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IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCHES : I-1 : NEW DELHI

BEFORE SHRI R.S. SYAL, AM AND SHRI A.T. VARKEY, JM

ITA No.5846/Del/2011
Assessment Year : 2007-08

Aithent Technologies Pvt. Ltd., A-16/9,Vasant Vihar, New Delhi. PAN: AAACS2319H	Vs.	DCIT, Circle 1(1), CR Building, New Delhi.
(Appellant)		(Respondent)

Assessee By	:	Shri Akhilesh Gupta, Partner
Department By	:	Shri Vivek Wadekar, CIT, DR & Ms Y. Kakkar, Sr. DR

Date of Hearing	:	10.06.2015
Date of Pronouncement	:	12.06.2015

ORDER

PER R.S. SYAL, AM:

This appeal by the assessee is directed against the final order passed by the Assessing Officer (AO) on 31.10.2011 u/s 143(3) read

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with section 144C of the Income-tax Act, 1961 (hereinafter also called 'the Act') in relation to the assessment year 2006-07.

2. The first issue raised in this appeal is against the addition of Rs.8,61,31,210/- made by the AO on account of transfer pricing adjustment.

3. Briefly stated, the facts of the case are that the assessee, an Indian company, was incorporated on 3.11.2000 and has a branch office in Canada. The assessee is a wholly owned subsidiary of Aithent Inc., USA. The assessee is engaged in development of computer software. Seven international transactions were reported in Form No.3CEB, which have been enlisted by the Transfer Pricing Officer (TPO) in his order dated 26.10.2010. The assessee benchmarked these international transactions and demonstrated them to be at arm's length price (ALP) by following the Transactional Net Margin Method (TNMM). The last two transactions, namely, Reimbursement of expenses and Apportionment of administrative expenses, etc., are not in dispute. The first five transactions are of rendering software development services by the

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assessee to its associated enterprises (AEs). The assessee, apart from having head office in India has also a branch office in Canada providing software development services to its AE in the USA. The assessee also paid for certain consulting services rendered by its AE to its Canada branch. For the time being, we are not considering the international transaction of unsecured interest free loan for which an adjustment of Rs.87,90,467 was recommended by the TPO. In so far as the above transactions of rendering software development services and receiving consulting services, to the exclusion of interest free loan are concerned, the assessee used certain comparables and showed that these transactions were at arm's length price. The assessee's total revenue from services rendered as per its Profit & Loss Account, a copy of which is available on page 58 of the paper book, stands at Rs.36,63,45,769/-. The assessee received a sum of Rs.13.67 crore, as per page 485 of the paper book, from its associated enterprises (AEs). This shows that the remaining amount of Rs.22.96 crore (Rs.36.63 crore minus Rs.13.67 crore) was the revenue earned from non-AEs (unrelated parties). The TPO altered some of the comparables chosen by the assessee and computed the arm's

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length margin of his final set of comparables at 23.56% of the operating cost. This arm's length margin was applied on total revenues earned by the assessee at Rs.36.63 crore (inclusive of revenues from non-AEs). That is how, he proposed transfer pricing adjustment of Rs.8,61,31,210/- on this score. The assessee remained unsuccessful before the DRP on various issues including the selection of comparables made by the TPO. However, the assessee's claim for not considering depreciation on building let out to outsiders as an operating cost, was accepted by the DRP and a direction was given to the TPO, which aspect will be discussed *infra*. The assessee is aggrieved against the determination of the ALP and the resultant addition made by the AO.

4. We have heard the rival submissions and perused the relevant material on record. It is observed that while computing the arm's length price (ALP) of the assessee's international transactions under this segment, the TPO applied arm's length margin on the total transactions undertaken by the assessee inclusive of the revenue received from non-AEs.

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5. We have noticed above that the assessee has a branch office in Canada and there are some transactions between the head office in India and the branch office in Canada. These transactions have also been taken into sweep for the purposes of making the transfer pricing adjustment. There is no dispute on the fact that the assessee has offered its total income for taxation, which also comprises of the revenues from its Canada branch. In other words, the figures of expenses and incomes, assets and liabilities of branch office in Canada have been merged with such figures of head office in India. It is the merged figures of both the head office and branch office taken together as one unit, that have been taken into consideration for all practical purposes including the computation of total income and the transfer pricing analysis.

6. The first question for our consideration is whether the transactions between the head office in India and branch office in Canada can be considered as international transactions, even though the assessee inadvertently reported the same so as a matter of abundant caution. The answer is obviously in negative because section 92B(1) categorically

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provides that: 'For the purposes of this section and sections 92, 92C, 92D and 92E, an *"international transaction" means a transaction between two or more associated enterprises* ……..'. A bare perusal of the definition of 'international transaction' brings to light that for treating any transaction as an international transaction, it is *sine qua non* that there should be two or more separate AEs. When we consider the definition of 'International transaction' given in section 92B along with the meaning of the AE given in section 92A, it clearly transpires that in order to describe a transaction as an 'international transaction', there must be two or more separate entities.

7. It is simple and plain that no person can transact with self in common parlance. As such, one cannot earn any profit or suffer loss from self. The same is true in the context of business as well. Neither any person can earn income nor suffer loss from self. It is called the principle of mutuality. When expanded commercially, the proposition which follows is that there can be no profit from trade with self. This has been fairly settled through a catena of judgments from the Hon'ble Apex

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Court including *Sir Kikabhai Prem Chand VS CIT (1953) 24 ITR 506 (SC)* and also the Hon'ble High Courts. In *Betts Hartley Huett & Co. Ltd. (1979) VS. CIT 116 ITR 425 (Cal)*, it has been held that there cannot be a valid transaction of sale between branch office and head office and hence profit on such sales is not includible in assessee's computation of total income. Similar view has been taken in *Ram Lal Bechairam VS. CIT (1946) 14 ITR 1 (All).* Even if for a moment, we accept the contention of the Revenue as correct that the head office earned profit from its branch office, then such profit earned would constitute additional cost of the Branch office. On the aggregation of the accounts of the Head office and branch office, such income of the HO would be set off with the equal amount of expense of the BO, leaving thereby no separately identifiable income on account of this transaction.

8. Reverting to the extant context, we find that when the assessee is only one entity, then such *inter se* dealings between the head and the branch office cease to be commercial transactions in the primary sense, what to talk of an 'international transaction', whose pre-requisite is a

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transaction between two or more associated enterprises. Since the office in Canada is only a branch office and not a separate entity distinct from the assessee, the transactions between the head office in India and branch office in Canada cannot be considered as international transaction.

9. There is hardly any need to accentuate that there can be no estoppel against law. Merely because the assessee took an inadvertent appreciation of the transactions with self as international transactions, that cannot prevent it from claiming before the authorities that the correct legal position should prevail. In view of the fact that the assessee's office in Canada is its branch office, the transactions between the head office and the branch office, under the provisions of the Act, cannot be considered as international transactions. We, therefore, hold that the TPO was not justified in determining the ALP of the international transaction of 'Software Product Development/Software Consultancy Services' by applying the average operating profit margin of the comparables to the cost base of transactions with its AE, which

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also included the transactions with the branch office in Canada. Such cost base is directed to be considered as exclusive of transactions with the Canada branch. We, therefore, set aside the impugned order to this extent.

10. It is uncontroverted, as is also apparent from the TPO's order, that the transfer pricing adjustment has been made by considering the total costs incurred by the assessee in respect of both the controlled and uncontrolled transactions with the associated enterprises (AE) and non-AEs. An addition towards transfer pricing adjustment can be made by comparing the assessee's profit rate from the international transaction with that of comparable uncontrolled transactions. Under the TNMM, the process is simple in initially finding out the operating profit margin of the assessee and then the average adjusted operating profit margin of comparable cases. Such adjusted profit margin of the comparables constitutes benchmark margin, which is then compared with the operating profit margin from the assessee's international transactions with its AE. It is not permissible to make transfer pricing adjustment by

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applying the average operating profit margin of the comparables on the assessee's universal transactions entered into with both the AE and non-AEs. As the entire exercise under Chapter-X is confined to computing total income of the assessee *from international transactions* having regard to the arm's length price, there is no scope for computing the income even from non-international transactions having regard to the ALP. As the TPO has computed the transfer pricing adjustment *qua* all the transactions carried out by the assessee with reference to the base of 'total costs', also inclusive of costs relevant for transactions with non-AEs, we vacate the impugned order on this issue and restore the matter to the file of AO/TPO for recalculating the amount of addition of transfer pricing adjustment by taking into consideration the international transactions only under this segment to the exclusion of transactions with Canada Office and non-AEs.

11. The assessee has assailed the inclusion of some companies in the list of comparables. The TPO is directed to consider the arguments of the assessee and then decide as per law as to whether such companies

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are comparable or not. Needless to say, the assessee will be allowed a reasonable opportunity of hearing by the TPO/AO.

12. The second issue raised in this appeal is against considering depreciation on building as operating cost, which building was let out and some rental income was also earned therefrom. We do not find any discussion in the order passed by the TPO on this issue. The assessee argued before the Dispute Resolution Panel (DRP) that depreciation on building let out to some third party should be excluded from the total operating costs. The DRP has discussed this aspect on page 2 of its Directions given on 3.9.2011 directing the TPO: 'to verify and exclude the excess amount and recomputed ALP as per law and facts.' It is noticed that such direction given by the DRP has not been given effect to by the TPO/AO. There is no discussion in the final assessment order passed by the AO on 31.10.2011 giving effect to the TPO's order on this aspect of the matter. The ld. AR contended that both the TPO as well as the AO failed to give effect to the direction given by the DRP which is binding on them.

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13. In such circumstances, the question arises as to whether the direction given by the DRP is mandatory or directory on the TPO/AO. In order to find an answer to this question, we need to have a look at the mandate of section 144C(13), which is as under:-

> "(13) Upon receipt of the directions issued under sub-section (5), *the Assessing Officer shall, in conformity with the directions, complete,* notwithstanding anything to the contrary contained in section 153 or section 153B, *the assessment* without providing any further opportunity of being heard to the assessee, within one month from the end of the month in which such direction is received."

14. A bare perusal of this provision indicates that upon receipt of the directions issued by the DRP under sub-section (5) of section 144C, the AO has to complete the assessment *in conformity with the directions* so given. In other words, the assessing authority is bound by the directions given by the DRP and these directions are mandatory and not directory in nature. Reverting to the facts, once the DRP directed the TPO to exclude the excess amount of depreciation, it was incumbent upon him to give effect to such direction notwithstanding his contrary view on the issue.

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15. Here, we want to note that the Finance Act, 2012 has inserted sub-section (2A) to section 253 w.e.f. 1.7.2012 providing remedy to the Department against the direction given by the DRP which is not acceptable to it. This sub-section provides that the Commissioner may direct the AO to appeal to the Tribunal against the order if he objects to any direction issued by the DRP in respect of any objection filed on or after 1.7.2012 by the assessee u/s 144C(2), in pursuance of which the AO has passed an order completing the assessment. The insertion of this provision reaffirms that the direction given by the DRP u/s 144C(5) is binding on the AO who, under sub-section (13) of section 144C, is bound to complete the assessment in conformity with the direction given by the DRP. It is only in the secondary stage after the completion of assessment, as per which the Revenue, if aggrieved against direction given by the DRP, can appeal before the tribunal against the order passed by the AO giving effect to such direction. In any case, the direction given by the DRP has to be honoured by the AO while finalizing the assessment u/s 143(3) read with section 144C(13) of the Act. Coming back to the facts of the instant case, we find that the

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direction given by the DRP for verifying and excluding the excess amount of depreciation has not been adhered to by the TPO/AO, which position is contrary to law. As such, we set aside the impugned order on this score and remit the matter to the file of the AO/TPO for passing an order in conformity with the direction given by the DRP. We want to make it explicit that we have not undertaken the exercise of examining any aspect of the actual amount of the excess depreciation liable for exclusion. The DRP has also simply directed the TPO to verify this aspect, and, then, exclude the excess amount of depreciation in determining the ALP of the international transaction. As such, the Officer is not only entitled but also duty bound to verify the correctness of the claim lodged by the assessee before excluding the excess amount of depreciation.

16. The next issue raised in this appeal is against the treatment of hypothetical interest on security deposits as income u/s 28(iv) of the Act. The facts apropos this ground are that the assessee was found to have let out its property on receiving an interest-free security deposit of

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Rs.77,25,480/-. The AO determined interest rate of 15% which, in his opinion, should have otherwise led to increase in the annual letting value of the property. Initially he discussed the inclusion of this amount in the annual letting value of the property, but, later on, he switched over to section 28(iv) and, finally, included a sum of Rs.11,58,822/- in the assessee's total income towards notional interest on interest free deposit. The assessee challenged the view taken by the AO in the draft order before the DRP, who, vide para 3.3 of its direction, directed the AO to delete this addition. It was held that neither the ALV of the property can be increased u/s 23 with the notional interest nor section 28(iv) can be applied. However, we find from the final assessment order passed by the AO that the addition of Rs.11.58 lac has still been made.

17. Again, it is amply clear that the direction given by the DRP for deletion of this addition has not been taken into consideration by the AO while finalizing the assessment. We have noticed above that the direction given by the DRP is binding on the AO in terms of section 144C(13). Adopting the discussion made above, we hold that the

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addition of Rs.11.58 lac is not warranted because of the direction given by the DRP for the deletion of the addition. This ground is allowed.

18. The last issue in this appeal is against the addition on account of transfer pricing adjustment towards interest on interest free loan given by the assessee to its AE. The TPO observed that the assessee advanced some interest free loan to its AE. He applied interest rate of 14% on such amount for working out the TP adjustment of Rs.87,90,467/-. The assessee remained unsuccessful before the DRP and the AO in his final order made the above addition.

19. After considering the rival submissions and perusing the relevant material on record, we find that this is a recurring issue coming from the earlier years, which has been decided by the Tribunal in assessee's own case for the preceding years. In its order for the AY 2002-03, the Tribunal restored this matter for a fresh consideration in the light of certain directions. Similar view has been repeated by the Tribunal vide para 16 on page 10 of its order for the immediately preceding assessment year, namely, 2006-07, by remitting the matter to the file of

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the AO/TPA. In the absence of any distinguishing facts for this year *vis-à-vis* the earlier years, respectfully following the precedent, we set aside the impugned order and remit this matter to the file of AO/TPO for a fresh determination of the transfer pricing adjustment, on the basis of the directions given by the Tribunal for such earlier years.

20. At this juncture, we want to clarify that the direction given by the Tribunal in earlier years should be seen in the light of the recent judgment delivered by the Hon'ble Delhi High Court on 27.3.2015 in *CIT vs. Cotton Naturals (I) Pvt. Ltd.* In this case, it has been held by the Hon'ble Delhi High Court that the currency in which the loan is to be re-paid normally determines the rate of return on the money lent, i.e. the rate of interest. As such, we direct the TPO to compute the rate of interest to be applied in conformity with the aforesaid judgment of the Hon'ble Delhi High Court in *Cotton Naturals (I) Pvt. Ltd. (supra),* if the earlier Tribunal order does not accord with its *ratio.* In so far as the quantum of loan is concerned, the assessee did not agitate the same.

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21. In the result, the appeal is partly allowed.

The order pronounced in the open court on 12.06.2015.

Sd/-	Sd/-
[A.T. VARKEY] JUDICIAL MEMBER	[R.S. SYAL] ACCOUNTANT MEMBER

Dated, 12th June, 2015.

dk

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT (A)
5. DR, ITAT

AR, ITAT, NEW DELHI.