IN THE INCOME TAX APPELLATE TRIBUNAL
"C" BENCH: MUMBAI

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

ITA No.97/Mum/2010
(Assessment year: 2005-06)
ITA No.2974/Mum/2010
(Assessment year: 2007-08)

Onward eServices Ltd.,
2nd Floor, Sterling Centre,
Worli,
Mumbai -400 018 ..... Appellant

Vs

ACIT –Central Circle-37,
Ground Floor,
Aayakar Bhavan,
M.K. Road,
Mumbai -400 020 ..... Respondent

PAN: **AAACO 6297 N**

Appellant by:	Shri Paresh Shaparia
Respondent by:	Shri J.Y. Wagh & Shri A.C. Tejpal
Date of Hearing:	16.02.2012
Date of Pronouncement:	09.05.2012

O R D E R

PER R.S. PADVEKAR, JM:

These two appeals are filed by the assessee challenging the respective impugned orders of the Ld. CIT (A)-22, Mumbai for the A.Ys. 2005-06 & 2007-08. In both the appeals issues are common, hence, these appeals are disposed off by this consolidated order.

2. We first take the appeal for the A.Y. 2005-06 being ITA No.97/M/2010. The assessee has taken the following grounds:

"1. The Learned CIT (A) erred in confirming the disallowance of re-imbursement of interest of Rs.1,41,12,002/-, paid to the

parent company Onward Technologies Ltd., u/s.40(a)(ia) of Income Tax Act, 1961.

"2. The Learned CIT (A) ought not to have confirmed the disallowances of re-imbursement of interest of Rs.1,41,12,002/-, paid to the parent company Onward Technologies Ltd., u/s.40(a)(ia) of Income Tax Act, 1961.

3. The facts which revealed from the record are as under. As observed by the A.O. the assessee company is engaged in the business of software development, trading of software and hardware and allied software and hardware services. It is stated that the assessee has taken over a banking division of its parent company i.e. M/s. Onward Technologies Ltd. (in short OTL). It is further stated that in view of the taking over of the banking division the assessee has to share the interest cost burden of M/S. OTL which is a parent company, based on the funds utilised as the parent company is enjoying borrowing facilities from the bank for its group companies. The assessee filed the return of income for the A.Y. 2005-06 declaring total income of Rs. 'Nil' and the said return was selected for scrutiny and assessment has been completed u/s.143(3) of the Act. It was noticed by the A.O. that the assessee had credited an amount of Rs.1,41,12,002/- in account of it's parent company namely 'M/S. OTL' towards the interest payment.

4. In the opinion of the A.O. the assessee should have deducted tax at source as per the provisions of sec.194A of the Act. The A.O. sought the explanation of the assessee why the whole interest payment of Rs.1,41,12,002/- made to M/s. 'OTL' should not be disallowed u/s.40(a)(ia) of the Income-tax Act as no tax is deducted at source. The assessee filed the explanation before the A.O. stating that the assessee is wholly owned subsidy of M/s. 'OTL'. There are various facilities, which are commonly shared between parent and the assessee company. Most of the facilities are normally in the name of parent company i.e. 'OTL', hence, at the first instance parent company incurred the expenses and it reimburses the appropriate share of

expenses from assessee depending on the uses of the company. It is stated that as a part of the arrangement, parent company ('OTL') enjoys certain borrowings facilities from the bank. Out of borrowings from the bank, funds are transferred to the assessee-company and for use of the said funds the assessee's parent company ('OTL') reimburses its share of cost of funds utilised. The assessee also contended that the reimbursement of the cost is on actual basis both in terms of uses as well as cost thereof and no income is earned by the parent company ('OTL') out of reimbursement of the interest from the assessee. The assessee also demonstrated how the entries are passed in its books of account debiting the interest account and crediting the OTL's account and in the final entries interest account is carried to the profit and loss account. The assessee also stated that in the case of the parent company i.e. OTL; amount of interest reimbursed from the assessee company is reduced from the interest paid to the bank and net amount of the interest paid is taken to the profit & loss account. The assessee also contended that as the interest payment by the assessee is only towards the reimbursement of the cost to the parent company and no income is earned by the parent company, hence, there is no obligation on the assessee to deduct the tax at source u/s.194A of the Act.

5. The A.O. was not impressed with the explanation of the assessee. In his opinion the assessee should have deducted tax at source u/s.194A of the Act from amount paid/credited to M/S. OTL. He invoked the provisions of sec.40(a)(ia) of the Act and disallowed the entire interest payment of Rs.1,41,12,002/- and made the addition to the total income of the assessee. The assessee carried the issue before the Ld. CIT (A) but without success. In the opinion of the Ld. CIT (A) whatever have been received by the parent company i.e. 'OTL' it is nothing but income on account of interest. The Ld. CIT (A) has also observed that the assessee itself has shown amount of loan in its balance sheet under head 'unsecured loans', which is payable to 'OTL'. In the opinion of the Ld. CIT (A) payment by the assessee-company to the 'OTL' is nothing but interest irrespective of

nomenclature assigned by the assessee-company. The Ld. CIT (A) confirmed the addition made by the A.O. by invoking the provisions of sec.40(a)(ia) of the Act. Now, the assessee is in appeal before us.

6. We have heard the rival submissions of the parties and perused the records. The Ld. Counsel submits that the assessee company is incorporated on 19.06.2003 as a subsidy of the 'OTL', which is a parent company. He submits that there is no income element in the reimbursement by the assessee to the parent company as the reimbursement is made on actual basis. The Ld. Counsel took us through paper-book, more particularly, copy of the 'Agreement to Assignment of Business' Page nos.4 to 20 of compilation. The Ld. Counsel referred to details of the liabilities as per the Second Schedule to the said Agreement (Page No.20 of the compilation). He submits that a sum of Rs.5 crore, which is working capital in form of cash credit limit of the parent company, was also taken over by the assessee as per the terms of the Agreement dated 21.06.2003. He submits that in the balance sheet also the Bridge Loan of Rs.5 crore, which was on the name of the parent company i.e. 'OTL' has been shown in Schedule-II with a heading "unsecured loans". The Ld. Counsel took us page no.23 of the Paper-book which is a part of the balance sheet in the form of the 'notes' to the accounts and submits that as per Note No.5; it is made clear that working capital enjoyed by the parent company to the extent of Rs.50.00 millions has been utilised by the assessee company and the approval is awaited from the bank to transfer said loan facility on name of assessee. The Ld. Counsel submits that as per sec.194A, interest payment should be in the nature of 'income' to the recipient and reimbursement cannot be treated as 'income'. He also took us through sec.194C to make the distinction in language used by the Legislature and submits that in sec.194C language used is 'any sum'. He, therefore, pleaded that there is no statutory obligation on the assessee to deduct any tax at source in respect of amount reimbursed to the parent company and as there is no statutory obligation, the provisions of sec.40(a)(ia) cannot invoked. The Ld. Counsel strongly relied on the decision in the case of

ITO vs. Dr. Wilmar Schwer India P. Ltd. 3 SOT 71 (Del.), Jaipur Vidyut Vistar Nigam Ltd. Vs. ITO 123 TTJ (Jp) 888. Per contra, the Ld. D.R. relied on the order of the Ld. CIT (A).

7. Sec.194A reads as under:

(1) Any person not being an individual or a Hindu undivided family, who is responsible for paying to a resident any income by way of interest other than income by way of interest on securities, shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rates in force:

Provided that an individual or a Hindu undivided family, whose total sales, gross receipts or turnover from the business or profession carried on by him exceed the monetary limits specified under clause (a) or clause (b) of section 44AB during the financial year immediately preceding the financial year in which such interest is credited or paid, shall be liable to deduct income-tax under this section.

Explanation—For the purposes of this section, where any income by way of interest as aforesaid is credited to any account, whether called "Interest payable account" or "Suspense account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and the provisions of this section shall apply accordingly.

(2) Omitted by the Finance Act, 1992, w.e.f. 1-6-1992.

(3) The provisions of sub-section (1) shall not apply—

(i) where the amount of such income or, as the case may be, the aggregate of the amounts of such income credited or paid or likely to be credited or paid during the financial year by the person referred to in sub-section (1) to the account of, or to, the payee, does not exceed—

(a) ten thousand rupees, where the payer is a banking company to which the Banking Regulation Act, 1949 (10 of

1949) applies (including any bank or banking institution, referred to in section 51 of that Act);

(b) ten thousand rupees, where the payer is a co-operative society engaged in carrying on the business of banking;

(c) ten thousand rupees, on any deposit with post office under any scheme framed by the Central Government and notified by it in this behalf; and

(d) five thousand rupees in any other case:

Provided that in respect of the income credited or paid in respect of—

(a) time deposits with a banking company to which the Banking Regulation Act, 1949 (10 of 1949) applies (including any bank or banking institution referred to in section 51 of that Act; or

(b) time deposits with a co-operative society engaged in carrying on the business of banking;

(c) deposits with a public company which is formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes and which is eligible for deduction under clause (viii) of sub-section (1) of section 36,

the aforesaid amount shall be computed with reference to the income credited or paid by a branch of the banking company or the co-operative society or the public company, as the case may be;

(ii)

(iii) to such income credited or paid to—

(a) any banking company to which the Banking Regulation Act, 1949 (10 of 1949), applies, or any co-operative society engaged in carrying on the business of banking (including a co-operative land mortgage bank), or

(b) any financial corporation established by or under a Central, State or Provincial Act, or

(c) the Life Insurance Corporation of India established under the Life Insurance Corporation Act, 1956 (31 of 1956), or

(d) the Unit Trust of India established under the Unit Trust of India Act, 1963 (52 of 1963), or

(e) any company or co-operative society carrying on the business of insurance, or

(f) such other institution, association or body or class of institutions, associations or bodies] which the Central Government may, for reasons to be recorded in writing, notify in this behalf in the Official Gazette;

(iv)

(v)

(vi)….(x)

Explanation 2.—

(4) The person responsible for making the payment referred to in sub-section (1) may, at the time of making any deduction, increase or reduce the amount to be deducted under this section for the purpose of adjusting any excess or deficiency arising out of any previous deduction or failure to deduct during the financial year.]Explanation.—[Omitted by the Finance Act, 1992, w.e.f. 1-6-1992."

8. As per the language used by the Parliament what is contemplated is the 'interest in the form of income'. In the present case the argument of the assessee is that it is only reimbursement of the interest payment in respect of the funds utilised by the assessee towards borrowing facility of it's parent company. We find that as per the facts on record the assessee company was originally incorporated on 19.06.2003 with the name of 'Onsoft Technologies Ltd.' but the said name was subsequently changed to 'Onward eServices Ltd.'. Nowhere it is controverted that he assessee-company is a subsidy of 'OTL'. The assessee company entered into Agreement with the parent company dated 21.06.2003 and took over the business of providing 'Software Driven Solutions' vide Agreement of Assignment of Business.

As per the terms of the said Agreement, the assessee also took over the different liabilities of the parent company along with assigned of its business, which included sundry creditors, advances from customers, provisions for salary and funds base working capital cash credit limit of Rs.5 cores. (Page no.20 of the paper book). In the Audit report for year ending 30th June, 2003, factum of acquisition of running business of 'Banking Software Solutions Division' of 'OTL' (Parent company) is mentioned (page no.21 of the compilation). In the balance sheet Schedule –II under the head 'unsecured loans' the 'Bridge Loan' from the parent company 'OTL' towards banking borrowing to the extent of Rs.5 crore is shown (page no.22 of the compilation). As per Note No.5 (page No.23 of the compilation) it is made clear that the working capital limit of Rs.5 crore currently enjoyed by the parent company for which approval is awaited from the bank. In the interim period M/S. OTL has advanced a 'Bridge Loan' of similar amount. From the above evidence, it can safely be concluded that the parent company was enjoying borrowing facilities from the bank through it's parent company and the funds have been advanced to the assessee as the bank has not approved transferring the said borrowing facility to the assessee. As per the contention of the assessee to the extent of the funds utilised in respect of bank borrowing in the name of the parent company, the interest cost is reimbursed. In fact, the assessee is paying only the interest to the bank but it is through the parent company as admittedly parent company is not in lending business, as the transfer of the bank liability on the name of the assessee is awaited for the approval.

9. There are other aspects also to be considered. If it is an actual reimbursement of the interest by the parent company from the assessee in respect of the utilisation of the banking funds in respect of borrowing facilities enjoyed by the 'M/S. OTL', the parent company then it cannot be said to be the income of the parent company. In the assessment order, as per the explanation filed by the assessee, the 'OTL' has reduced the amount of interest received from the assessee company from it's interest account and only the net amount of the

interest is taken to the profit & loss account. Moreover, as per the provisions of sec.194A, otherwise also there is no liability on the assessee to deduct the tax at source if the interest is paid to any banking company to which Bank Regulations Act, 1949 applies. In present case assessee has paid interest to bank only but through it's parent company.

10. The AO as well as Ld. CIT (A) has observed that the assessee has shown the loan amount in the name of the 'OTL' (parent company). In our opinion, if the credit limit has not been not transferred in the name of the assessee but the credit facility is being enjoyed by the assessee through the parent company, then in such a situation the assessee cannot directly show the name of the bank but liability has to be shown on the name of the parent company. We further find that in the assessment year 2006-07 the AO has not made any disallowance even though the assessment is completed u/s.143(3). The AO has also made the reference in respect of the disallowance of Rs.1,41,12,002/- made u/s.40(a)(ia) of the Act but no disallowance is made in this year. We, therefore, hold that in the light of the above discussion, the assessee is under no statutory obligation to deduct the tax at source u/s.194A of the Act and, hence, there is no justification to invoke the provisions of sec.40(a)(ia) of the Act in making the disallowance. We, therefore, allow the grounds taken by the assessee and delete the addition made by the A.O.

11. Now, we take-up assessee's appeal for the A.Y. 2007-08 being ITA No.2974/M/2010.

12. The first issue is in respect of disallowance of interest expenses of Rs.91,36,748/- u/s.40(a)(ia) of the Act. In this year also the assessee has credited interest amount of Rs.91,36,748/- to the accounts of its parent company namely i.e. M/s. 'OTL' and the same has been claimed as 'deduction' in the profit & loss account. In the opinion of the A.O. the assessee should have deducted the tax at

source as per the provisions of sec.194A of the Act. The facts are identical as in the A.Y. 2005-06. In this year also the AO made disallowance of Rs.91,36,748/- by invoking the provisions of sec.40(a)(ia) of the Act. The Ld. CIT (A) confirmed the disallowance.

13. We have already decided the identical issue in this order in the appeal for the A.Y. 2005-06. Following our reasoning in the A.Y. 2005-06, in this year also i.e. A.Y. 2007-08, we hold that the assessee was not under statutory obligation to deduct the tax at source u/s.194A of the Act and hence, the disallowance made by the AO u/s.40a(ia) of the Act is not justified. We, accordingly, delete the addition of Rs.91,36,748/- made u/s.40(a)(ia) of the Act and accordingly relevant grounds ground are allowed.

14. The next issue is disallowance of R&D expenditure of Rs.2,93,13,061/-.

15. The A.O. has observed that the assessee has capitalised an amount of Rs.2,93,13,061/- under the head 'R&D expenditure'. The assessee has not claimed any depreciation on the said amount but has claimed entire amount as revenue expenditure in the income computation statement. The A.O. asked the assessee to file the details /break-up of said expenditure . The break-up given by the assessee is reproduced on page No.5 of the assessment order. The A.O. rejected the claim of the assessee giving reference to A.Y. 2006-07. The A.O. also did not allow any depreciation on the said amount i.e Rs.2,93,13,061/-. Before the Ld. CIT (A) the assessee pleaded that it has host of products in the 'Total Branch Automation' and 'Core Banking Spehere' as well as 'TBA applications', which were introduced by the assessee are successfully running across 4,000 branches of the various banks. It was pleaded that software is a ongoing process wherein features and modules of the software are revived and updated and modified and said process is a continuous process and required to be done each year. It was submitted that the same has to be

allowed as revenue expenditure or alternatively it was pleaded that if the expenditure was treated as capital in nature then it should form the part of 'software development' and depreciation @ 60% had to be allowed. The Ld. CIT (A) was not convinced with the contention of the assessee and he confirmed the entire addition. In respect of the alternate plea of the assessee the Ld. CIT (A) has directed the A.O. to expeditiously dispose off the application filed by the assessee u/s.154 dated 20.02.2010. Now, the assessee is in appeal before us raising the grievance against the finding of the Ld. CIT (A).

16. We have heard the rival submissions of the parties and perused the records. The Ld. Counsel reiterated the submissions, which he made before the Ld. CIT (A). Main thrust of the argument of the Ld. Counsel is that the said expenditure relates to the R&D of the Software Solutions, which are provided by the assessee to the different banks and hence, the said expenditure is in recurring nature. Alternatively, it is pleaded that if the said expenditure is treated as a capital expenditure and it has direct nexus with the software development then the depreciation @ 60% may be allowed. We find that the assessee treated the said expenditure as a capital expenditure in its books of account but in the statement of computation of income, the said expenditure was claimed as revenue expenditure. Though it is pleaded that the said expenditure is incurred on the research and development of 'software modules and solutions' but no evidence is placed before us to support the said contention. Hence, without supporting evidence it is very difficult to accept the plea of the assessee in respect of the nexus of the said expenditure with the development of the software and also to arrive at a conclusion whether the same can be treated as a revenue expenditure being recurring in nature. We, therefore, due to lack of evidence reject the contention of the assessee and confirmed the order of the Ld. CIT (A) to the extent of allowing the expenditure as revenue expenditure.

17. So far as alternate plea of the assessee is concerned, claiming 60% depreciation on the said amount being a part of the software development, we find that the assessee has already filed application under sec. 154 of the Act before the A.O. claiming the deprecation on the said amount and said application was pending before A.O. on the date when the appeal was heard. At the most we can restore issue of allowing depreciation to file of the A.O. but we find that the Ld. CIT (A) has already given suitable directions to the A.O. on the issue of the depreciation to dispose off assessee's application filed under sec. 154 of the Act. In our opinion, no interference is required in the directions of the Ld. CIT (A) as issue is open before A.O. Hence, we accordingly confirm the order of Ld. CIT (A) giving directions to the A.O. on alternate plea/issue of allowing depreciation @ 60% on said amount as finally it is treated as 'capital expenditure' and relevant grounds are dismissed.

18. In the result, assessee's appeal for the A.Y. 2005-06 is allowed and for the A.Y. 2007-08 is partly allowed.

Order pronounced in the open court on this day of 9th May, 2012.

Sd/-	**Sd/-**
(**J. SUDHAKAR REDDY**)	(**R.S. PADVEKAR**)
ACCOUTANT MEMBER	**JUDICIAL MEMBER**

Mumbai, Date: **9th May, 2012**

Copy to:

1) The Appellant.
2) The Respondent.
3) The CIT (A)-22, Mumbai.
4) The CIT -10, Mumbai.
5) The D.R. "C" Bench, Mumbai.

By Order

/ / True Copy / /

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

*Chavan