) *Thus, under TNMM, in the first step, net operating margin from international transaction is computed in relation to the appropriate base. In the second step, net operating margin of the uncontrolled transactions are identified. In the third step the net operating margin of uncontrolled transaction are adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entered into such transactions which could materially affect the amount of net profit margin computed in step 3 above is then taken to be net operating margin and the Arms Length Price of the transactions computed by that operating margin."*

3.11. DRP has discussed Skoda Auto (India) Pvt.Ltd. vs. Asst.CIT reported as (2009) 122 TTJ (Pune) 699, wherein one of us, i.e. JM is the co-author. The difference in quantum of imports was held as difference in business model and, therefore, it was suggested that the requisite adjustment is required to be carried out for such functional difference. But the DRP was of the view where there is no difference in the

functions performed, then there could not be any need for any change in PLI in those circumstances.

3.12. DRP has further referred that the assessee has followed TNMM method for bench-marking its transactions. It was observed that TNMM method emphasizes the adoption of net margin from various transactions. The profit level indicator adopted should indicate the real and not notional profit. Any indicator which may either indicate increase profit or reduce loss due to non-consideration of certain factors, according to DRP, do not represent the actual state of affairs. According to them, bench-marking done, therefore have no meaning. They also ruled out that as per Rule 10B(10)(e)(iii) the items of expenses which were proportionately higher should also not be allowed. Ld.DRP has rather commented that the assessee had not given any kind of working as to how and as to what kind of adjustment would be warranted. They have held that the bench-marking analysis conducted by the TPO did not require any intervention.

3.13. The assessee has pleaded to grant benefit of "proviso" to section 92C(2) of the Act. This proviso prescribes that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be arithmetical mean of such prices. An option is prescribed that a price which may vary from the arithmetical mean by an amount not exceeding 5% of such arithmetical mean can be substituted. However, a press note issued by the Ministry of Finance dated 22/08/2001 was referred, wherein it was expressed that in view to avoid hardship to the taxpayer, no adjustment is to be made if the price adopted by the assessee is up by 5% or less by 5% more than the ALP. The DRP

has referred CBDT Circular No.12 dated 23/08/2001(251 ITR 15 (St.) specifying that the AO should not make any adjustment to the price shown by the assessee if such price is within that range. DRP has thereafter mentioned that the ALP of the International transaction as undertaken by the assessee had fallen beyond the said margin of 5%, therefore, the AO was correct in invoking the relevant provisions for the adjustment. For this legal proposition, case law cited was - Global Vantage Pvt.Ltd. 1 ITR 326 (Trib.)[Delhi].

C) Appellant's argument:

4. During the proceedings before us, Shri S N Soparkar, Ld. Counsel for the assessee has narrated the facts of the case and submitted that the A.O. had erred in not giving due regard to the contentions of the assessee and confirmed the additions proposed by the TPO. The Ld. Counsel explained the grounds raised in the appeal and proceeded to make various arguments summarized as follows:

a) The Ld. Counsel stated that the assessee derived maximum revenues from the UK market. From 1.1.2005, the business model of the assessee had undergone a change. This was keeping in perspective inter alia the **HMRC (Her Majesty of Revenue & Customs) guidelines** of UK to ensure that the assessee and MUK comply with the transfer pricing regulations in both India and UK respectively as regards the export of software services to MUK were concerned. The extracts of the HMRC guidelines relied upon by the Ld. Counsel is reproduced below:

"The selling function treated as a provision of services

> *A selling entity is rewarded on a cost plus basis by a connected party. You should scrutinize carefully any claims that the company has no risk and is merely introducing the customer, or helping to*

maintain existing customer relations - that the company is providing a service to the principal who is actually selling the goods.

Between independents selling is usually a critical, entrepreneurial part of any trade rather than a low level service type activity.

Such cases may range from a small representational office with a *few employees, to a large presence involving hundreds of staff. In the selling world, even a relatively small concern would expect some form of reward related to the sales made. The larger the presence, the more unlikely it is that the company is just providing a service.*

It is of course possible to think of services that might be provided to someone carrying on the business of selling, for example the selling company will very likely pay someone to advertise their goods. However, the act of soliciting and securing a sale goes beyond the provision of services to the selling activity; instead it is a fundamental aspect of the selling activity itself. ***A cost plus method of reward is unlikely to be appropriate A better way of establishing an arm's length reward will be to use a price linked to the sale of the goods.***

As with other cases involving selling activity, you should consider whether there is another party trading (eg a UK permanent establishment of a foreign principal)."

The Ld. Counsel thus highlighted that the UK Revenue authorities would expect entities performing the role of a distributor (i.e. performing a selling function) would **need to be compensated on a return on sales basis and not cost plus basis.**
He stated that the **risks in the nature of market and customer credit risks were borne by MUK and accordingly the compensation should be that of price linked to sales.**

b) The Ld. Counsel further explained the need to change the business model by stating that MUK started performing selling activities on a large scale as against marketing activities it performed in the past. Prior to 1.1.2005, MUK acted as a marketing services provider for offshore

services performed by the assessee. As regards the onsite activities, MUK performed the same on its own account but obtained certain technical support services from MIL. From 1.1.2005, MUK acted as a distributor of software service capabilities of MIL and entered into a fresh agreement titled "Distribution Agreement" which was made effective 1 January 2005 and the old services agreement titled as 'Services Agreement" was terminated.

c) The Ld. Counsel explained that the compensation to MUK which was a derivative figure, was based on the market back-up approach. Therefore the computation to MUK was worked out on the basis of the Revenue generated and the said working was demonstrated by the TPO through an example in the order; already mentioned supra.

d) Another plank of argument of The Ld. Counsel is that the entire income earned by **MIL** from its transactions with MUK was **exempt under section 10A of the Act,** as a result of which, there was no shifting of the tax base. He emphasized the point that as the entire profits were exempt u/s 10A in India, there was no incentive on the part of the assessee to park profits in UK. No logical businessman would want to abuse the transfer pricing provisions by not bringing the profits back to India, which otherwise was exempt, and park the same in UK and continue to pay taxes at a rate as high as 30% in UK. In this regard, the Ld. Counsel relied upon the decision of the High Court of Delhi in case of **Moser Baer India Ltd. V. Additional Commissioner of Income-tax [2009] 176 Taxman 473 (Delhi) / 316 ITR 1,** which brings out the reasons for introducing Chapter X in the Act, which is to prevent an assessee from avoiding payment of tax by transferring income yielding assets to non-residents even while retaining the power to enjoy the fruits of such transactions i.e. the income so generated. In the instant case, the entire income even if brought back to India in the first place would have never suffered a single rupee of tax.

e) In addition to above, the Ld. Counsel relied upon the following to support the fact that there was no reason for shifting of tax base by MIL, which is enjoying Section 10A benefits:

- Circular No. 12 dated August 12, 2001 [251 ITR(St.) 15];
- Circular No. 14 dated November 09, 2001 [252 ITR(St) 65] - Para 55, which brings the objective of introducing TP

regulations. The same has also been discussed in the case of Moser Baer as discussed above;

- Dufon Laboratories (2010-39-SOT-59-Mumbai) - Para 13 and Para 29;
- Indo American Jewellery (2010-131-TTJ-Mumbai-63) - Para 11 and 12
- Phillips Software Centre (Private) Limited (2008-119-TTJ-Bangalore-721) - Para 5.1

f). The Ld. Counsel for the assessee during the course of the proceedings filed a written synopsis of the arguments. Referring to this synopsis, the Ld. Counsel for the assessee referred to various documents and submission filed before us. The same have been briefly narrated below:

i. He highlighted Para (c) and (f) of Para 2.1 of the **Distribution Agreement**, which discusses Roles and Responsibilities of the transacting entities viz: MUK and MIL;

ii. He pointed out Article 3 of the Distribution Agreement stating that MIL will **not compensate MUK for any negligent act of MUK.** This aspect is typical of any distribution activity vis-a-vis marketing activity;

iii. There was no agency relationship between MUK and MIL, which was evident from Para 6.1 of the Distribution Agreement. The **relationship was on principal to principal basis;**

iv. He then referred to the agreement entered into by MUK with the customer and stated that **MIL does not feature at all in the said third party agreement, which further demonstrates the point that entire risks and responsibilities vis-a-vis third party was borne by MUK;**

v. He discussed the Article 4 - Pricing and Invoicing clause of the Distribution Agreement along with Exhibit 1 to demonstrate 5.52% compensation mechanism for MUK;

vi. He pointed out that selling activities (negotiating and concluding contracts) performed by MUK were value added functions separate from marketing and front office. MUK

takes independent decisions as regards pricing to customers and is not acting like an agent of MIL.

vii. He further stated that selling activity is very critical to any business function and does need focused attention. In this regard, he brought out the organizational structure of the sales team as well as the employee data, their qualification, designation and roles in MUK. He pointed out that MUK with the set of highly qualified and experienced employees, was quite capable to take business decisions and enter into negotiation and conclusion of contracts on its own behalf.

viii. MUK employed well qualified Managerial and Technical personnel with skills as well as the experience to understand the software offerings, create proposals, negotiate and conclude contracts independently. The break-up of the employees were discussed by the Ld. Counsel. He identified apart from 1 Country head, there were 28 employees of MUK who were involved in Sales Solutions & Strategy, 13 employees were involved in Sales operations and support and 8 employees were part of legal and finance.

ix. After a sale contract is concluded, MUK informs MIL of the specifications and the terms of the contract. Accordingly, MIL'S role would start only after MUK has concluded the customer contract. The customer contracts may be discussed at times with MIL before concluding. However this is from the perspective of only aligning with the group's business policies and goals. This is in accordance with any third party distributors who would need to consult with the manufacturers to find out as to when the required goods would be made available. The contracts between MUK and the UK customer were independent and not entered into on behalf of MIL. MIL was providing the software services as per the contract terms entered into between MUK and the customers.

x. He drew our attention to the case studies prepared for AY 2006-07, which clearly depicted the work performed by MUK through its employees on major clients in UK. The case studies explained the complexities of the nature of work involved and the involvement of the employees of MUK in carrying out selling activities in addition to marketing.

xi) The Ld. Counsel then brought out an another point for our consideration that the TPO was given an opportunity during the course of the hearing to interview key sales personnel of MUK (either telephonically / in person). However, according to the Ld. Counsel the TPO never exercised this option. In this regard, the Ld. Counsel relied upon **Nestle India Limited (2005-094-TTJ-Delhi-53)** - Para 91. In the said case, the assessee had given an opportunity to the tax office to visit the office premises and factory in relation to confirming the technology availed by the assessee from its group entity(ies). However, the officer did not avail of this opportunity. Further, the assessee placed various submission on record for its claim. The Hon'ble Tribunal held that the officer had been less than fair in his observations that the requisite details and supporting material, evidence and information were not furnished by the assessee.

g). Reverting back to the main reason of disallowance; the functions performed by MUK, in nutshell were reiterated as follows:

- Identifying customers;
- Establishing contacts;
- Soliciting enquiries;
- Managing customer relationships;
- Appointment of agencies or engaging into advertisement and sales promotion;
- Negotiation of contracts and signing of contracts on concluding;
- Agreeing the scope deliverables and time schedules with the customers

The Ld. Counsel has emphasized on the last two functions, which are in the nature of selling functions. Marketing activity is just a subset of the entire selling functions. Negotiation of contracts, taking a decision on the same and concluding the contracts is an important part of the selling function and commands a reward much more than for a marketing activity. It therefore warrants remuneration above mere cost plus. The Ld. Counsel further emphasized that UK HMRC's website provides

that cost plus method is unlikely to be appropriate only for selling activity.

h). In relation to the tangible / intangible assets owned by MUK, the Ld. Counsel pointed out that **MUK owns tangible assets. MUK owns marketing intangibles also in the form of customer relationship and contracts.** In this regard, the Ld. Counsel pointed out that if MUK were to sell its business to a third party, would it not claim adequate compensation towards marketing intangibles owned by it.

i). The Ld. Counsel then pointed out that after considering the selling functions performed, **MUK should be characterised_as a distributor and not a mere marketing services provider.** The said characterization was adopted by the assessee and documented in the TP Study Report. In this regard, the Ld. Counsel relied upon the following case laws:

- **Bechtel India Private Limited (2011-TII-07-ITAT-DEL-TP**) Para 12, wherein it was held that entity characterisation should be done after proper FAR analysis of the assessee and only thereafter, the comparables should be selected;
- **Development Consultants Private Limited v/s DCIT (2008-115-TTJ-Kolkatta-577)** - Para 10, wherein the characterisation of the "Distribution of services" has been taken into cognizance by the authorities. Further a passing reference was made by the Kolkatta ITAT in the said case that the margins of a distributor of services should be based on sales.

j). In addition to above, the Ld. Counsel made several other points to support the assessee's position, which are briefly discussed below:

- **Contracts are negotiated and signed by MUK with customers:** The TPO has on a presumptive basis stated that MUK is not capable of entering into contracts. The TPO has without any evidences concluded that the MUK is merely a customer facing entity and marketing assessee's business using goodwill and name of the assessee company. The TPO has further erroneously presumed that it is the assessee

company which is more involved in getting a contract in fixing competitive pricing and taking profit risk. The Ld. Counsel categorically stated that the TPO has not shared any documents / evidences which supports his views that MIL was involved in fixing the price. MIL'S involvement is nowhere brought out even in the third party agreement that MIL has entered into with its customers in UK. It is incorrect on the part of the TPO to state that MUK signs the contracts on behalf of the assessee(MIL). **Even in a third party scenario, the distributor would always consult with the manufacturer to find out as to when would the required goods be made available.** Similarly, in the instant case if MUK consults MIL to find out the time scale for delivery, it would not undermine its role as a distributor.

. As regards the employee profile submitted before the TPO, the TPO has again erroneously stated that **providing a highly qualified team is merely a marketing exercise, which provides comfort to third parties**. According to the Ld. Counsel, the TPO has never examined any key employees of MUK and has arrived at this conclusion without any proper findings to this regard.

- **Fixed compensation for MUK**: The Ld. Counsel vehemently argued that just because MUK was compensated at 5.52%, it cannot be treated as a marketing / front office entity. Contracts have to be recognised. Legally binding agreements cannot be disregarded without assigning well argued reasons. He relied upon **Abhishek Auto Industries Ltd. (2010 Til 54 ITAT Delhi TP).** The said ruling in turn relied upon the following judicial precedents:

  - Azadi Bachao Andolan (263-ITR-706-SC);
  - Gillette Diversified Operations (Pvt) Limited (2010-324-ITR-226-Delhi);
  - Walfort Share & Stock Brokers Private Limited (2010-233-CTR-42-SC);
  - Sony India (P) Limited - (2008-114-ITD-448-Del).

In this regard, Ld. Counsel questioned that would the Revenue department agree to give fluctuating returns to MUK and would that be treated arm's length ?

- **Comfort letter to third parties:** The Ld. Counsel argued that even in a third party scenario the manufacturer of goods would always give guarantee about the products manufactured. In the instant case, if MIL has given comfort letter to third parties, it is for its own performance and this by no way dilutes the role of MUK as a distributor of services.

- **Case studies depicting complexities in selling activities:** The Ld. Counsel has explained the role of employees of MUK in negotiating and concluding complex projects in UK and ensuring the timely delivery for the same. According to the Ld. Counsel the TPO's order is absolutely silent in this regard. Even as regards the HMRC guidance produced before us, according to the Ld. Counsel, the TPO has not dealt with the same in his order.
- **Marketing / Front Office:** The Ld. Counsel stated that the TPO was not sure as regards the role of MUK. This was evident from the varying conclusions drawn by the TPO in his order viz: Para 6.1, the TPO regarded first five activities as marketing activities and the balance two as front office activities. As against these, in Para 7.3, the TPO treated MUK as a marketing entity / front end office of the assessee.

K). **Commission to employees of MUK:** The Ld. Counsel emphasized that MUK provides incentives to its employees (i.e. sales personnel) in the form of commission as a percentage of sales generated by them. In this regard, the Ld. Counsel during the course of the hearing produced a chart of commission paid to the employees for the period FY 2005-06 to FY 2009-10. He drew our attention to the fact that during this period, the average commission as a total percentage to the salary was

around 40%. In this regard, the TPO incorrectly linked the same to the fact that MUK was a 100% subsidiary of MIL and any profit earned by it will benefit the assessee company if the same was repatriated as dividend to the assessee company. The Ld. Counsel stated that this aspect had no connection to the point being discussed that if the employees who are earning commission linked to sales generated by them to increase the overall revenues of MUK, why would MUK be not compensated on return on sales basis.

L) **Comparability analysis :** The Ld Counsel stated that the TPO has incorrectly compared MUK's operations with the comparability analysis carried out for US market. The assessee had submitted the details about UK comparability . The Ld. Counsel stated that even if MUK is to be treated as a marketing services provider, though obviously without accepting, the comparables performing similar functions in UK market need to be treated as comparables and not US market. The UK comparables, if adopted, reflected an arithmetic mean of 11.96%. Further, the benefit of (+/-)5% as provided in proviso to Section 92C(2) should also be provided to the assessee. After granting the benefit of (+/-)5%, the assessee would have well complied with the transfer pricing regulations of India and the question of adjustment would not arise. Further, the Ld. Counsel also highlighted the error on part of the TPO by adopting the financials of MUK for the period July 2005-June 2006 instead of April 2005-March 2006. At this juncture it is worth to mention that Ld. CIT DR has not objected and accepted the said fallacy. About DRP's observation Ld. Counsel has briefly mentioned that the said order is nothing but a copy-paste of the TPO's order as also the submissions of

the assessee, hence the points discussed therein has already been attended by him.

M) **Basis of Study :** About search strategy for uncontrolled comparables it is informed that renowned external data- bases were consulted namely FAME (by Bureau Van Dijk), Standard & Poor's Research Insight, Compustat Global Data, Primark's disclosure Worldscope and on the basis of the study filtered out the non-comparables. He has thus pleaded that the primary onus as casted upon by CBDT Circular No.14 of 2001 dated 9.11.2001 (252 ITR 65)(St.) to substantiate the arm's length price was duly discharged.

N) Main customer : Ld. AR has emphasized that the main customer in UK is British Telecome (BT) and the sales accounted were 40 million pounds i.e. 311 crores apx. Such an organization U.K. Government might not negotiate and assign the job to a front office entity or a marketing entity, argued before us.

D) Revenue's argument

5. The ld. Commissioners Shri V.K. Gupta and Shri Kartar Singh have appeared. The Ld. DRs now presented the Revenue's case and relied on the TPO's as well as Ld. DRP's order. The arguments put forward are discussed below:

i. The Ld. DR pointed out that the customers in the UK were given comfort by MIL through the presence of MUK. It is MIL which helps the customers. Same model was followed by MIL in the said AY 2006-07 as regards its another subsidiary in USA, where the **compensation continued to be cost plus mark-up.**

ii. According to the Ld. DR, there has not been any significant change in the functions performed by MUK. It is only that the **onsite activities earlier performed by MUK were now shifted to the UK Branch of MIL.** The Ld. DR pointed out that when he enquired about why was the US subsidiary's model changed later, the assesses replied stating that functions were wrongly identified and later corrected.

iii. The Ld. DR stated that the financials of the UK units, which is now presented by the Ld. Counsel was never produced before the TPO and so it is difficult to comment on its authenticity. Even if the same needs to be relied upon, the workings should be made after allocation of common costs incurred by MIL.

iv. The main argument as per the Ld. DR was to establish that whether MUK would conclude the contracts on their own or would they take help from India? Also given the answer that without the help and support from MIL not a single contract could be completed on its own by MUK.

v. The Ld. DR further denied the allegations that no persons from MUK were interviewed. He stated that the persons were called but the assessee never produced the same. He also categorically mentioned that the same has been noted on the proceedings sheet.

vi. According to the Ld. DR, MUK on a stand-alone basis is not able to fix up the price, as also the time of delivery ; and for that has to necessarily consult MIL. **Delivery of the software has always taken place from MIL to the customer.**

vii. MUK has no brand / technical expertise to distribute. They use MIL'S India brand. As per Ld. DR how would a customer in UK give a contract to MUK without MIL's back-up. **The requisite technical capabilities are with MIL and therefore MUK cannot enter into contract on its own.**

viii. The Ld. DR took us through the relevant portion of the TP Study Report, where the asset analysis was carried out by the assessee and re-emphasized that without MIL's name, MUK will not be able to sell the contracts to third parties in UK.

ix. Further, **MIL has also given performance guarantee to the customers in UK,** which further strengthens the point that MUK acts like a marketing support service provider.

x. As per the conclusion of the Functions, Assets and Risks analysis, it is MIL which is primarily responsible to the customer and acts like an entrepreneur.

xi. Further, the **rate of the compensation for MUK is also fixed at 5.52% every month.**

xii. Then, the Ld. DR put up his contentions against the arguments put forward by the Ld Counsel for the assessee, can be summarized as follows:

a. No shifting of profits:- The Ld. DR stated that the transfer pricing provisions are attracted as soon as there are international transactions. The Ld. AO/TPO is not required to see the motive for entering into an international transaction. There is nothing specified in the law as to whether the onus lies on Revenue to demonstrate that the profit shifting motive was prevalent in relation to a particular international transaction. The Ld. DR read out the provisions of Section 92 of the Act and based on the plain reading, argued that no where any satisfaction as to the motive to shift profits need to be shown or recorded. The **TPO relied upon Aztec Software & Technology Services Ltd. [107 ITD 141 (SB)].** As regards the **Moser Baer case** (316 ITR pg.1)referred to by the Ld. Counsel for the assessee, the Ld. DR pointed out that the same was only an observation by Delhi High Court and no decision was taken that only if motive was proved, one can go ahead. The Ld. DR also stated

that the instruction of the CBDT is automatic viz: if the transaction value is more than Rs. 15 crores, it should be referred automatically to TPO.

The Ld. DR continued and clarified that there was **no dispute as regards most appropriate method, or as regards tested party.** The dispute was more to do with the Functions, Assets and Risks analysis of MUK and MIL and the characterisation of MUK that flows from the same as to whether MUK should be treated as full fledged distributor or marketing support services provider.

b. HMRC Guidelines:**-** In relation to the HMRC guidelines relied upon by the Ld. Counsel for the assessee, the TPO stated that those were mere guidelines and neither binding on the TPO nor assessee or MUK either.

d. Fixation of 5,52%:**-** Even after the authorities repeatedly asked for as to how was 5.52% fixed for MUK, the Ld. Counsel never responded to the same.

e. Customers interaction with MUK:- According to the Ld. DR, it is too far fetched statement that the customers in UK would know only MUK and not MIL, This is because, MIL has given performance guarantees to such customers. Also, **MUK uses MIL's brand to market the services.** Finally, the deliveries are taking place directly from MIL to the customers.

f. Commission to employees of MUK:- The Ld. DR vehemently argued that this plea was taken for the first time by the assessee before the Tribunal. The assessee has never produced any evidence as regards the staff of MUK being paid salary and commission. These details now given should not influence the Tribunal and should be disregarded.

g. Use of US comparables:**-** In this regard, the Ld. DR stated that in the show cause notice he requested the assessee to state why UK/US comparables should not be used. According to the Ld. DR, the assessee never submitted the details of UK comparable until the TPO placed his order for DIT's approval. He pointed out that the assessee gave his replies but never gave any replies in relation to the UK comparables. The details given by the assessee were submitted late and not within the time given in the show cause. As per the Ld. DR, the procedure is to send the draft order for DIT's approval, which would take a gap of around 5 to 6 working days. The Ld. DR further stated that the TPO used the same report of the assessee, which was prepared in relation to another subsidiary in USA having similar business model and where same functions were carried out. The Ld. DR agreed that UK comparables can be used and offered that the TPO would be happy to re-look into the same and revert back within a week's time. According to the Ld. DR, whether one uses UK / US comparables, in an arms' length situation the margins would be very close and not vitiate on a larger basis. As regards the comparability analysis carried out by the assessee, the Ld. DR stated that the **assessee identified the companies engaged in distribution of software products and not software services. He has pleaded that uncomparables cannot be compared.**

h. Period of financials:**-** As regards the usage of the period July-June against April-March, the Ld. DR accepted the error on part of the Revenue and stated that the same need to be rectified.

i. +/-5% benefit to the assessee:**-** In this regard, the Ld. DR relied upon the case law of **Global Vantedge Private Limited v DCIT [2010-TIOL-24-ITAT-**

DEL] and Marubeni India Private Limited and stated that the benefit of +/-5% is available only when the assessee computes the arm's length price and not when the TPO determines the same. Further, the Ld. DR stated that if the law of +/-5% is correctly applied the assessee's case does not fit within this range as the assessee has selected MUK as the tested party. The Ld. DR also did not accept the working of the arithmetic mean of 11.96% of UK comparables as according to him the same was never submitted before the TPO.

xiii. The Ld.CIT DR Mr. Gupta has proceeded on the characterization of MUK. He discussed the real characteristics of a distributor and stated that MUK never falls within that loop. **Price fixation between MIL and MUK is never on a Principal - to - Principal basis.** This is because, MUK will always inform MIL about the expenditure incurred in a particular month and accordingly, MIL shall raise the invoice on MUK. The Ld. DR stated that the price for customer is always fixed by MIL and MUK will accordingly never incur any loss. MUK shall always get a fixed rate of return viz: 5.52% and shall accordingly not assume any risk.

xiv. As regards the technical services are concerned, the same are provided by MIL. The **after sales service is the responsibility of MIL** and its UK Branch and not that of MUK. This is further supported as there are no technical people in MUK to carry out any technical support services after sales. The Ld. DR highlighted that as regards the functions of MUK, which have been submitted by the assessee, the functions relating to after sales services have not been discussed. The team of MUK though technical are not from the software services perspective but merely commercial perspective.

xv. Based on the above, the Ld. DR concluded that the TPO has rightly treated MUK as a marketing support service

provider/performing front office activities and should be therefore compensated only on a cost plus basis.

E) Rejoinder:

6. In the Rejoinder, the Ld. Counsel for the Assessee responded to the aforesaid arguments and the same are summarized below:

a. Shifting of tax base:- The Ld. Counsel clarified that the point raised by him was not to challenge the jurisdiction of the TP Regulations but was more from a commercial perspective and in his view it is an important point to be considered as to why would a businessman not bring all the profits in India, when the same were exempt and continue to pay taxes at a rate of 30% in UK by parking these profits there. He further emphasized that the Delhi High Court's ruling need to be respected. . The judgement of ITAT viz: Aztec Software (supra) relied upon by the TPO has no application. The Ld. Counsel emphasized that this issue should be dealt from the commercial aspect.

b. HMRC's guidance:- In this regard, the Ld. Counsel emphatically stated that as MUK is a taxable entity in UK, the guidelines of HMRC are applicable to UK. It would be incorrect on the part of the TPO, who represents Government of India, to state that guidance of HMRC is a mere guidance and any guidance given by the CBDT in India is in fact a law. Given the circumstances, it would be incorrect to assume that Government of India would be happy simply if the assessee would have charged in the first instance. However, it is pertinent to note that even if assessee would have charged in the first instance, the Indian Government would not have been able to collect any tax, due to the specific provisions of Section 10A in the Act. As against this, the Revenue is now expecting the assessee to pay tax simply because it appears to them that the assessee had undercharged its AE in the first instance, which in Ld. Counsel's belief is an unfair approach.

c. 5.52% remuneration to MUK:- In this regard, the Ld. Counsel pointed out that yardsticks for applying tax to an Indian entity cannot be different than the yardsticks for deciding how UK should be compensated. With the arguments of Ld. DR, the expectation is to leave less than 1% in UK on a turnover of Rs. 300 crores as against 5.52% left currently. Considering the functions performed by MUK, this would be incorrect to expect out of MUK. If foreign entities would perform similar activities whilst operating through their subsidiaries in India, would the Government of India ever allow them to earn less than 1% of the total revenues generated out of India.

d. Customer relationship:- As regards the Ld. DR's argument that customers in UK would know MIL, the Ld. Counsel stated the following points:

i. Any third party distributor would display the brand of a manufacturer;

ii. Performance guarantee is given by MIL to a customer of MUK and not to all the customers. Further, the contracts are entered into by MUK with third party customers and MUK is obligated towards the third party for the terms and conditions of such contract.

iii. MIL under no circumstances is ever issuing any letter to MUK supporting / rejecting the terms of the agreement between MUK and third parties, which proves that MIL does not interfere in the process when MUK signs the contracts with the customers in UK.

e. Employees of MUK:- MUK sells based on the software capabilities of MIL. It does not have

technical people to perform the software services. However, it does all that is required to distribute a complex software solution to a customer and the same have been well demonstrated through the business case studies.

f. Deliveries to the customer by MIL:- The software solutions developed by Mastek are customised software solutions and will always have to be put up at the customer's site by MIL. This does not give any right to MIL to raise any invoices on customers directly. Deliveries directly to the customers will have no bearing on the case as to whether MUK acts as a distributor or a mere marketing services provider.

g. Commission to the employees:- It was incorrect on the part of the Ld. DR to state that this was never discussed before the TPO. This aspect has been very much discussed with the TPO and placed on record. Page 1242 of the Paper Book No. IV reflects the same.

h. Show Cause Notice:- The Ld. Counsel stated that it was no where brought out in the show cause notice of the TPO that he shall use US comparables. The UK comparables were given on 6th October 2009. Further, the same were also given to the Ld. DRP and a copy of the same was again marked to the TPO. The Ld. Counsel also highlighted that the TPO raised queries regarding the database and search strategy used and also requested for financials of the UK marketing service providers. All of this information was duly submitted to the TPO with a copy to the DRP. However the DRP directions have remained silent on this matter. Accordingly, there arises no further need to give one more opportunity now to the Ld. TPO / DRP. As the Ld. DRP / TPO did not act upon the same, an adverse inference be drawn in this regard. The Ld. Counsel also further stated that in the subsequent assessment year viz: AY 2007-08, the TPO has used the UK comparables.

i. Model of US subsidiary same as that of MUK:- In this regard, the Ld. Counsel pointed out that for the Tribunal in order to conclude whether the US model is similar to that of UK would need to peruse the records of the US subsidiary. Also each geography has to be seen separately. The Ld. Counsel further clarified that the model adopted by the US subsidiary was different than the model adopted by the UK subsidiary.

j. +/-5% benefit:- The Ld. Counsel pointed out Para 30 in relation to Marubeni India Pvt. Ltd. and stated that the assessee's case is not to claim standard deduction of +/-5%. In the assessee's case, the assessee is within the +/-5% range.

F) CONCLUSION :-

7. We have heard the submissions of both the sides at a considerable length. It is to be stated at the outset itself that the preliminary issue is **whether the MUK is to be considered as carrying on "distribution operations" as contested by the appellant, or whether the MUK is to be considered as carrying on "marketing services" as held by the Revenue Department.** Based upon the TPO's findings and DRP's directions, the AO had treated MUK as a "Marketing Support Services Company". To examine the correct nature of the services performed by MUK, we have gone through the **"Master Agreement" dated 30/03/2005,** refer page (235) of paper-book. This Agreement was between Mastek Ltd., an Indian Corporation (referred as "Mastek" in short MIL), Ahmedabad and Mastek UK Ltd. (MUK), A United Kingdom Corporation, UK. The said Agreement was effective

from 01/01/2005. In the preamble, it is stated that from 01/01/2005, "Mastek" has changed its business model for UK operations. Consequently, "Mastek" has started providing on-site software services to customers in UK through Mastek UK- Branch . The Agreement says that earlier those services were provided by MUK. An another opening remark in the preamble was that the Mastek has engaged as also retained MUK to perform the distribution activities for the software development and information technology services. On-site and off-shore services to be performed by "Mastek". MUK has accepted to perform such distribution activities but for consideration as recorded therein below in the said Agreement. Relevant portion is reproduced below.

> *"WHEREAS with effect from January 1, 2005, Mastek has changed its business model for the UK operations. Consequently, Mastek has started providing onsite software services to MUK's customers in the UK, through Mastek Ltd., -UK Branch, which were earlier provided by MUK.*
>
> *WHEREAS henceforth Mastek engages and retains MUK to perform the distribution activities for the Software Development and Information Technology Services (onsite and / or offshore) to be performed by Mastek.*
>
> *WHEREAS, MUK is willing and committed to perform such distribution activities for consideration as recorded in this Agreement.*
>
> *NOW, THEREFORE, in consideration of the premises and of the terms hereinafter set fort, the Parties hereto agree as follows:*
>
> *ARTICLE 1 – APPOINTMENT*
>
> *Subject to the provisions of this Agreement, Mastek hereby appoints MUK as its distributor and MUK hereby accepts such appointment as distributor of the software development and other*

Information Technology related Services (hereinafter referred to as "Services")."

7.1. We have perused **Article 2,** which has prescribed role and responsibilities of MUK and Mastek(MIL). MUK was made responsible for carrying out distribution activities for software development to be provided by Mastek, inter-alia, identifying customers, establishing contacts, soliciting enquiries, customer relationship in UK, etc. On the other hand, Mastek((MIL) agreed to take responsibility to provide material in support of distribution activities, to ensure adequate numbers of Engineers of the required skills, to make available them at all times for execution of "on-site" and "off-shore" services.

7.2. Vide **Article 4** of the said Agreement, it has fixed the price and the method of invoicing. It says that **MUK shall be entitled to retain an artm's length return on the revenues received from its customers in UK for its distribution activities performed.** MUK is to earn arm's length return commensurate with its functions and risk.

7.3. **Article 4.3** prescribes that at the end of each month Mastek shall determine the total transfer price due from MUK for services rendered during that month and shall issue an invoice in GBP for payment to MUK. It was agreed upon that the service fees shall be payable by MUK within 60 days of receipt of invoice issued by Mastek India Ltd. (MIL).

7.4. Before us, **Abhishek Auto industries (2010-TII-54-ITAT-DEL-TP)** cited wherein the Tribunal has made a clear verdict that **written**

agreements which are duly executed by the respective parties based on commercial expediency cannot be disregarded without giving any cogent reason. In the present appeal, it has not been disputed that the said Master Agreement was not genuine or it was sham/fake. It is a settled proposition that commercial transactions are in the domain of the business-man and the Revenue Department cannot intervene in the realm of intricacies of commercial expediencies involved, hence it is improper to ignore the terms & conditions incorporated therein without assigning some strong reason.

7.5. On the basis of the above Master Agreement a vehement argument from the side of the assessee was that the **activities performed by the MUK was distribution of software services.** A question was raised that why at all business model was required to be changed and why the impugned Master Agreement date 30.3.2005 was executed and that what was the necessity to substitute the existing business pattern. In this regard, ld.AR has referred **Her Majesty of Revenue and Customs** ('HMRC').

8. Relevant portion of **HMRC** is reproduced below:-

> *"It is of course possible to think of services that might be provided to someone carrying on the business of selling for example the selling company will very likely pay someone to advertise their goods. However, the act of soliciting and securing a sale goes beyond the provision of services to the selling activity; instead it is a fundamental aspect of the selling activity itself.* ***A cost plus method of reward is unlikely to be appropriate. A better way of establishing an arm's length reward will be to use a price linked to the sale of the goods****."*

8.1. In the light of the above, the stand of the of the assessee is that **UK Revenue Authorities have expected that entities performing the role of the distributor would need to be compensated on the return on sale basis and not cost plus basis.** In the said guidelines it was made clear that a "selling entity" could be rewarded on sale basis. Since the assessee has changed its business pattern, therefore, the said guidelines have a direct impact on the transactions involved and therefore it was a justified move to adopt a price linked reward. Therefore the methodology adopted by the MIL and MUK for International Transaction can be said to be a business demand as also business necessity.

9. Reverting back to the **functions of a distributor** we have been informed that a distributor performs selling of a product, price negotiation, enter into a contract, settle the scope of deliverables, fixed the time schedule with the customers, identify the customers, establish the contact with the customers, solicit the enquiries and appointment of other agencies and also promote the sales by advertisement. As against that, in agency relationship all such activities are not expected from an agent. Since the MUK has its own team of qualified persons and that due to deployment of the said team the revenue has increased substantially, therefore, **it is meaningful to hold that the MUK in fact is in a position to independently negotiate the terms with the customers** and handle the customers in respect of fixing of time schedule and the scope of deliverables.

10. Once we have examined that aspect, therefore we are not in agreement with the TPO that MUK is merely a customer facing entity and simply meant for the marketing of assessee's business. We are of the view that there was no direct evidence in the hands of the TPO to say that

the assessee was simply a selling agent and that it appears that the TPO had proceeded on a presumption that the MUK has acted as a selling agent for the year under consideration. His presumption is primarily based upon one fact that there was a fixed percentage of award given by MIL to MUK; which in his opinion is prevalent in selling agent's case. We have examined this thought of the TPO in depth. Even in the case of a distributor, it is expected from a distributor to consult with the manufacturer or the main concern while finalizing a contract so that the negotiation should be in line with the requirement of the main manufacturer. Though the parties i.e. MIL and MUK are associated to each other but simultaneously two separate legal entities having separate tax structure hence **settled the terms of payment on sales basis,** considering their respective advantages, though can be a fixed amount, so that **there should be enviable incentive to generate more revenue.**

11. One must not overlook a basic fact that the MIL had changed its business model in respect of UK operations. Before us, the percentage of award/ compensation paid to other Associate Enterprises is informed. **The geographical revenue was compared and it was found that out of the other Associate Enterprises the revenue generated by MUK from UK was highest at 60%.** Because of the substantial growth in business in UK and substantial increase in revenue, it was a business decision to change the business pattern. Therefore with effect from 01/01/2005 Mastek has changed its business model for UK operations. Consequently, the Mastek has started performing 'on-site' software services in the UK through a UK branch which was earlier provided by MUK. As a result, Mastek has engaged and also retained MUK to perform the distribution activities for software services to be performed

by Mastek 'on-site' and 'off-shore' Vide said agreement MUK was therefore appointed as a distributor. The international transaction entered into between Mastek and MUK were summarized before us as follows:-

Sr.No.	*Nature*	*Value (INR)*
1.	*Software services (distributed by MUK)*	*2,993,335,552*
2.	*Common Infrastructure Costs – Cost Allocation paid/payable to MUK*	*11,579,249*
3.	*Reimbursement of expenses received/receivable from MUK*	*14,524,952*

12. Since it was a high volume of turnover, therefore the AO has also enquired about the **risk profile of MUK.** A discussion was that on account of increased business there should be increased competition. It was explained to the Revenue Authorities that MUK is the customer facing entity. Because of that position in the market in UK, the MUK had also assumed market risk. Likewise, the credit risk, vis-à-vis customer, was assumed by MUK, whereas Mastek has assumed the credit risk vis-à-vis MUK. An another feature in this regard has also been brought on record that MUK had obtained borrowing limits from Bank in India. That borrowings were after the issuance of guarantee to the Bank by Mastek. But in return MUK has given performance guarantee. All these information, thus indicated that MUK has acted as a distributor and not merely a front office concern of MIL. We can therefore hold that only one criteria of fixed percentage of compensation/ award agreed to be given to MUK must not be measured as a sole criteria to interrupt the status of MUK from "Distributor" to " selling agent".

13. There was an objection that due to the change in the business model, there was a fall in the profits of MIL from 26% to 12%. In this regard, a vehement contention was made by ld.AR Mr.Soparkar that on one hand, the Revenue has argued that there was no significant change in the business model and on the other hand, Revenue has alleged that there was a fall in the profit due to change in the business model. It was explained that due to change in the business model, there was also a change in the profitability. According to ld.AR, there was **an overall increase in profit due to increase in turnover** and that the said change has resulted into excess profit of MIL group. Due to the change in the business model, the entire 'on-site' revenue, approximately it was stated to be Rs.150 crores, was accounted in the books of MIL. And that on account of the UK operations, the profits have been increased in Indian Rupees from 45 crores to Rs.51 crores. The percentage of profitability was low simply because of increase in denominator, but there was no shifting of profit from MIL to MUK. Otherwise also it is a general market phenomenon that whenever there is high turn over there is decline in profit ratio so as to sustain the market competition as also to garner more business. This universal realty thus supports the stand of the appellant.

14. An another argument has also been raised that there was no advantage in shifting of profit from India to UK. A vehement contention was raised that once the entire income of MIL is subject to special benefit as prescribed u/s.10A and there was NIL incidence of tax, then there was **no justifiable reason to park the profits in UK.** It was informed by the ld.AR that in UK the assessee would suffer tax @ 30%, hence there was no logic to shift the profit. At that juncture, ld. CIT DR Mr.V.K.Gupta

has referred Aztech Software & Technology Services Ltd. reported as (109 TTJ 892) (107 ITD 141)(Bang)(SB) for a legal proposition that any adjustment on account of transfer pricing would not qualify for the special benefit prescribed u/s.10A of I.T. Act. Ld.AR has opposed and pleaded that once the transaction was ALP transaction, then there was no requirement of any adjustment and hence there was no requirement of rejection of benefit of section 10A of I.T. Act. This argument has force because by applying a very common logic no business man will shift the profits from a country where such profits are exempt or having lower incidence of tax. Rather Revenue was unable to answer the question that why at all this assessee has shifted its business profit to UK where rate of tax is said to be 30% as against NIL rate of tax in India. Naturally, the decision of **Moser Bear India Ltd.** vs. Addl.CIT 316 ITR 01(Delhi), **Global Vantedge Pvt.Ltd.** (2010) TIOL-24 (ITAT-Del)(1 ITR 326(AT) and **MSS India Pvt.Ltd.** (2009) TIOL 416 (ITAT-Pune) are worth for reference.

14.1. This very question had raked up in the case of ITO vs. **M/s.Zydus Altana Healthcare Pvt.Ltd. (2010-TII-29-ITAT-MUM-TP)** that where assessee's income is exempt u/s.10B, whether the TPO was justified in taking higher mark-up than the one declared by the assessee. In the said case, in regard to clinical trial services performed by the assessee, the TPO after examining the various aspects, concluded that the mark up to 5% over cost was not as per arm's length price and as per TPO the same should have been 17.14% on the basis of comparables. The assessee had adopted Transactional Net Margin Method (TNMM) and in order to examine the appropriateness of this method the TPO resorted to Comparable Uncontrolled Price method (CUP) along with

TNMM.(Identical is position in the present appeal as argued before us.) The first appellate authority has held that 17.14% mark up was required to be adjusted before it could be made applicable for determining the arm's length price in regard to international transactions entered into by the assessee. When the matter was carried before the Tribunal, it was held that the profits were exempt u/s.10B and in no way benefitted by charging 5% mark up as against 17.14% fixed by the TPO and that the profits of the AEs being subject to tax out of country's jurisdiction, therefore there was no necessity for the assessee to transfer the profits in any overseas jurisdiction. We have also noticed that in **an unequivocal terms it is pronounced, quote " that since the profits by the AEs have been subjected to tax in the respective overseas jurisdiction, there was no necessity for the assessee to transfer the profits in any overseas jurisdiction" unquote.**

15. An another question is that merely because in terms of the Master Agreement the MUK has received a fixed compensation at 5.5%, whether it could lead to a conclusion that the said entity was a marketing or front office entity. Though undisputedly a legally binding agreement must not be disregarded but that agreement has to be understood and taken into account as a whole and not in piece-meal. A decision of **Abhishek Auto Industries Ltd. (2010 TII 54 ITAT Delhi TP)** has been referred. It is also worth to refer **Azadi Bachavo Andolan & Anr. 263 ITR 706 (SC)**. An another fact has also been brought that the MUK had prescribed commission to its employees on sales. The employees who have earned commission on sales have generated more revenue to MUK. The progressive figures of revenue generation during the year under consideration has been brought on record and informed

about the trend followed in the years to come in comparison to the revenue generation in the past. Since the MUK had made all endeavours and efforts to improve the revenue generation, therefore, in our considered opinion, it was not appropriate to characterize MUK as a 'marketing services provider' instead of a 'distributor'. In our humble opinion, MUK was rightly characterized as a distributor of services.

16. The TPO has discussed a comparability analysis to determine whether 5.52% return on sales achieved by MUK was at arm's length or not. The assessee has carried out a search analysis and identified certain **distributors of software products** , but considering assessee's business, it was expected to identify **distributors of software services.** There was a reference of T P Study Report. According to assessee, the said bench-marking was closest available instances, however, pleaded to apply the same, nevertheless, considering the constraints of the database used. It has been submitted that arithmetic mean of the profit margins of those comparables was 4.62% and considering the Proviso to Section 92C(2) of I.T. Act, the benefit of (+/-)5% range was available to the assessee. There was a reference of **OECD TP guidelines which states that emphasis is to be provided on functional similarities rather than on products similarities.** This observation of OECD is helpful to this assessee. The assessee has selected few comparables pertaining to the software industry. Those comparables were involved in distribution activities and can be said to be functionally similar, therefore there ought not to be any reason on the part of the TPO to reject such bench-mark. We are aware that the TPO had selected marketing services for bench-mark. He has identified certain comparables, but all were performing the operations in US. The arithmetic mean of those US marketing

comparables was 6.02% and thereupon the impugned adjustment were worked out by the TPO. However, as far as the question of adjustment based upon certain comparables are concerned, it is a well-known law that the same should be close to the facts of the case and nearest to the business model of the assessee. Naturally, if one has to select the comparables between UK and US bench-marks, then in the present case only UK bench-mark can be said to be most appropriate and most suitable comparable. **We, therefore, do not endorse the bench-marking of TPO being based upon US comparables**.

16.1. It is clear that arm's length price is to be determined by taking result of **comparable transactions** and those transactions must be in **comparable circumstances**. It is therefore required to have a proper study of specific characteristics of controlled transaction. It is also required that there should be proper study of functions performed so as to match the identical situations under which functions have been performed. Then risk profile is also required to be compared. We may like to add that there are so many perspectives which are required to be compared and in this connection the Hon'ble Courts have also suggested so, such as, comparison of functional profile, similarity in respect of assets employed and a thorough screening of the comparables etc. Hence, in the present case, it is necessary to consider an analysis that whether the **comparables** selected by the TPO had **analogous functional profile** to that of functional profile of the assessee. It is true that functional profile and assets & risk analysis was made available but that is to be correctly understood in the light of the nature of International transaction carried out by the assessee with the said AE. A similar problem was considered by ITAT Delhi Bench in the case of **Bechtel**

India Pvt.Ltd. vs. Dy.CIT (2011-TII-07-ITAT-DEL-TP) where the assessee stated to be engaged in the business of providing electronic data support service to AE and the difficulty arose that the said function was compared with the companies engaged in the business of development of software. So the question was that whether a minute examination of functional profile is necessary for the purpose of selection of comparables and the answer given was that functional profile must be first examine and after that proceed to select the comparables. Interestingly, in the present case now before us, comparables chosen by the assessee were discussed by the TPO and those were discarded. The basic reason for rejection of those comparables was that the companies those were quoted by the assessee were dealing in product distribution, whereas the TPO was of the view that the AE was nothing but "front office" of the assessee and simply engaged in marketing activity. In this context, we are of the view that in order to determine the most appropriate method for determining the arm's length price, first it is necessary to select the "tested party" and such a selected party should be least complex and should not be unique, so that prima facie cannot be distinguished from potential uncontrolled comparables.

17. We have also examined the exact nature of the adjustment as proposed by TPO on the basis of the figures involved. Total expenses of MUK was stated to be £ 82,11,483. The mark-up as per TPO was 6.02% i.e. 4,94,331. Hence, as per TPO only this much profit ought to have been earned by the assessee. As against that, the operative profit of MUK was 28,60,974. Therefore, as per TPO the excess operating profit transferred was (28,60,974 – 4,94,331) £ 23,66,643. Hence, as per TPO,

the MUK has earned excess profit of 23,66,643 and after converting the same into Rupees an upward adjustment was made. The figures as mentioned have been taken from the audited financial statement of MUK for the year ended 30th June, 2006. We have been informed that as per the P&L A/c. of MUK ended on 31/03/2006, the revenue was 4,98,26,033 and the Mastek billing was 3,82,63,673. The expenses, such as, administrative cost, selling, travelling, communication, etc. were 88,13,223. The total of the billing and the expenses was thus 4,70,76,896. This amount was deducted from the Revenue of 4,98,26,033 and the balance was the Operating Profit (OP) came to 27,49,137. This figure of OP is in fact 5.52% of the total revenue. The calculation of transaction has been further explained and in this connection paper book-II is referred wherein on page 306 there was a list of invoices raised on MUK. For example, for the month of July 2005 as per Mastek Invoice No.(MH-1030001) the invoice amount was 2450.82. However, the total revenue of MUK was 3333.78. The front office cost of MUK was 699.60. Thereafter, the Operative Profit of MUK was calculated as 183.36. This amount of OP is 5.5%. For the entire period, the MUK's operating margin was uniform at 5.5%. In this regard, invoices have been placed before us. On the basis of the said figures it was certified; after economic analysis; that "the most appropriate method" for the assessee was TNMM method. It has also been certified that the application of TNMM requires the selection of an appropriate Profit Level Indicator (PLI). The PLI measures the relationship between profit and cost incurred or revenue earned or assets employed. In the instant case, the Return On Sales (ROS) to bench mark the profit or return on the operations by MUK was selected to reliably measure the

income of the tested party. It was decided that the said revenue was earned had it dealt with uncontrolled parties at arm's length. As far as the Operating profit Margin (OM) is concerned, the ratio of operating profit to sales is normally a good indicator of total return to the business activity. This measure accounts for operating expenses as well as cost of goods sold and thus is less likely, than the gross margin, to be distorted by differences in functions or accounting conventions. In the instant case, the said ratio would be a good indicator of total return to the onsite business activity carried out by MUK. It would account for operating expenses as well as direct cost of conducting the said operations by MUK. In the instant case, MUK has been left with an OM of 5.52%. For justification of ALP the assessee has further argued in support of TNMM method, briefly described in the following para.

17.1. There is one more point that in determination of **arm's length price** in the present case, the dispute is, whether to be determined by **CUP(Comparable Uncontrolled Price) method** or by **TNMM (Transactional Net Margin Method)method** and what method would be accepted as the **most appropriate method? Reference made of Sec.92C(1) of the Act r.w.r.10B(1)(e).** However, all methods, such as TNMM, etc., other than CUP, are the methods that enable the determination of ALP on the basis of respective margins earned by comparable uncontrolled companies. The Regulations have been provided that where more than one price is determined by the most appropriate method, the ALP shall be taken to be the arithmetic mean of such prices. Therefore, ld.AR has suggested such an alternate practical

approach to arrive at such ALP. The same could be used to compute the arithmetic mean of margins of comparable companies and apply the same to the appropriate base of MUK to determine the ALP. The arithmetic mean of the margins of the comparable companies was obtained and bench-marking analysis was stated to be as under:-

Arm's Length OM

Particulars	*Percentages*
Arithmetic Mean of the comparable companies	*4.62%*
Median	*2.11%*
Upper Quartile	*3.59%*
Lower Quartile	*0.68%*

We have been informed that in respect of the software services distributed by MUK, after the amounts received by Mastek, the MUK was left with an OM operative margin of 4.62% or less for such transaction. But in the instant case, MUK was left with an OM of 5.52%. Since it was better, therefore the impugned international transaction between Mastek and MUK can be held an Arm's Length transaction. If on examination of facts and figures the situation is that the comparisons do not give a clear picture rather they skew the result, then such results cannot be considered as the representative of the industry. Rather, we may like to comment that the DRP being a high-power and highly qualified consortium of high-ranking Revenue Officers, therefore their order should be precise on the issues raised and must not be lacking in reasoning. Though the present order of the DRP cannot be said to be a laconic order or a cursory order but devoid of precisely handling the issues raised by the TPO and confronted by the assessee.

17.2. We are aware that the selection of comparables and selection of similar transactions is not easy to find out and a difficult task to pick up exactly identical business model. Only an endeavour should be made so that the comparables should match with the assessee as close/near as possible. In the case of **Schefenacker Motherson Ltd. vs. ITO (2009-TIOL-376-ITAT-DEL) :: [123 TTJ 509]** an observation has been made that a similar transaction is not easy to find. An attempt is to be made to find entities carrying similar functions. Their profit margins or the mean of the such profit margins is required to be taken into account and, therefore, required to be compared with the profit margin with the "tested party". FAR has been suggested as a step to achieve such target. It has been suggested that if there are differences between the selected comparables and the tested party, then such differences can also required to be adjusted. The object of T.P. proceedings is to compare like with like and to eliminate suitable differences. For the purpose of arriving at a fair amount of adjustment; in the case of **Skoda Auto (India) Pvt.Ltd. 122 TTJ 699(Pune),** it was opined that if external CUP method is found to be irrelevant, then internal CUP can be made the basis for adjustment, if any. It has been suggested that the ALP should be arrived at with such adjustment which compare itself with the functionally similar companies. A reference was made by the Bench of Rule 10B(3) which provides that "an uncontrolled transaction shall be comparable to an international transaction if (i) none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open maker; or (ii) reasonably accurate adjustments can be made to eliminate the

material effects of such differences". We therefore add that the business strategies must also be examined in determining comparability for transfer pricing purposes. If the business model are fundamentally different, then naturally no comparison is possible. The right recourse thereafter is that the impact of differences be eliminated so as to arrive at a most near comparison. In respect of the adjustments in the case of **Sony India Pvt.Ltd. [(2008)–118-TTJ-Delhi-865]** the observation is that, quote "while comparing controlled and uncontrolled transactions or enterprises, one has to look for the differences and whether such differences are likely to affect the price, cost charged or paid or profit arising from the transaction in the open market. It has further to be examined whether a reasonably accurate adjustment can be made to eliminate the material effect of the differences between the transactions or entities. If a reasonably accurate adjustment for the difference to eliminate material effect of the differences cannot possibly be made, then such comparables (uncontrolled) are to be rejected" unquote. While deciding the case of **Mentor Graphics (Noida) Pvt.Ltd. 122 TTJ 408** [Del.], the guidelines given were as under:-

> *"The first step in the determination of arm's length price is to analyse the specific characteristics of the controlled transaction whether it relates to transfer of goods, services or intangibles. Without proper study of specific characteristics of controlled transaction, no meaningful comparison or location of comparable is possible.* ***For example, a mere consideration that controlled transaction relates to "software supply" is not sufficient as there are hundreds of softwares with different characteristics which materially affect their open market value.*** *The characteristics that are the property, its quality, reliability and availability (supply). In case of provisions of services, the nature and extent of*

services and where tangible property is involved for comparison, the form of transaction. To put it in other words, all the characteristics of the controlled transaction which are likely to affect its open market value must be taken into account. The study should include analysis of functions, risks and assets of the controlled transaction for correct location of similar or nearly similar characteristics in uncontrolled transactions. Specific characteristics are necessary to carry search of similar comparables with similar characteristics. After the selection of the comparables, best method of determining arm's length price is selected. ***Thereafter, functional analysis is carried to identify functions, risks and assets of uncontrolled transactions and comparison is carried with characteristics of the controlled transaction.*** *This is necessary to find whether comparables selected are really comparable and reliable. Comparison based on functional analysis includes economically significant activities and responsibilities undertaken or to be undertaken by the independent and associated enterprises. The structure and organization of the group and more particularly the judicial relationship between different entities of same group are to be seen. The function that needs to be identified while carrying comparison as per OECD guidelines includes design, manufacturing, assembling, research and development, servicing, purchasing, distribution, marketing, advertising, transportation, financial and management activities. It is also necessary to examine as to what is the principal function of the entities. The analysis of comparison should consider total aspects employed and assets used to earn profit.* ***The risk assumed by respective parties is a very important consideration.*** *It is a simple principle of economics that the greater the risk, the greater the expected return (compensation). If there are material and significant differences in the risk involved, then the comparables identified are not correct as appropriate adjustments for differences in such cases are not possible. Therefore, while performing searches for potential comparable companies, not only turnover and operating profit but functions performed and risk profile are to be considered. However, it can always be shown on the given facts of the case that comparables found are similar or almost similar to the controlled transaction and no adjustments are needed. It is useful to see the level of intangible assets in comparison to an*

appropriate base. Depending on facts of the case, final set of comparables may need to eliminate differences by making adjustments for the following : (a) working capital; (b) adjustment for risk and growth; (c) adjustment of R&D expenses. The risk not only due to human resources, infrastructure and quality which are normally taken into account yet more significant risks like market risk, contract risk, credit and collection risk and risk of infringement of intellectual property are being ignored here. If there are differences which can be adjusted, then adjustments are required to be made. If the differences between the companies are so material that adjustment is not possible, then comparables are required to be rejected. Further in the analysis numerous ratio are applied, depending on the specific of the comparables. The search may include the following: Inventory/sales; operating assets to total assets, fixed assets to total sales, fixed assets to number of employees, operating expenses to sale, cost of sales.- Aztech Software & Technology Services Ltd. vs. Asstt.CIT (2007) 109 TTJ (Bang) (SB) 892 ***relied on.***

(emphasis given) (Paras 26 to 27.3)"

It is important to note that in the said reported judgement, the "tested party" was developing specific software for its parent-company. The software developed by the tax-payer was used in-house for integrating the sale with other software components developed by itself. The whole software supported the hardware manufactured by the parent and sold as a package in the open market. The roll of the tested party has been that it has contract for software development and supports service provider. It was found that it was a "captive company". Most of the business risk, such as, contract risk, market risk, credit risk, warrantee risk, price risk, etc. specially borne by the AE. All intangibles including discoveries, improvement, inventions and trade-secrets conceived or reduced to practice, were the sole and exclusive property of the parent-AE. The taxpayer only maintained and developed necessary human

resources and infrastructure for development of software. The Bench has held that the above characteristics of the controlled transactions were not kept in mind by the TPO. **The Bench has even mentioned that when TNMM is applied to determine arm's length price as per OECD guidelines, functional profile, assets, assumed risk of controlled and uncontrolled transactions as per Rules are to be seen while screening.** Since it was found that there was wide difference, then it was held that it was a clear pointer to the fact that the method adopted by the TPO was faulty. Similarities and dissimilarities of the transactions under comparison are to be scrutinized to see differences of situations, circumstances and environment. Even it is evident from Rule 10B that while comparing transactions or even comparing enterprises if applying TNMM, the differences which are likely to materially affect the price, cost charged or paid, or the profit in the open market, all these points are to be taken into consideration with the sole idea to make a reasonable and as much as possible accurate adjustments. If the differences are such that they cannot be subject to evaluation, then such transactions are to be eliminated for the purposes of comparison.

18. In the light of the above discussion and the case laws cited, we are tempted to make certain observations in respect of the scheme of transfer pricing as it was enumerated in **Circular No.12/2001 dated 23/08/2001(251 ITR 15 (St.).** The provisions of Section 92 & 92A upto Section 92F have been enacted with a view to provide a Statutory frame-work which can lead to computation of a reasonable, fair and equitable profit and tax in India, so that the profits which are chargeable to tax in India do not get diverted elsewhere. These provisions have therefore laid

down certain rules to arrive at a ALP through the most justifiable method. Generally the allegation is that by ordering the prices charged and paid in intra-group transaction the *modes operandi* leads to erosion of tax revenue in India. Naturally, for the purpose of determination of arm's length price of an international transaction a very fair method has to be adopted and that our tax-payers must not be put to avoidable hardship in the implementation of these regulations. We have to keep in mind the preliminary objective as it was propounded vide a **Circular No.14 dated November 09,2001(252 ITR 65 St)** that Section 92 provides that if an income is arising from an International transaction between AE; shall be computed having regard to the arm's length price. Section 92 therefore only deals specifically with the cross boarder transaction and also prescribes an adjustment to be made to the profits of a resident. A distinction at this juncture has to be read that the relevant provisions provide for adjustment of profits rather than adjustment of prices. A general awareness is about the procedure that primary onus is on tax-payer to determine an arm's length price in accordance with the Rules. Section 92C provides the arm's length price in relation to an international transaction, which is to be determined by (a) comparable uncontrolled price method(CUP); or (b) resale price method or (c) cost plus method; or (d) profit split method; or (e) transactional net margin method(TNMM); or (f) any other method which may be prescribed by the Board. **The provisions of selection of 'comparable instances' is a very difficult procedure to apply in practice.** Even in the CUP method, the price of the services or the price of the goods is to be directly compared with the price of an uncontrolled transaction under similar conditions. But the similar conditions or the similar factors are generally

subject of controversy because of the dynamics, such as, turnover difference or the quantity difference or the geographical difference or the difference in the profiles, etc. etc. which do not match exactly with the business pattern of the assessee in question. **In a philosophical manner we comment that it is like searching two identical human beings, whether ever made by Almighty, on earth.** Therefore, while deciding such issue, in the case of Asstt.CIT vs. Dufon Laboratories (2010-TII-26-ITAT-MUM-TP), the Respected Coordinate Bench has concluded that due to lack of similarity with the comparable transactions, the transaction with the AE was at arm's length and that there was no case of making adjustment. Therefore the transfer pricing schedule of the assessee in the light of FAR analysis should be very accurate and ALP has to be determined of an international transaction in a very systematic manner and a fair adjustment has to be made.

The I.T.Act has otherwise adopted a very fair approach while drafting this Chapter and thus included Sec.92C(3) for the purpose that TPO has to communicate to the taxpayer which one of the four conditions prescribed in this section are satisfied which render the Transfer Pricing as void or not at an Arm's length. Rather **CBDT Circular No. 12 dated 23 Aug. 2001 (252 ITR 15 St.)** made clear to the A.O. vide it's clause (vi) that when an International Transaction has been put to a scrutiny, the recourse is to follow the four conditions as prescribed in Sec.92C(3) based upon the material information or document in possession, otherwise the value of the international transaction be accepted. Therefore in the case of Philips Software (119 TTJ 721) the observation is as follows:-

> *"5.1 We have heard the rival contentions and we proceed to adjudicate on the issues in the sequence which has been argued by the rival parties before us. The learned counsel for the assessee has argued that the tax payable by it in India is lower than the tax rate applicable to its AE in the Netherlands. Since the assessee is availing the benefit under s. 10A of the Act, one cannot take a simplistic view on the matter of tax avoidance. In this connection the learned Departmental Representative has drawn reference to the proviso to s.92C(4). Relying on OECD Guidelines, the Departmental Representative has mentioned that the consideration of transfer pricing should not be confused with the consideration of problems of tax avoidance, even though transfer pricing policies may be used for such purposes. In this connection, it was pointed out that by not declaring proper profits in India, the assessee is indirectly reducing its liability to DDT. The Special Bench of the Tribunal, in the case of Aztec Software (supra), has concluded that the AO/TPO need not prove the motive of shifting of profits outside India for making a transfer pricing adjustment. The assessee had generally argued that one of the factors driving any motive for shifting profits would be the difference in the tax rate in India and the tax rate applicable to the AE in the overseas jurisdiction.* ***In the instant case, since the assessee was availing the benefit under s.10A of the Act, it would be devoid of logic to argue that the assessee had manipulated prices (and shifted profits) to an overseas jurisdiction for the purpose of avoiding tax in India."***

18.1 Before we part with; a thought has bothered us that while dealing with the TP proceeding as prescribed under Chapter X of I.T. Act, why the help of Section 40A(2)(a) be not taken. This section also has a list of persons which are said to be related to the assessee or connected with the entity. So this section says that where an assessee incurs any expenditure in respect of which payment has been made to any person, as listed therein and the AO is of the opinion that such expenditure is excessive or unreasonable having regard to the fair market value of the goods, services, facilities for which the payment is made or the legitimate needs

of the business, or the benefit derived by accruing to him therefrom, so much of the expenditure as is so considered by the AO to be excessive or unreasonable shall not be allowed as a deduction. As far as the implementation of Section 40A(2)(a) is concerned, a series of judgement of several Courts are available. Those decisions have laid down the guidelines in respect of determination of an amount whether to be treated as excessive or unreasonable having regard to the fair market value of the goods. Even in the transfer pricing cases, Rule 10B and Rule 10C also indicate the same method as well as the analogy while relying upon or comparing the uncontrolled transaction. These Rules also prescribe that while comparing the international transaction, then conditions prevailing in the markets, functions performed, contractual terms, etc. etc. are the factors to analysis the comparability. Therefore, we express an opinion, though presently not the subject matter of dispute, that the case laws which are already in public domain in respect of deciding the disallowances made u/s.40A(2)(a) of the Act can be helpful. We have expressed this opinion because in a difficult Transfer Pricing case, primarily because of the complexity of the facts, even the best intentioned tax-payer can make an honest mistake and like-wise the best intentioned tax-examiner, may genuinely draw wrong conclusion . OECD TP guidelines thus suggest, first, tax examiners are to be flexible because precision may be unrealistic and , second, commercial judgment or business expediency or trade realities do play a vital role in the application of arm's length principle.

18.2. Under the totality of the facts and circumstances of the case, first we hereby hold that considering the FAR analysis, risk factor and the

business model as well as the terms and conditions of the Master Agreement incorporated in the light of the changed circumstances of UK, the AE, i.e. MUK has functioned as a distributor in UK. Once we have held so, then the question arises that the assessee has rightly reimbursed "front office" cost to MUK. We are of the conscientious view that the TPO has not raised any question or doubted the payment of "front office" cost. Next we hereby hold that if an agreement in its totality has not been held a sham agreement, then there was no justification to disbelieve one of the clause, in the present case, the clause of profit reimbursement of 5.5% to MUK. It was a mutual decision of the parties to the agreement to fix the percentage of profit for MUK. There is no hard and fast rule that a distributor always have a fluctuating percentage of profit. The TPO was not justified in collecting the data of alleged comparable instances which in fact were either advertising agencies or in business consulting services but not a distributor and then adopted arithmetic mean of 6.02% of profit which was used for computation of arm's length price. Such an adjustment was uncalled for so cannot be approved in the light of foregoing discussion. We also hold that prima-facie there was no reason to shift the tax burden to UK when admittedly there was no incentive or tax benefit to this assessee. The adjustment as made by the TPO is hereby reversed and, accordingly, the AO is directed to delete the impugned addition while computing the total income of the assessee. **This ground No.1 is allowed.**

19. **Ground No.2 reads as** under:-

> ***2. GROUND NO. 2 - Human Resource Management ('HRM') s Services/Secondment services***

i. The Ld. AO has erred in law and on facts in alleging the HRM function to be an international transaction and thereby making an adjustment of Rs.2,92,22,683.

ii. The Ld. AO has erred in law and on facts by not taking cognizance of the fact that the said issue has been decided in favour of the Appellant by the orders of the Hon'ble Commissioner of Income Tax (Appeals), Ahmedabad ['CIT(A)'] for assessment year 2005-06, 2004-05, 2003-04 and 2002-03.

iii. Without prejudice to the above, the Ld. AO has erred in law and on facts by disregarding the counter claims submitted by the appellant and the argument of making adjustment on a flat fee basis.

A) FACTS :

19.1. The observation of the AO was that the services rendered by the assessee were for the benefit of its Associate Enterprises by seconding employees. The seconding of employees has involved recruitment, training, re-allocation of personnel, re-absorption on return. **According to TPO, Human Resource Services were different from software development services.** Therefore, the TPO has decided to examine the quantum of services rendered and to determine the arm's length price of such services. As per the Function Asset Risk (FAR) analysis, the performance included recruitment and selection. The HRD carried out an analysis to determine the vacancies at various levels. Thereafter, *re'sume* of suitable candidates was obtained. After evaluating those candidates, they have been given general as well as technical training. According to TPO, the assessee was responsible for maintaining a pool of skilled man-power. The TPO has taken a view that it was clear from the functions performed that the assessee has performed **human resource function**. Therefore, according to TPO, it was essential to **bench-mark the**

Human Resource Services separately. He has observed that the direct quantitative indicator of the human resource management services rendered by the assessee to its AEs is the number of persons deputed by the assessee from year to year, on secondment basis. No doubt the services rendered by the assessee under the head "human resource management" is much more than merely providing manpower, as it is also responsible for training, performance evaluation, administrative functions etc. The assessee actually maintains a ready pool of skilled manpower from which persons are made available to the AE whenever required by them. The assessee in effect bears the bench cost for the whole group. However, the assessee should at least be remunerated for the service of providing suitable manpower as and when required by the AEs.

20. It was not in dispute that the assessee-company had regularly provided man-power to its AEs and in this regard TPO had noted the figures of secondees ranging from 279 persons in the month of March-2001 upto 444 persons in March-2005. The TPO had drawn a conclusion that the assessee had provided man-power on a regular basis to its subsidiaries located overseas. The manner in which the secondments were done was mentioned by the AO as follows:-

> *"(a) The AEs have its own pool of manpower. Over and above which it may sometimes require additional manpower of specified skills to undertake certain jobs. On such occasions, it may make a request to the assessee to provide required manpower.*
>
> *(b) The assessee then identifies suitable persons and second them to the AE location as per the requirements placed.*

(c) Once the persons are seconded, they cease to be on the assessee's payrolls. They are immediately shifted to the respective AEs payrolls, and hence their salary costs are borne by the AEs.

(d) After the secondment, the assessee has nothing to do with the work performed by the seconded employees. The entire on-site billings relatable to the work done by them, belongs to the respective AEs.

(e) The persons seconded may either be newly recruited employee or existing employees, of the assessee company.

(f) From time to time, the persons seconded may return to the payrolls of the assessee upon completion of the project for which they were sent abroad. However, there is no hard and fast rule in this regard. It is the discretion of the AEs to send back the employees depending upon their ability to absorb them with adequate work.

20.1. The assessee's contention was that the said HRM function was not a separate function and it was a part of the software services. The assessee has explained that there were two different types of transactions, **first one,** providing software services to the clients through AEs. For this services, charges are to be made by the clients through AEs for the software services. The **second one** is, providing man-power including technical man-power to AEs for carrying out their work as an independent entity. For this purpose, assessee-company provides the man-power out of its own pool of man-power. Seconding of these employees from existing assessee's business thus effects its Bench-strength and the assessee is in turn is required to recruit further man-power to fill up the gap. It is also common that those seconded-personnel may return, after the agreed time, back to assessee-company,

however at the time of return those employees become the employees of the assessee-company. It has also been explained that during the period of secondment the assessee had to perform certain administrative functions regarding those employees. On the other hand, those AEs are responsible only for payment of the employment cost of the seconded employees and AEs are not responsible to pay for related expenses. As per TPO, due to the said reason that the assessee-company had to incur certain administrative expenses, therefore required a mark up for the secondment of employees. Therefore, TPO has expressed that arm's length test is to be applied for such integral services. According to him, in similar type of cases where in-bound seconded employees has been received by the related party, then besides paying employment cost a 20% mark up has been considered for the purpose of covering such administrative work. He has, therefore, expressed that in respect of the secondment function carried out by the assessee a mark up element for computing arm's length price is required. Due to non-charging of any mark up in respect of the services rendered for secondment of man-power a mark up at 9% of the total annual salary was applied in respect of the persons seconded. He has noted that the assessee had paid 8.33% to other recruitment agencies. The annual salary was taken as the comparable uncontrolled price and the arm's length price was determined as follows:-

Total No.of persons seconded	*148 (In nos)*
Total Annual Salary	*Rs.32,46,96,487*
8.33% of annual salary if the person seconded	*Rs.2,70,47,217*
Arm's length price for the human	*Rs.2,92,22,683*

resource Management services	
Adjustment to the total income (i.e. income to be increased)	*Rs.2,92,22,683*

21. As far as the opinion of the ld.**DRP** is concerned, it was observed that since the assessee itself has paid 8.33% of annual salary to other recruitment agencies, **therefore the CUP method applied by the TPO was correct.** An argument was raised before the DRP that as against 148 employees which were seconded during the F.Y. 2005-06, out of them, 92 employees had returned back to assessee-company. Hence, it was argued that those employees were the responsibility of the assessee. Sometimes, such employees add to the idle bench-strength of the assessee. It has also been mentioned that in the earlier Assessment Years such an addition was deleted by the CIT(A). The DRP was not convinced and held that the assessee had kept a pool of skilled and trade employees keeping in view the secondment requirement of the AEs. Therefore, such function of the assessee is a separate from its core business activity of providing software services. According to DRP secondment services are used by the AEs and therefore those services should be compensated to the assessee as per arm's length principle. It was therefore held that the TPO was justified for the said adjustment. Now the assessee has challenged the observation of the Revenue Authorities.

B) ARGUMENTS :

22. At the outset, ld.AR Mr.S.N.Soparkar has drawn our attention on an **Additional Ground**; reproduced below:-

1. The Learned Transfer Pricing Officer, and consequently the D.R.P. and the Assessing Officer, have no jurisdiction to make any adjustment in relation to any item other than covered under Ground 1 of the appeal memo in as much as the same were not subject matter of Reference made to the Transfer Pricing Officer under section 92CA(1) of the Income Tax Act, 1961."

23. From the side of the Revenue, ld.DRs Mr. V.K. Gupta and Mr. Kartar Singh have vehemently objected that, while seeking approval, the said transaction has duly been communicated and it is incorrect on the part of the assessee to raise an objection in this regard. Ld.DRs have referred a letter dated 31/08/2009 in this regard which was an internal correspondence, relevant portion is extracted below:-

"2. In addition the transactions mentioned in the above letter, perusal of records reveals that the assessee has made further payments to associate enterprise in respect of HRM Functions and has also allowed credit period for amounts outstanding with its associate enterprise which tantamount to making finance available to such enterprises for the duration of the credit period.

These transactions are not mentioned in Form 3CEB furnished by the assessee. It is requested that the above issues may also be taken up while determining arm's length price in relation to the international transactions".

24. Having heard the submissions of both the sides and after examining the record, we are of the view that the subject matter as disputed in Ground No.2 was well within the jurisdiction of the TPO. According to us, the TPO had acted as per the provisions of section of section 92 of the Act and he has not acted beyond jurisdiction. We, therefore, **dismiss this**

additional ground and adjudicate the main ground, i.e. Ground No.2 hereunder.

24.1. On merits, ld.AR Mr.S.N.Soparkar has stated that the assessee is providing 'offshore' software development and related services. Simultaneously, the AEs are providing 'onsite' software development and related services. To enable AEs to provide 'onsite' services to their customers, the assessee is sending the employees 'offshore'. Such secondment of employees brings back more 'offshore' work to the assessee. The result of such secondment of employees could be seen from the fact that there was remarkable increase in 'offshore' revenue generated from UK. Ld. AR has also argued that MIL cannot be termed as a recruitment agency. The MIL has more than 3000 employees on its pay roll, however, only 148 persons were sent abroad on secondment for temporary period. Ld.AR has also informed that out of them about 92 employees have returned back during the year. He has also informed that the secondment period ranges from 12 to 24 months. He has therefore vehemently argued that such HRM function was nothing but an integral part of software business. He has vehemently opposed the view of the TPO that such HRM function was a separate service for which an added cost should have been charged by MIL from its AEs. **The Ld.AR has highlighted that the said matter is covered in favour of the assessee by the orders of Ld. CIT(A) for the AY 2005-06, AY 2004-05, AY 2003-04 and AY 2002-03.** For all these assessment years, the Hon'ble CIT(A) have deleted the disallowance as regards human resource management function. Ld.AR has concluded that it was not appropriate on the part of the TPO to regard HRM function as

"recruitment services". The assessee has not acted as an external recruitment agency. He has argued that the TPO has considered the third party rate paid by MIL during the financial year 2004-05 (viz.8.33% of the annual salary paid by the associated enterprises to its employees) to other recruitment agencies as the benchmark and on a presumptive basis used 9% determining the arm's length compensation on the ground that assessee incurs certain administrative costs in relation to providing HRM services. This would mean that the TPO has regarded Comparable Uncontrolled Price Method ('CUP') as the most appropriate method. Application of CUP method requires stricter comparability between the controlled and uncontrolled transactions. In order to draw the comparability, the provisions of the Rules 10B(2) and 10B(3) need to be considered. He has referred transfer pricing guidelines issued by Organisation for Economic Cooperation and Development (in short OECD) and mentioned that the business strategies are required to be examined in determining comparability for transfer pricing purposes, such as, product development, innovation, input of existing and plant labour loss, etc. and such business strategies may need to be taken into account when determining the comparability of controlled and uncontrolled transactions. He has also stated that HRM function are altogether different "function of recruitment service provider". He has stated that a critical difference is that the assessee in HRM function gives training to the employees. As against that, a **recruitment provider** do not give any training. The assessee also provides constant update post recruitment. He has therefore pleaded that one must appreciate that such factors ought to have been considered for judging the comparability. The comparability as attempted by TPO was therefore not relevant. He has

also alternatively pleaded that at any rate the 9% cost plus was towards higher side. Rather, he has alternatively pleaded that since 92 employees have returned back, therefore assessee should be given the credit for the counter claim. For the purpose of reference to OECD case law relied upon was **Cheminova India Limited (2007-17-SOT-453-Mumbai).** In respect of the alternate suggestion of adjustment, he has placed reliance on **Boston Scientific International BV – India Branch (2010-TII-16-ITAT-MUM-TP).** Finally, ld.counsel made a point that even if MIL was to charge for secondments, then the income would otherwise exempt u/s.10A of I.T. Act being inextricably linked with the main activity of software development services.

25. From the side of the Revenue, ld.DR has supported the action of the AO. He has pleaded that the services rendered by the assessee under HRM function is quite broad in nature and such recruitment, selection, training, etc. should be properly compensated. Ld.DR has harped upon the point that MIL has in fact maintained a bunch of qualified persons and on requirement seconded them to AEs and if need be called back to India and if need be again reabsorbed by AEs. For this facility, the assessee should have asked for a margin of profit to arrive at the arm's length price of this transaction. In respect of the compensation computed; ld.DR has mentioned that the direct quantitative indicator of the HRM services rendered by MIL is the number of persons deputed by MIL on yearly basis. He has also vehemently pleaded that the 'offshore' activity and 'onsite' activity cannot be segregated and both the activities go hand in hand. According to him, the AEs have derived valuable benefit of availability of technical persons as and when required, hence

for providing this facility the assessee-company should recover the compensation at arm's length price.

C) FINDINGS :

26. We have heard both the sides at length. We have perused the orders of the Revenue Authorities in the light of the voluminous compilation filed. It is true that the assessee is engaged in providing 'offshore' software development. The Associate Enterprises are also in the business of providing related services for software development 'onsite'. Facts have revealed that for enabling the AEs to provide 'onsite' service, the assessee has seconded its employees to those AEs.

26.1) To deal with this problem it is better to first examine the correct meaning of this notion i.e. **" Secondment"** and have found that a 'secondment' takes place when an employee or a group of employees are temporarily assigned to work for an another organization. The 'secondment' is a practice through which one entity makes the services of it's employee/ employees available to another entity for a short period of time , while continuing to treat that person as it's employee either by remunerating him or by not removing from the roll of employment. Possible reasons for the 'secondment' are viz. career development, to gain new skill/ experience, enabling such employee to remain with the parent-employer so as to preserve benefits such as pension benefit etc., income generation for the parent-employer, to provide cover for off-shore short term projects, to provide cover for short term absence etc. The idea behind a' secondment arrangement' is that the **'secondee'**(the employee) will remain employed with the **'seconder'**(the parent or seconding-employer) during the period of secondment and following the termination of requirement of the 'host' (the other absorbing unit) such

persons 'return' to the 'seconder'. The benefit of such arrangement is the continuity of the employment. The 'secondee' remains employed by the 'seconder' so that the statutory period of continuous employment remain unbroken, to qualifying for pension or other employment rights. The payment of fees or remuneration depends upon the 'secondment agreement' from party to party, but the primary liability is of the 'seconder'. Now the argument is that by such secondment of trained employees, in return, the assessee has substantially been benefitted and because of the 'onsite' services provided by AEs, in the result, there was more 'offshore' work was generated for the assessee. As far as the assessee is concerned, its 'offshore' revenue has admittedly increased. A fundamental question has cropped up because of TPO's decision that whether the HRM function can be said to be an integral part of the overall software development services of the assessee? If we consider the overall scenario and the globalization of such services, then what is apparent is that the entities which are in the business of software development have to engage technically expert employees. Those employees perform their duties 'onsite' as well as sometime 'offshore'. Such entrepreneurs provide cushion to those employees if they have been sent abroad for an 'onsite' deployment. Whether it was justifiable on the part of the TPO to hair-split these two activities? As far as our common understanding of the business model of this assessee is concerned, as also the prevailing business pattern all over the world is concerned, the deployment of Human Resources is inter-linked with the business activity of the assessee, then such HRM activity can be said to be the intricately linked activity with the main business activity of an entrepreneur. Reason being, in the present case, software development

services cannot be performed independently or in isolation with the deployment of technical persons. In such business model, there is an established existence of AEs abroad. Those AEs generally demand for supply of technical employees/engineers so as to accomplish the software development project 'onsite'. Such facility is provided by the Head Office, i.e. MIL. In return, MIL has also heaped the prize i.e. high revenue generation . By displaying different FAR, the TPO had made an attempt to distinguish the two activities. Nevertheless, the law prescribes that FAR should be appropriately documented, so that the correct figures is in the knowledge of the Revenue Department.

26.2. As far as the commercial and business expediency is concerned, we have been informed that the **ld.CIT(A) in past four years has decided this issue in favour of the assessee.** It was held that in the business interest of the assessee to second its employees to its AEs, the MIL has seconded the employees. However, the allegation of the TPO is that the AEs have been benefitted from such secondments. Be that the position, even if it was so, that an Associate Enterprise is benefitted, then there should not be any scope to draw an adverse inference that MIL should also snatch the profit out of the pockets of AEs. As long as the MIL has got his pound of flash and disclosed better revenue generation, there should not be any objection to the revenue.

26.2. As far as the non-mentioning of HRM function in Form No.2CEB is concerned, a clarification has been given that no international transaction of HRM services had actually been carried out with any of the AEs in respect of secondment of employees, hence there was no question about reporting the same in the said prescribed form. The expenses in relation to performing the HRM function are stated to be

entirely incurred and borne by MIL. Expenditure on training is also borne by MIL. Those were not recruited on the basis of any request of AEs. At the time of recruitment there was no surety given of their off-shore appointment immediately but they could be seconded at a later stage. Hence at first instance, none of the expense relate to the employees was meant for sending them to AEs. The purpose of recruitment at the first stage is their in-house absorption. No part of the expenditure was on behalf of AE hence there was no transaction which could be alleged as International Transaction. We find this explanation a reasonable explanation because admittedly there was no international transaction with AEs for charging the HRM services but the TPO had made out a case that there ought to be some mark up and hence he has opined for an addition in the total income. There was no such case that an upward adjustment was recommended by the TPO in respect of an international transaction already executed between the parties..

27. The assessee has made out a case that by such an arrangement of sending the employees to AEs, in return assessee has also been benefited. Employees, after returning, are with upgraded skills, better experience, update knowledge and with a better delivery skills. This is one part of the advantage and the other part of the advantage happened to be procurement of "offshore" business in high volume. We are therefore of the view that the comparability analysis as carried out by the TPO do not match with the facts of the case. **It is not appropriate to hold that HRM function as carried out by this assessee is to be taken as recruitment services.** We therefore hold that the assessee was not functioning as an external recruitment agency. At the cost of repetition, while arguing before us, the ld.DR has supported the action of

the TPO primarily on the ground that by the deployment of skilled engineers at the services of AEs, those AEs have been benefitted, hence, in return, the assessee should have recovered some compensation on secondments. It is not a correct approach because one has to examine the business strategies and the business model of an Enterprise and if it is found that other benefits are much higher than the small amount of compensation, then naturally applying a common business acumenship, no compensation or mark-ups should be asked for. In the present case as well, facts and figures have revealed that following the said business strategy the business growth as a whole was much higher than the impugned compensation amount. This allegation is also to be ruled out that those very employees were otherwise regular employees of the assessee-company and they have been absorbed after their return for the period for which they were sent abroad and worked "offshore" with AEs. It is true that such employees are the regular group of experts but they have been paid by AEs when worked on-site abroad, which means the burden of salary for the "offshore" period was in fact borne by AEs, otherwise to maintain bunch of trained employees the MIL had to incur the expenditure on salary. Therefore, there was an argument of counter claims and in support reliance was placed on Boston Scientific International VV (210-TII-16-ITAT-MUM-TP). **For these reasons we also hold that the secondee-provider is not akin to recruitment-service-provider or that "secondment" is different from "recruitment".** Finally, we hold that there was no legal basis for the impugned upward adjustment and the same is hereby directed to be deleted. **This ground is allowed.**

28. **Ground No.3** reads as under:-

> ***3. GROUND NO. 3 - Interest on account of excess credit period to AE's:***
>
> *i. The Ld AO has erred in law and on facts in alleging the credit period granted to the AE's as an international transaction and made an adjustment of Rs.1,122,281 by charging notional interest on excess credit granted to the associated enterprises.*
>
> *ii. The Ld. AO has erred in law and on facts by not taking cognizance of the fact that the said issue has been decided **in favour of the Appellant by the order of the Hon'ble CIT(A) for assessment year 2005-06 and 2004-05.***
>
> *l. The Ld. AO ought to have appreciated that:*
>
> - *the appellant has not charged any interest to the third parties even though the payments have been received beyond the normal credit period;*
> - *the appellant has not paid any interest to the third parties for services, if any, availed and the payments would have been made beyond the normal credit period;*
> - *the appellant is a zero debt company having no borrowings from external sources;*
> - *this is an Industry practice, which is followed by your appellant.*
>
> *iv. Without prejudice to the above the Ld. AO / the Additional Commissioner of Income-tax, Transfer Pricing-l, Ahmedabad.('Ld. TPO') has erred in law and on facts by disregarding the appellant's counter claim for recoveries made before the credit period of 60 days.*

28.1. The TPO had observed that the assessee had granted excessive credit period to its AEs. According to him, normal credit period is 60 days, however, it was noticed that the assessee had granted credit period above 60 days. **The TPO was of the view that the assessee should have charged interest @ 6.65% on account of excess credit period granted to AEs.** A working was called for from the assessee and on

that basis the TPO has asked the AO to make an adjustment of Rs.11,22,281/-.

28.2. When the matter was discussed before DRP, the action of the TPO was affirmed with the finding that the AE had retained the sale consideration beyond a stipulated time, hence, the assessee was entitled for compensation in the form of interest.

28.3. Ld. AR Mr.S.N.Soparkar stated that though a working was provided to TPO but that was made only to comply with the directions but there was no concession or acceptance was offered. As far as challenging the jurisdiction of the TPO is concerned, the same has already been dismissed by us in above paras. Ld.AR has informed that MIL is a debt free company. The company had issued paid up and subscribed capital of about Rs.7 crores. The company has reserves of Rs.198 crores. The company has no unsecured loans. The bank charges or lease rentals and financial cost was only Rs.25 lacs. It is not the case that the assessee has charged interest for late payments from any other party. Likewise, the assessee has also not paid interest to its suppliers for any such delay in payment. Non-charging of compensation of interest is stated to be the market practice of this Industry. Referring one of the guidelines of OECD (para 1.29), it is prescribed that no interest could be charged on delayed payment on commercial consideration for ensuring a long and healthy relationship. It is observed that only in the event of severance of relationship, parties do resort to charging of interest. Rather, in the case of **Nimbus Communications (211 – TII – 03-ITAT-Mum-TP)** it was held that an outstanding debit balance from AE is not an International transaction *per se*. An another argument has also been raised that MIL sometimes used to receive payment from AE prior to the

stipulated period of 60 days and in that case, no interest has been paid on such proponed payments received. For this counter claim, reliance was placed on **Boston Scientific International Transaction BB (210 TII – 16- ITAT-Mum-TP).** In the past for A.Y. 2005-06 and A.Y. 2004-05, a view has already been taken by ld.CIT(A) in favour of the assessee, ld.AR has informed.

29. From the side of the Revenue, ld.DR has supported the action of the TPO. Rather, we have enquired the position of recovery by AEs that whether third parties have made late payments, but that question could not be answered by the Revenue.

30. Once it is an admitted fact that the MIL is a debt free company and that there was no interest burden on the assessee, then it cannot be justifiable to presume that the borrowed funds have been utilized to pass on that facility to AEs. Revenue has also not brought on record that the assessee has found paying interest to its creditors or its suppliers on delayed payments. The moot question is that in deciding this issue; a commercial consideration and market practice has to be taken into account. Naturally, even as per the OECD(TP) guidelines, now worth mentioning, it has been subscribed that to ensure a healthy relationship and to maintain a long business transaction, such compensation or charging of interest are being ignored commonly by business man. We cannot ignore this fact as well that in past few Asst.Years, such an adjustment was overruled by ld.CIT(A). It was a correct decision that a business and commercial consideration have to be looked into and one cannot apply arm's length method to say that the assessee ought to have earned the compensation from the AE. Rather, during the course of proceeding, it was enquired by us whether it would be relevant to see if

the AEs have received the funds from the third parties within reasonable credit period and whether the transaction as a whole need re-consideration. If the AEs have not charged interest to third parties for late recoveries, would it be reasonable to expect MIL to recover the interest from the AEs. Likewise if MIL is not paying interest on advance/ preponment of payment to AE then was it justifiable to levy interest on few days delay? In response to this, the Ld. DR has stated that since MIL and its AEs were undisputedly dealing on a principal to principal basis, so it would not matter whether the AEs have recovered the same from their customers. This argument is not appropriate in our humble belief. If the AEs are not recovering interests from third parties for late recoveries, then in the instant case it would be too much to expect the assessee to charge the interest from the AEs. There is no rationale to inflict upon the assessee, merely on presumption, that he ought to have charged the interest from it's AEs. We therefore hold that there was no justification to presume that there was a shift of profit to avoid tax in India. **This ground is allowed.**

31. **Ground No.4** reads as under:-

> ***4. GROUND NO. 4 - Excluding exchange fluctuation gain while computing deduction under section 10A of the Act***
>
> *The Ld. AO has erred in law and on facts in* ***excluding Rs.1,03,82,636 being gain on account of exchange fluctuation from profits of the eligible unit, while calculating deduction under section 10A of the Act****. The Ld. AO ought to have appreciated the following facts:*
>
> *i. The exchange fluctuation gain accruing on account of change in the rate of foreign currencies is having intimate connection with the export business and thus, eligible for deduction under section 10A of the Act.*

*ii. The aforesaid issue has been **decided in favour by the Hon'ble CIT (A) in appellant's own case for earlier Assessment Years ('AY's) viz. AY 1999-2000 to 2005-06** and the same has been confirmed by the Hon'ble Income-tax Appellate Tribunal - C Bench, Ahmedabad ('ITAT') for earlier AYs 1999-00 and 2000-01.*

31.1 The opening remark of the AO was that while calculating the deduction u/s.10A of IT Act, the assessee has reduced the amount of "other income", however, not reduced "foreign exchange gain". Therefore the AO has issued a show-cause notice to restrict the claim of deduction u/s.10A by the amount of foreign exchange gain. In compliance, assessee has submitted that the assessee is in export of software development and the change in the rate of foreign currency has intimate connection with the export business activity. The accounting entry for exports are generally passed on that date when the invoice are made. On the date of the invoice, as per the prevailing exchange rate, entry is recorded in the account. However, the export proceeds are generally realized after the gap of sometime. The gain in exchange rate is therefore recorded on the date of realization. The said difference is duly accounted for in the books of accounts as "exchange rate difference". Few case laws have also been cited as follows:-

"1.Decision of the Hon'ble Chennai ITAT in the case of Changepond Technologies P Ltd v. Assistant Commissioner of Income Tax Circle 1(3) (2007) (22 SOT 220)
2. *Decision of Hon'ble Ahmedabad ITAT in the case of Gami Exports vs. Assistant Commissioner of Income Tax (2005) (94 TTJ 557)*
3. *Decision of the Hon'ble Gujarat High Court in case of Hindustan Trading Corp. 160 ITR 15*

4. *Decision of the Hon'ble Mumbai ITAT in the case of K. Uttamlal Exports v. DCIT [2004] (133 Taxmann 196)*
5. *Decision of the Hon'ble Delhi ITAT in the case of Smt. Sujata Grover v. Deputy Commissioner of Income Tax (2001)(74 TTJ 347)*
6. *Decision of the Hon'ble Mumbai ITAT in the case of CMC Limited, Mumbai v. The DCIT, Spl.Range – 36, Mumbai (ITA No.4811/Mum/1998)."*

31.2. The AO was not convinced and held that on perusal of computation of deduction u/s.10A, it was noticed that the assessee has himself reduced "interest on deposit", "dividend income", etc. from the eligible profit of the business for section 10A deduction. However, the assessee has not excluded "foreign exchange gain". According to him, for the purpose of section 10A, profit derived from export business are eligible. According to him, "foreign exchange gain" was not the profit derived from export business. The AO has also referred a decision of ITAT Ahmedabad pronounced in assessee's own case for A.Y. 2002-03 for the proposition that in respect of "other income", the stand of the Department for the purpose of computation u/s.10A was upheld and held as not allowable. However, in respect of the issue of "exchange gain" the **Tribunal has held that the "exchange gain" is a part of the export business of the assessee.** Against the said decision, the Revenue had preferred an appeal before the High Court, consequently, the AO has held that the "foreign exchange gain" is not to be allowed as a deduction while computing the amount u/s.10A of IT Act. The AO has recomputed the deduction u/s.10A of Rs.72,98,75,878/-.

31.3. Before the DRP, it was explained that in respect of "foreign exchange fluctuation gain" of Mahape Unit of Rs.1,03,82,636/-

the same was eligible profit being derived from the export business. The DRP was not convinced and after discussion in the light of Woodward Governor India (P.)Ltd. 312 ITR 254(SC), Pandian Chemicals 262 ITR 278 (SC) and Sterling Foods 237 ITR 579, it was observed that for the purpose of claiming deduction u/s.10A, it is not only required to establish that it was business profit of an Industrial Undertaking but also required to establish that such profits are derived from the business activity of that Industrial Undertaking. Further, a decision of Cambay Electric Supply Industrial Co. 113 ITR 84 has also been cited and finally held that the gain on "foreign exchange" was not eligible for deduction u/s.10A of I.T. Act.

CONCLUSION:

31.4. After hearing both the sides, in brief, in respect of this legal ground in the light of the facts narrated hereinabove, we have noticed that the issue stood decided in favour of the assessee vide an order of ITAT "C" Bench Ahmedabad bearing ITA Nos.2762/Ahd/2003 & 09/Ahd/2004(By Revenue), ITA Nos.1688 and 4352/Ahd/2003 tiled as M/s.Mastek Ltd. vs. Asst.CIT for AYs 2000-01 & 1999-2000, dated 17/06/2008 and finally held as under:-

> *"16.4 As regards income on account of exchange rate fluctuation,* ***Hon'ble Gujarat High Court in the case of CIT Vs. Amba Impex 282 ITR 1445(Guj) h****eld that merely because an amount is received in a year subsequent to the year of export by way of exchange rate difference, it does not necessarily always follow that the same is not relatable to the exports made.* ***The ITAT in the case of Renaissance Jewellery (P.) Limited vs. Income-tax Officer, Ward 8(3)(3), Mumbai 289 ITR SP 65 (Mum.)*** *held that the profit on account of foreign exchange gain is directly referable to the articles and things exported by the assessee. Such profits are, therefore, of the same nature as the sale proceeds and there is*

no reason as to why deduction under section 10A should not be allowed in respect of such exchange gain. No contrary decision has been brought to our notice. However, in the case under consideration, it is not evident from the order of lower authorities as to whether or not gain due to difference in exchange rate is on account of exports or otherwise. In these circumstances, we vacate the findings of ld. CIT(A) and restore the matter to the file of the AO with the directions to ascertain the nature of gain. In the even such gain is derived from the export of goods or articles manufactured or produced by the taxpayer, exemption/deduction u/s.10A or 80HHE as the case may be, should be allowed in accordance with law after allowing sufficient opportunity to the taxpayer. Thus, grounds of the Revenue relating to exemption/deduction u/s.10A and 80HHE of the Act in respect of profits on exchange fluctuation are disposed of as indicated hereinbefore for these two assessment years.

32. Once the respected coordinate bench of the Tribunal has already restored this ground back to the file of the AO with certain directions, therefore it is not proper for us to deal this very issue independently for the year under consideration, but to refer back to the file of the AO to be decided *de novo* as per the said directions. Therefore, this ground may be treated as **allowed but for statistical purposes only.**

33. **Ground No.5 reads as under:-**

5. GROUND NO. 5 - Disallowance under section 14A of the Act on account of expenses incurred in relation to earning exempt income

The Ld. AO has erred in law and on facts in disallowing expenses of Rs.20,39,041 under section 14A of the Act read with Rule 8D of the Income Tax Rules ('the Rules') incurred in relation to earning exempt income The Ld. AO ought to have appreciated the following:

i. *Rule 8D of the Rules creates a departure from settled principles and goes beyond the object and scope of section 14A (1) of the Act.*

ii. *The Hon'ble Mumbai High Court in the case of* ***Godrej & Boyce Mfg Co Ltd, Mumbai v Dy. Commissioner of Income Tax [2010 TIOL 564] (MUM)*** *has held that Rule 8D of the Rules is prospective in nature and as such, shall apply with effect from AY 2008-09.*

33.1. The assessee has earned dividend income of Rs.7,65,60,202/-. It was observed by the AO that as per the provisions of Section 14A an expenditure related to the income which does not form part of the total income should be disallowed. Rule 8D prescribed the amount of disallowance, it was quoted. The assessee was asked to explain as to why the "proportionate interest expenses" and "administrative expenses" incurred for earning the said exempt income should not be disallowed by applying Rule 8D of IT Rules. The assessee has submitted that no part of the investment was made out of borrowed funds. It was explained that the company had sufficient funds in hand. The entire investment was made out of its own funds. The position of the reserves and surplus was narrated to the AO to explain that there were sufficient share capital and reserve and surplus funds in comparison to the investment amount. However, the AO was not convinced and according to him, the assessee has not furnished details of exact source of investment in shares. According to AO, the assessee has not explained whether separate accounts were maintained to demonstrate that non-interest bearing funds were utilized for the said investment. According to AO, apart from the above, certain administrative expenses would have also been incurred for managing the said investment. Applying the Rule 8D, which according

to him was applicable for the year under consideration, he has computed expenditure in relation to the income which did not form part of the total income and a proportionate computation was made. Finally a disallowance u/s.14A of Rs.20,39,041/- was taxed. The DRP has referred Daga Capital Management 117 ITD 169 (Mum.) and held that the disallowance was rightly made.

34. Having heard the submissions of both the sides, as far as the decision of Daga Capital Management (supra) is concerned, the legal view taken therein has now been reversed by **Hon'ble Bombay High Court pronounced in the case of Godrej & Boyce Mfg. Co.Ltd. Mumbai vs. Dy.CIT in Income tax Appeal** No.626 of 2010 and Writ Petition No.758 of 2010 order dated 12/08/2010 [**now reported as 328 ITR 81(Bom)].** In this judgement at the end, the Hon'ble Court has recapitulated the conclusion and pronounced that a finding is required whether the investment in shares is made out of own funds or out of borrowed funds. **A nexus is required to be established between the investments and the borrowings.** In section 14A of the Act expenditure incurred in relation to exempted income is to be disallowed only if the Assessing Officer is satisfied with the expenditure claimed by the assessee pertaining to the said exempt income. Rather, the Ho'nble Court was very specific that in case, **no such exercise was carried out by the Assessing Officer then the matter is to be remanded back for afresh investigation.** It has also been made clear that the proviso to section 14A of the Act was effective from 2001-02. The Hon'ble Court has also pointed out the importance of Rule 8D of the I.T.Rules, 1962. It was made clear that sub-section (1) to section 14A was inserted with retrospective effect from 01/04/1962, however, sub-sections (2) & (3)

were made applicable with effect from 01/04/2007. The proviso was inserted with retrospective effect from 11/05/2001 , however Rule 8D was inserted by the Income Tax (Fifth Amendment), Rules, 2008 by publication in the Gazette dated 24/03/2008, relevant findings are reproduced below:-

"a) The ITAT had recorded a finding in the earlier assessments that the investments in shares and mutual funds have been made out of own funds and not out of borrowed funds and that there is no nexus between the investments and the borrowings. However, in none of those decisions was the disallowability of expenses incurred in relation to exempt income earned out of investments made out of own funds considered. Moreover, under Section 14A, expenditure incurred in relation to exempt income can be disallowed only if the assessing officer is not satisfied with the correctness of the expenditure claimed by the assessee. In the present case, no such exercise has been carried out and, therefore, the Tribunal was justified in remanding the matter.

b) Section 14A was introduced by the Finance Act 2001 with retrospective effect from 1 April 1962. However, in view of the proviso to that Section, the disallowance thereunder could be effectively made from assessment year 2001-2002 onwards. The fact that the Tribunal failed to consider the applicability of Section 14A in its proper perspective, for assessment year 2001-2002 would not bar the Tribunal from considering disallowance under Section 14A in assessment year 2002-2003.

c) The decisions reported in ***Sridev Enterprises*** *(supra),* ***Munjal Sales Corporation*** *(supra) and* ***Radhasoami Satsang*** *(supra) holding that there must be consistency and definiteness in the approach of the revenue would not apply to the facts of the present case, because of the material change introduced by Section 14A by way of statutory disallowance in certain cases. There, the decisions of the Tribunal in the earlier years would have no relevance in considering disallowance in assessment year 2002-2003 in the light of Section 14A of the Act.*

73. For the reasons which we have indicated, we have come to the conclusion that under Section 14A(1) it is for the Assessing Officer to determine as to whether the assessee had incurred any expenditure in relation to the earning of income which does not form part of the total income under the Act and if so to quantify the extent of the disallowance. The Assessing Officer would have to arrive at his determination after furnishing an opportunity to the assessee to produce its accounts and to place on the record all relevant material in support of the circumstances which are considered to be relevant and germane. For this purpose and in light of our observations made earlier in this section of the judgment, ***we deem it appropriate and proper to remand the proceedings back to the Assessing Officer for a fresh determination.***

Conclusion :

74. Our conclusions in this judgment are as follows ;

i) Dividend income and income from mutual funds falling within the ambit of Section 10(33) of the Income Tax Act 1961, as was applicable for Assessment Year 2002-03 is not includible in computing the total income of the assessee. Consequently, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to such income which does not form part of the total income under the Act, by virtue of the provisions of Section 14A(1);

ii) The payment by a domestic company under Section 115O(1) of additional income tax on profits declared, distributed or paid is a charge on a component of the profits of the company. The company is chargeable to tax on its profits as a distinct taxable entity and it pays tax in discharge of its own liability and not on behalf of or as an agent for its shareholders. In the hands of the shareholder as the recipient of dividend, income by way of dividend does not form part of the total income by virtue of the provisions of Section 10(33). Income from mutual funds stands on the same basis;

iii) The provisions of sub sections (2) and (3) of Section 14A of the Income Tax Act 1961 are constitutionally valid;

iv) The provisions of Rule 8D of the Income Tax Rules as inserted by the Income Tax (Fifth Amendment) Rules 2008 are not ultra vires the provisions of Section 14A, more particularly sub section (2) and do not offend Article 14 of the Constitution;

v) The provisions of Rule 8D of the Income Tax Rules which have been notified with effect from 24 March 2008 shall apply with effect from Assessment Year 2008-09;

vi) Even prior to Assessment Year 2008-09, when Rule 8D was not applicable, the Assessing Officer has to enforce the provisions of sub section (1) of Section 14A. For tht purpose, the Assessing Officer is duty bound to determine the expenditure which has been incurred in relation to income which does not form part of the total income under the Act. The Assessing Officer must adopt a reasonable basis or method consistent with all the relevant facts and circumstances after furnishing a reasonable opportunity to the assessee to place all germane material on the record;

vii) The proceedings for Assessment Year 2002-03 shall stand remanded back to the Assessing Officer. The Assessing Officer shall determine as to whether the assessee has incurred any expenditure (direct or indirect) in relation to dividend income / income from mutual funds which does not form part of the total income as contemplated under Section 14A. The Assessing Officer can adopt a reasonable basis for effecting the apportionment. While making that determination, the Assessing Officer shall provide a reasonable opportunity to the assessee of producing its accounts and relevant or germane material having a bearing on the facts and circumstances of the case." (emphasis given)

On the basis of above decision, we are also of the view that it depends on the facts of each case. Admittedly , the fact of the present case was that the Assessing Officer had not enquired the issue in the light of the above legal pronouncement. Specially the pronouncement of the Hon'ble Bombay High Court was not available at that time, hence, the Assessing Officer's assessment order was devoid of merits as also the law applicable . Now we have got certain guidelines, though can not be said to be exhaustive or complete, but on these lines, the Assessing Officer is expected henceforth to compute the correct disallowance, needless to say after providing an adequate opportunity of hearing to the assessee. Therefore, the matter is restored to be decided afresh, hence, **this ground of the assessee may be treated as allowed for statistical purposes.**

35. **Ground No.6 reads as under:-**

> ***6. GROUND NO. 6 - Disallowance of expenses incurred by appellant's UK branch under section 40(a)(i) of the Act on the ground of non deduction of tax while making payments to non-residents***
>
> *The Ld. AO has erred in law and on facts in disallowing expenses amounting to Rs.12,26,18,416 under section 40(a)(i) of the Act incurred and paid outside India by appellant's branch in UK. The Ld. AO ought to have appreciated the following:*
>
> *i. The **services availed by UK branch from non-residents have been rendered and utilized outside India and as such, the payments made by UK branch to nonresidents does not accrue or arise in India in terms of section 9(1)(vii) of the Act.** Hence, the said payments to non-residents by UK branch are **not chargeable to tax under the provisions of the Act**.*

ii. Without prejudice to the fact that such income of non-resident does not accrue or arise in India under the provisions of the Act, even as per Double Taxation Avoidance Agreement ('DTAA') between India and UK, the payments made by UK branch to non-residents are not liable to tax in India.

iii. Without prejudice to the above, even otherwise, if the expenses would have been paid by the appellant, the same would not have been treated as Fees for Technical Services ('FTS') liable to tax in India as Article 13 of India - UK DTAA requires that in order to treat the services as FTS, the same should make available technical knowledge, experience, skill know-how or processes, or consist of the development and transfer of a technical plan or technical design. The services provided by the non-residents to the UK branch neither make available any technical knowledge, skill, know-how nor is in the nature of transfer of technical plan or technical design and as such, not liable to tax in India.

iv. When the income of non-resident is not liable to tax in India, then the provisions of section 195 is not applicable and as such, the appellant has no liability to deduct tax on such payments and accordingly, no disallowance can be made under section 40(a)(i) of the Act.

v. The aforesaid issue has been decided in favour by the Hon'ble CIT (A) in appellant's own case for earlier AY 2005-06.

A) FACTS:

35.1. It was noted by the AO that the assessee has made payment to 19 parties, listed in the assessment order, for software consultation and recruitment services. **The payment to the extent of Rs.12,26,18,416/- was made without deduction of tax.** A show cause was issued as to why the disallowance under the provisions of section 40(a)(i) should not be made in respect of the said payment. The explanation of the assessee was that the MIL is executing software development project in UK through its branch set up in UK. During the course of execution of software

development project, the UK branch has incurred various expenses. The payments to those parties for the said expenditure have been directly made by the UK branch from its bank account in UK. The submission of the assessee was as follows:-

"2.1. Assessee's branch in UK is a separate and distinct entity:

a. It is submitted that the ***UK branch is considered as a Permanent Establishment ('PE') of Mastek in the UK*** *and accordingly charged to tax in terms of Article 7 of India – UK Double Taxation Avoidance Agreement ('DTAA') on profits attributable to branch operations in the UK. As per Article 7(5) of India – UK DTAA, in the determination of the profits of a PE, there shall be allowed as deduction, expenses which are incurred for the purposes of the business of the PE, including executive and general administrative expenses so incurred whether in the UK or elsewhere, which are allowed under the provisions of and subject to the limitations of the UK law. Thus the allowability of expenses of the UK branch is governed by the UK law as per India – UK DTAA.*

b. Further, we submit that expenses incurred by the assessee and expenses incurred by its UK branch need to be treated separately. ***UK Branch is a separate legal entity formed under the UK Regulations. The same is evident from Article 7(2) of India – UK DTAA,*** *which states that where an Indian entity carries on business in the UK through a PE situated therein, the profits which that PE might be expected to make if it were a distinct and separate enterprise. Further,* ***Circular No.740 dated 17 April 1996 s****tates that branch of a foreign company/concern in India is a separate entity for the purposes of taxation. Applying the same logic, foreign branch of an Indian Entity has to be treated as a separate legal entity."*

35.2 It was contested before the AO that the services were availed by UK branch from non-residence. Those services were rendered as well as utilized outside India. According to assessee, there was no application of section 195 on the said payment. It was also contested that as per DTAA

with UK the assessee was not under obligation to deduct TDS. The AO was not convinced and after analyzing section 195 of IT Act and the provisions of section 9(1)(i) and section 9(1)(vii) held that the payment was in the nature of "Fees for Technical Services" ('FTS'). He has mentioned that in section 9(1)(vii) the word used is the services "utilized in India" as against "services rendered in India". He has explained that the effect of the word "utilized" in place of "rendered" is that the non-resident need not to come physically to India or the transaction need not to take place in India. According to AO, it is enough if the services or the end result of the services are utilized in India. He was of the view that irrespective of the source and place of delivery, the FTS deemed to accrue or arise in India, if the services are utilized in India for which FTS is paid. The AO has also referred **Explanation to section- 9(1) of IT Act.** The intention of this Explanation is to bring certain income of non-residents to tax in India if the source is in India. According to AO, the source is MIL, an Indian Company. From the side of the Assessee, **CBDT Circular 740** was cited for the argument that the branch of a foreign company in India being treated as a separate entity, likewise branch of the assessee in UK should be considered as a separate non-resident entity. However, the AO was not convinced and stated that the branch in UK is only a branch as well as part and parcel of Indian Company. The AO has also mentioned that the alleged payment which was made through the branch was not accounted as transferred to branch but accounted as such in the name of the payees. According to him, the expenditure was incurred by the assessee-company. The AO has finally concluded as under:-

"7.20. In view of the above facts and legal position it is held that the assessee was under obligation to deduct tax from the payments made to non resident for consultancy and training and recruitment which it had failed to discharge. Therefore the expenditure claimed under recruitment and training and consultancy paid to non resident is disallowed and added back to income u/s.40(a)(i) of Income tax Act. Thus an amount of Rs.12,26,18,416/- being expenses in the nature of consultancy income on which TDS has not been deducted, is disallowed as expenditure in the hands of the assessee. However, since all these expenses relate to the export income of the assessee for which deduction under section 10A has been claimed, the assessee's income for the purpose of deduction shall be modified accordingly."

B) ARGUMENTS :

35.3. The first and the foremost submission of ld.AR is that in A.Y. 2005-06, ld.CIT(A) had already allowed this issue in favour of the assessee. Our attention was drawn by ld.AR on some of the observation of ld.CIT(A) while deciding this issue for A.Y. 2005-06. The main thrust was that the services was(i) **availed by the UK branch a**nd the services (ii) **rendered by non-residents** and that the services was also(iii) **utilized outside India.** It has also been argued that the said services were not "make available" to assessee. The technical knowledge or the skill had not remained with the assessee. Ld.CIT(A) has expressed that as per clause **(b) of section 9(1)(vii) an exception** has prescribed that where fees are payable in respect of services utilized in a business carried on by such person outside India or for the purpose of making income from any source outside India. According to ld.CIT(A), UK branch was considered as a "permanent establishment in UK". He has referred **Article 7 of UK DTAA t**o hold that the profit is charged to tax attributable to branch operations in UK. In his view, the UK branch is a separate legal entity formed under UK regulations. In his opinion, after

the combined reading of exception laid down in section 9(1)(vii)(b) along with India-UK DTAA the consultancy charges paid by the UK branch not to be held as income accrue or arising in India. A decision of Hon'ble Supreme Court in the case of **Ishikawajma-Harima Heavy Industries Ltd. v. Director of Income Tax, Mumbai 288 ITR 408 wa**s cited. Further, a decision of Hon'ble Madras High Court in the case of **Skycell Communications Ltd. v. DCIT [2001] 251 ITR 53** was also cited.

35.4. From the side of the Revenue, ld.DR has placed reliance on the order of the AO and the order of the DRP.

C) CONCLUSION ;

36. We have heard both the sides and noticed the basic facts that the impugned payment was made without deduction of tax. It is also not in dispute that the payment was made to 19 (Nineteen) parties and all of them are not Indian Residents. It is also not in dispute that the nature of expenses were, namely, "Recruitment Services", "Training Services" and "Software Consulting". Before DRP, the assessee has described the party-wise nature of services. Relevant pages of DRP are page Nos. 141 to 147, referred so as to understand the description of said services rendered. **Section 40(a)(i)** of the Act was invoked. This section starts with an ***obstante*** clause that notwithstanding of anything to the contrary in sections 30 to 38, certain amounts shall not be deducted in computing the income chargeable under the head "profits & gains of business" in the case of an assessee any interest, royalty, fees for technical services or other some **chargeable under this Act** which is payable outside India or in India to a non-resident on which tax is deductible at source under Chapter XVII-B of Act, but such tax at source has not been deducted or

after deduction has not been paid. The emphasis of argument is that the said sum should be "chargeable under the Act". This aspect has to be seen thoroughly because this phrase is used in the charging Section i.e. 40(a)(i). The next step is therefore to peruse the provisions of **Section 195 of IT Act** which says that any person responsible for paying to a non-resident any other sum **chargeable under the provisions of this Act** shall at the time of credit of such income to the account of the payee or at the time of payment thereof, deduct income tax thereon at the rate in force. Undisputedly, even in Section 195 the Statute has incorporated that for the purpose of deduction of TDS income is to be "chargeable" under the Act. As far as the facts of the case are concerned, the said 19 parties are (i)**not the resident of India** and they also(ii) **do not have 'PE' in India.** It has also not been found by the AO that except the TDS provision, was there any other provision under Act due towhich the said parties could be held chargeable to tax in India.

36.1. The next step is the application of Section 9 of IT Act which prescribes deeming provision to decide accrual of an income in India. Because of the deeming provision section 9(1) of IT Act says that certain incomes shall be deemed to accrue or arise in India, such as, any income from any business connection in India or an income from any property in India. Vide Explanation-1(b), an exception is that in the case of a non-resident, no income shall be deemed to accrue or arise in India to him from operations which are confined to the purchase of goods in India for the purpose of export. An issue has therefore been raised that the professional charges paid by the UK Branch of the assessee to various entities which are non-resident, then whether it can be held that an income has deemingly accrued in India. As far as the assessee's

vehement contention is that the AO should not have decided against the order of CIT(A) pronounced in A.Y. 2005-06, wherein vide an order dated 30/09/2009, the CIT(A)-VIII Ahmedabad has considered this aspect at length and thereupon held as under:-

> *"8.12. It may be further pointed out that Article 7 of the DTAA between India and UK states that business income of the UK enterprise shall not be taxable in India unless the UK enterprise has a Permanent Establishment ('PE') in India. The Ld. A.R. pointed out that the entities from whom UK branch availed services does not have PE in India. From the invoices submitted before me, it was observed that these entities are based in the United Kingdom with no business presence in India. The A.O. while drawing adverse conclusion has not brought any fact on record to controvert the claim of the app in this regard. I am of the view that the professional fees payable to should be considered as business income of the said entities and in the absence of PE in India, the same would n9ot be liable to tax in India. Since such income of non-residents is not liable to tax in India, the provision of section 195 of the IT Act are not attracted on such payments and consequently no disallowance can be made under section 40(a)(i) of the I.T. Act."*

36.2. This is the one aspect which has been argued and the other aspect was that on such income the deeming provisions of section 9 do not apply because the impugned income do not accrue or arise in India. In this regard, section 9(1)(vii)(b) has been cited and reproduced below:-

> **"Income deemed to accrue or arise in India**
>
> 9.(1) The following incomes shall be deemed to accrue or arise in India:-
>
> …..

…..

(vii) income by way of fees for technical services payable by-
(a) ..

(b) A person who is a resident, except where the fees are payable in respect of services utilized in a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India; or"

Therefore income by way of fees for technical services shall not be deemed to accrue or arise in India if payable in respect of services utilized in a business carried on by such person outside India or for the purpose of earning any income from any source outside India. The UK branch of the assessee has availed services of non-resident consultants. These services were provided from outside India. And these services have also been utilized outside India. These services were in fact rendered in UK for carrying out "onsite" work at UK. The Hon'ble Supreme Court in the case of Ishikawajma-Harima Heavy Industries Ltd. v. Director of Income Tax, Mumbai 288 ITR 408 (supra) has opined that whatever was payable by a resident to a non-resident by way of technical fees would not always come within the purview of section 9(1)(vii). According to the Hon'ble Court, it must have sufficient territorial nexus with India so as to furnish a basis for imposition of tax. If any service has been rendered outside India, then the other condition for taxability is that it must be utilize in India. The Hon'ble Apex Court has therefore said that two conditions for taxability are that firstly, rendered in India and secondly, utilized in India. As far as the instant case is concerned, it is not in dispute that services from the foreign consultants were neither rendered in India nor utilized in India. Our attention has been drawn on

an insertion of an Explanation below Section 9(2) of IT Act and for ready reference, reproduce below:-

> "Explanation – For the removal of doubts, it is hereby declared that for the purposes of this section, income of a non-resident shall be deemed to accrue or arise in India under clause (v) or clause (vi) or clause (vii) of sub-section (1) and shall be included in the total income of the non-resident, whether or not-
>
> (i) The non-resident has a residence or place of business or business connection in India; or
> (ii) The non-resident has rendered services in India."

This Explanation has been inserted by Finance Act, 2007 and later on substituted by Finance Act, 2010. Due to this reason, at the relevant point of time, i.e. during the relevant Financial Year, it was not possible on the part of the assessee to comply with the said Statute. We therefore hold since the services in question were neither "availed" nor "rendered" and even not "utilized" in India, therefore no tax was required to be deducted at source. Rest of the issues about the nature of the FTS and whether it was made available to the assessee are alternate plea of the assessee and need not to be addressed because on the preliminary question of "chargeability", the issue stands decided in favour of the assessee. **This ground of the assessee is therefore allowed.**

37. Ground No.7 reads as under:

> ***7. GROUND NO. 7 - Disallowance of 20% of recruitment and training expenses***

The Ld. AO has erred in law and on facts in disallowing 20% of recruitment and training expenses amounting to Rs.47,20,099 on the ground that such expenses have been incurred on employees deputed to overseas subsidiaries. The Ld. AO ought to have appreciated the following:

i. None of the recruitment and training expenses have been specifically incurred to recruit or train employees for the purpose of deputation to its subsidiaries. The expenses incurred are general in nature and have been incurred at an organizational level for its entire staff.

ii. All conditions laid down in section 37 of the Act are satisfied with respect to the recruitment and training expenses.

iii. Without prejudice to the above, the Ld. TPO has already made an upward adjustment in respect of HRM function for the captioned assessment on the ground that the assessee is not justified in not charging any mark-up on account of services for provision of skilled manpower to group companies. The Ld, TPO has accordingly made an upward adjustment of Rs. 2.92 crores calculated at 9% of the total annual salary of the persons seconded. As such, recruitment and training expenses cannot be again disallowed.

iv. The aforesaid issue has been decided in favour by the Hon'ble CIT (A) in appellant's own case in AY 2005-06.

37.1. It was noticed that the assessee had incurred an amount of Rs.2,36,00,496/- for recruitment and training expenses. In compliance of show-cause, it was informed that the nature of business of the assessee is to provide services to customers which constitute composite deliverables as well as “onsite” - “offshore” services. Therefore, to provide “onsite” software development services to customers, the technical support and the technical services of technical staff is required. It was categorically stated before the AO that none of the recruitment and

training expenses have been specifically incurred to train the employees only for the purpose of deputation to its subsidiaries. The expenditure has been incurred at organizational level. The HR Department of the Company on a continuous basis is indulged in recruitment programmes, training programmes, so as to retain the talent of technical persons. The assessee has explained the business rationale behind such expenditure that the Company derives double benefits, **one**, increase in offshore revenue, **second**, employees with upgraded skill has enhanced solution delivery skills. It has also been informed that there is "continuity of employment" even if sent abroad to AEs. Such employees remain on the pay-roll of the assessee-company. A detailed explanation was furnished, however the AO was not convinced and expressed that the Company had seconded as many as 148 persons to its AEs. The assessee is, therefore, in the opinion of the AO, is a supplier of man-power to its offshore subsidiaries. But those persons were recruited and trained at the expense of the Company. In his opinion, such persons deployed outside India may or may not come back and may be absorbed by AE. In such a situation, the benefits of recruitment and training have been enjoyed by AEs of the Company outside India. The AO has therefore held that 20% of the recruitment and training expenses has to be disallowed being not incurred wholly and exclusively for the purpose of the assessee's business. He has therefore disallowed a sum of Rs.47,20,099/-, however, and also held that the said disallowance cannot be added while computing the deduction u/s.10A of the IT Act.

37.2. In this regard, ld.Counsel has submitted that none of the recruitment and training expenses have been specifically incurred to recruit or train employees for the purpose of deputation to its subsidiaries. The expenses incurred are general in nature and have been incurred at an organizational level for all staff. Therefore there is no direct linkage of recruitment and training expenses with employees deputed to its subsidiaries. The ld.Counsel further pointed out that on an ongoing basis, the significant risk in the software industry where the assessee operates is to manage attrition and hence retention of employees is of utmost importance. The HR department of the company, therefore, on a continuous basis is required to indulge in activities such as recruitment programs, trainings required to obtain and retain the said world-class talent, etc., which enables the company to render world class solutions. It needs to be noted that the company's expertise in domain knowledge helps in attracting good talent from other competitors, which helps in delivering software solutions. In this regard, it is pertinent to note that the inflow of the employees for the company need not be only from the fresh recruits but also from the onsite employees returning during the concerned year.

37.3. On the other hand, from the side of the Revenue, the ld.DR supported the order of the AO.

38. On hearing the submissions of both the sides, we are of the conscientious view that in a situation where the requisite detail in respect of training of employees and the genuineness of the expenditure was very much before the AO and in respect of these two reasons, no

disallowance was suggested, then it was unjustifiable on the part of the AO to say that a 20% recruitment and training expenses would be disallowed on mere presumption that it was not wholly beneficial to the assessee. There is no evidence in the possession of the AO to hold that a particular expenditure on training was not business related. In fact, the argument of the assessee appears to be logical that considering the nature of the services provided a training of the technical staff is always a business necessity and because of the trained staff the assessee's revenue has substantially gone up. In the absence of any adverse material, we are not inclined to approve such an adhocism. This disallowance is hereby deleted and **Ground is allowed**.

39. Ground No.8 reads as under:-

> ***8. GROUND NO. 8 - Setting off losses of other units while computing deduction under section 10A of the Act from the profits of eligible units***
>
> *The Ld. AO has erred in law and on facts in computing deduction under section 10A of the I Act considering the net profits of business of all units taken together i.e. after setting off losses of eligible and non-eligible units with profits of eligible units thereby restricting deduction under section 10A of the Act. The Ld. AO ought to have appreciated the following:*
>
> *i. Each eligible undertaking is an independent and distinctive business unit and deduction under section 10A should be computed specific to eligible undertaking instead of computing such deduction after considering net business profits of the assessee (including losses of eligible and non-eligible units) as a whole.*

ii. Losses of eligible and non-eligible undertakings cannot be set off against profits of eligible undertaking while computing deduction under section 10A of the Act.

Each of the above grounds of appeal is distinct, independent and separate and without prejudice to the other grounds of appeal.

Your appellant craves leave to add to and/or to amend and/or to modify and/or to cancel any one or more grounds of appeal at any time before or at the time of hearing.

Additional Ground of Appeal

Appellant craves leave to raise this additional ground of appeal before the Hon'ble ITAT. This is a legal ground and therefore as per the decision of Hon'ble Supreme Court in the case of National Thermal Power (229 ITR 383), it can be raised before the Hon'ble ITAT.

Ld. AO erred in law and on facts in computing deduction u/s 10A of the Act considering the net profit of all units taken together i.e. after setting off losses of eligible and non - eligible units with profits of eligible units thereby restricting deduction u/s IDA of the Act. Ld. AO erred in not appreciating the fact that each eligible undertaking is an independent and distinctive business that required deduction to be computed specific to eligible undertaking instead of considering net profits of the assessee. Ld. AO ought to have granted deduction u/s 10A of the Act without setting off losses of eligible and non - eligible undertakings against profits of eligible undertaking while computing deduction u/s 10A of the Act.

Appellant craves leave to add, amend, alter, change, delete and edit the above ground of appeal before or at the time of the hearing of the appeal.

39.1. Ground No.8 and the Additional Ground both are connected, hence to be decided in a consolidated manner as under.

39.2. Though the assessee has raised this issue before us, but even on query from the Bench, exact facts and figures have not been produced. The AO has simply mentioned that the assessee's eligible u/s.10A of Rs.72,98,75,578/-. The connected calculation or the computation as made by the AO is not before us. Even the calculation of the assessee is not available, so that we can ascertain the correct quantums in appeal. Rather, it is strange to note that the assessee has claimed the deduction u/s.10A of lower amount and the AO has held that the eligible amount was higher. If it was so, then there should not be any grievance of the assessee. The only information before us in respect of the claim of deduction u/s.10A is as under:-

Particulars	**Amount (Rs.)**
Mahape unit	59,63,47,583
Pune Unit	1,75,61,530
Total	**61,39,09,113**

The AO has made the computation of the total taxable income wherein the deduction u/s.10A was mentioned as eligible for Rs.72,98,75,578/-, however, the same was allowed to the extent of the income computed at Rs.63,14,08,049/-. As far as the law is concerned, Section 10A prescribes a deduction of profits and gains derived by an Undertaking from the export of articles or things or computer software. After the substitution of word "deduction" the intention of the Legislature was to give only deduction and not the exclusion from total income. Section 10A has further been amended and sub-section(6) was introduced which prescribes that in computing the total income of the

assessee, no loss referred to in Section 72(1) or Section 74(1) or Section 4(3) shall be carried forward or set off so far as such loss relates to the business undertaking and such loss relates to any of the assessment years ending before 1st day of April-2001. In respect of this legal controversy, few case laws have been cited as follows:-

(i) Scientific Atlanta India Technology Pvt.Ltd. vs. ACIT [2010] (129 TTJ 273) [Chennai ITAT Special Bench]

(ii) Techspan India (P) Ltd. A Anr v. ITO (283 ITR 212)[Del]

There is one more decision of Cap Gemini India Pvt.Ltd. 141 TTJ 33(Mum.). According to the amended scheme the profits of the Unit eligible for deduction would form part of the income computed under the head "profits and gains of business". The deduction is therefore required to be made at the stage of computing the income and, hence, first it is required to arrive at the figure of "gross total income" as defined u/s.80B(5) of I.T. Act. The said gross total income is to be computed in accordance with all the provisions of the Act, including Section 10B as well, except Chapter VIA of the Act. In the context of set off of loss for an eligible undertaking an another decision of Honeywell International India 108 TTJ 94 (Pune) is also required to be taken into account. The AO is expected to provide such details to the assessee, so that the legally sustainable adjustment can be made. The assessee is also required to furnish the details of profit earning eligible Units and loss suffering eligible Units. Due to lack of complete information, we are constrained to adjudicate and finalize this issue as per law. We therefore remit this ground back to the stage of AO to decide *de novo*. This Ground along

with Additional Ground may be treated as allowed for statistical purposes only. Before we part-with; we want to place a word of appreciation for both the distinguished representatives; Mr.V.K.Gupta, Ld.CIT(TPO) and Mr.S.N.Soparkar, Senior Advocate for their valuable contributions to resolve the issue.

40. In the result, the appeal of the Assessee is partly allowed as per the terms indicated hereinabove.

Sd/-	**Sd/-**
(ए.मोहन अलंकामोनी)	(मुकुल कुमार श्रावत)
लेखा सदस्य	न्यायिक सदस्य
(A. MOHAN ALANKAMONY)	**(MUKUL Kr. SHRAWAT)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

Ahmedabad; Dated 29/ 02 /2012

टी.सी.नायर, व.नि.स./ *T.C. NAIR, Sr. PS*

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. संबंधित आयकर आयुक्त / Concerned CIT
4. आयकर आयुक्त(अपील) / The CIT(A)-
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, अहमदाबाद / DR, ITAT, Ahmedabad
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

सत्यापित प्रति //True Copy//

उप/सहायक पंजीकार (Dy./Asstt.Registrar)
आयकर अपीलीय अधिकरण, अहमदाबाद / ITAT, Ahmedabad