IN THE HIGH COURT OF KARNATAKA AT BENGALURU

DATED THIS THE 16TH DAY OF JANUARY 2021

PRESENT

THE HON'BLE MR. JUSTICE ALOK ARADHE

AND

THE HON'BLE MR. JUSTICE NATARAJ RANGASWAMY

I.T.A. NO.271 OF 2017

BETWEEN:

1. PR. COMMISSIONER OF INCOME TAX-5
BMTC COMPLEX, KORAMANGALA
BANGALORE.

2. DEPUTY COMMISSIONER OF INCOME TAX
CIRCLE 5(1)(2), BANGALORE.

... APPELLANTS

(BY SRI. T.N.C. SRIDHAR, ADV., FOR
SRI. SANMATHI E.I. ADAV.,)

AND:

M/S. NOVELL SOFTWARE DEVELOPMENT
(INDIA) PVT. LTD.
'LAUREL', BLOCK-D, 65/2
BAGMANE TECH PARK
C.V. RAMAN NAGAR
BYRASANDRA, BANGALORE-93.

... RESPONDENT

(BY SRI. T. SURYANARAYANA, ADV.)

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THIS I.T.A. IS FILED UNDER SEC. 260-A OF INCOME TAX ACT 1961, ARISING OUT OF ORDER DATED 30.09.2016 PASSED IN IT(TP)A NO.281/BANG/2015 FOR THE ASSESSMENT YEAR 2010-11, VIDE ANNEXURE-A, PRAYING TO:

(i) DECIDE THE FOREGOING QUESTION OF LAW AND/OR SUCH OTHER QUESTIONS OF LAW AS MAY BE FORMULATED BY THE HON'BLE COURT AS DEEMED FIT.

(ii) SET ASIDE THE APPELLATE ORDER DATED 30.09.2016 PASSED BY THE INCOME TAX APPELLATE TRIBUNAL, 'A' BENCH, BENGALURU, IN APPEAL PROCEEDINGS NO.IT(TP)A NO.281/BANG/2015 FOR ASSESSMENT YEAR 2010-11 VIDE ANNEXURE-A AS SOUGHT FOR IN THIS APPEAL AND TO GRANT SUCH OTHER RELIEF AS DEEMED FIT, IN THE INTEREST OF JUSTICE.

THIS I.T.A. COMING ON FOR HEARING, THIS DAY, **ALOK ARADHE J.,** DELIVERED THE FOLLOWING:

JUDGMENT

This appeal under Section 260A of the Income Tax Act, 1961 (hereinafter referred to as the Act for short) has been preferred by the revenue. The subject matter of the appeal pertains to the Assessment year 2010-11. The appeal was admitted by a bench of this Court vide order dated 09.11.2018 on the following substantial questions of law:

> *"(1) Whether on the facts and in the circumstances of the case, the Tribunal is right in law in setting aside disallowance of depreciation claimed on Software Expenses under Section 40(a)(ia) of the Act by following its earlier order in case of Kawasaki Micro Electronics in IT(TP)A No.1512/Bang/2010 dated 26.06.2015 even when assessing authority rightly held that payment for*

purchase of software was in the nature of 'royalty' in terms of Explanation 2 to Section 9 (1)(vi) of the Act?

(2) Whether on the facts and in the circumstances of the case, the Tribunal is right in setting aside disallowance made under Section 14A of the Act without the same is made in accordance with Rule 8D of I.T. Rules?".

Thereafter, additional substantial question of law was formulated which reads as under:

"Whether the direction issued by the Tribunal to the Transfer Pricing Officer to exclude depreciation from the cost of tax payer as well as comparables and directing the Assessing Officer / Transfer Pricing Officer to re-work the depreciation following its case in ***MARKET RESEARCH TOOLS PVT. LTD.****, is perverse*?"

2. Facts leading to filing of this appeal briefly stated are that assessee namely Novell Software Development (India) Pvt. Ltd. is a subsidiary of Novell Inc. U.S. (hereinafter referred to as 'the Novell U.S.' for short) and is a capital service provider. The assessee is engaged in the

business of providing software development and support services to its associative enterprises namely Novell U.S. During the relevant previous year the assessee provided software development and support devices to Novell U.S. On the basis of the transfer pricing study conducted by the assessee, it concluded that the transaction was at arm's length. The assessee had incurred an expenditure of Rs.7,61,728/- towards purchase of software which was capitalized and depreciation was claimed thereon. The Transfer Pricing Officer, by an order dated 30.01.2014, determined that the transfer pricing adjustment amounting to Rs.8,50,32,504/- was necessary in the software development services sector. The Assessing Officer, in the draft assessment order dated 10.03.2014, made an addition of a sum of Rs.8,50,32,504/- to the income disclosed by the assessee and also made disallowances under Section 40(a)(i)(a) of the Act. Thus, the Assessing Officer made a total addition of Rs.8,72,47,691/- and total income of the assessee was determined at Rs.21,51,59,762/-.

3. The assessee filed objections before the Dispute Resolution Panel, which vide direction dated 23.12.2014 reduced the transfer price adjustment made by the Transfer Pricing Officer by granting an adjustment towards depreciation as prayed by the assessee and the disallowance made under Section 40(a)(i)(a) of the Act was confirmed whereas disallowance under Section 14A of the Act was deleted. The Assessing Officer thereafter passed a final order of assessment on 29.01.2015. The revenue thereupon filed an appeal before the Income Tax Appellate Tribunal. On receipt of notice of the appeal filed by the revenue, the assessee filed cross-objections to the revenue's appeal in which grounds were urged that the order passed by the Transfer Pricing Officer be confirmed and disallowance under Section 14(a)(i)(a) of the Act be made. The Tribunal, by an order dated 30.09.2016, dismissed the appeal preferred by the revenue and allowed the cross-objection preferred by the assessee. In the aforesaid factual background, this appeal has been filed.

4. Learned counsel for the revenue fairly submitted that the first substantial question of law does not arise for consideration in this appeal. However, with regard to the third substantial question of law, it is submitted that the Tribunal has not considered whether the depreciation policies of the assessee are similar to that of comparables and has not given independent finding regarding reasons assigned by the Transfer Pricing Officer. It is further submitted that the Tribunal failed to note that depreciation cannot be excluded from the cost of tax payer as well as comparables and Rule 10B(1)(e)(iii) of the Income Tax Rules nowhere provides to exclude the depreciation as it will materially affect the adjustments and therefore, the same cannot be excluded. With regard to second substantial question of law it is argued that assessee has not determined the expenditure incurred in relation to exempt income and Assessing Authority has rightly held that even though there is no dividend income from the investment, the assessee was required to determine expenditure as per Section 14A read with Rule 8D of the Rules. In support of aforesaid submission, reliance has been placed on the decision of this Court in ***'THE***

COMMISSIONER OF INCOME-TAX Vs. M/s. KINGFISHER FINVEST INDIA LTD.' IN ITA NO.100/2015 DECIDED ON 29.09.2020.

5. On the other hand, learned counsel for the assessee submitted that Rule 10B of the Rules provides for the method in which comparability analysis is to be conducted under the transactional net margin method. It is pointed out that under sub-clause (i) of Rule 10B(1)(e) of the Rules, the net profit margin realized by the tax payer from an international transaction is computed having regard to a relevant base that is cost incurred and sales effected, etc. It is further submitted that since the assessee has a policy of charging a higher rate of depreciation as compared to the companies selected by the Transfer Pricing Officer, there is a definite impact on the net margins of the assessee as compared to comparable companies. Therefore, there is a need of making an adjustment to eliminate differences into accounting policies of the assessee and the comparable companies in terms of the Rules. It is also argued that Tribunal has rightly accepted the aforesaid submission by relying on decision of

Hyderabad Bench of the Tribunal in ***MARKET RESEARCH TOOLS PVT. LTD.*** and no errors have been pointed out in the aforesaid provision. It is also urged that the Tribunal has rightly deleted the disallowance made under Section 14A of the Act as the assessee had not incurred any exempt income. In support of aforesaid submissions, reliance has been placed on the decision of the Supreme Court in ***'CIT Vs. CHETTINAD LOGISTICS (P) LTD.' (2018) 95 TAXMANN.COM 250 (SC),*** decisions of Madras High Court in '***CIT Vs. CHITTANAD LOGISTICS (P) LTD.' (2017) 80 TAXMANN.COM 221 (MADRAS), 'REDINGTON (INDIA) LTD. Vs. ACIT' (2017) 77 TAXMANN.COM 257 (MADRAS),*** decisions of Delhi High Court in '***CHEMINVEST LTD. Vs. CIT' (2015) 61 TAXMANN.COM 118 (DELHI) AND 'CIT Vs. HLCIM INDIA (P) LTD.' (2015) 57 TAXMANN.COM 28 (DELHI).***

6. We have considered the submissions made on both sides and have perused the record. Admittedly, the first substantial question of law does not arise for consideration. Therefore, we need not deal with the same. Sofar as second

substantial question of law is concerned, this Court in ITA No.416/2014 decided on 12.01.2021, has held that if no exempt income has accrued to the assessee the provisions of Section 14A do not apply. However, reliance placed by the learned counsel for the revenue on the decision in the case of ***KINGFISHER FINVEST LTD.***, supra, is concerned, suffice it to say that reliance was placed in the aforesaid decision on the decision in ***MAXOPP INVESTMENT LTD. Vs. COMMISSIONER OF INCOME-TAX, NEW DELHI' (2018) 402 ITR 640 (SC)***. It is pertinent to note that the decision ***MAXOPP INVESTMENT LTD,*** *supra,* does not deal with the issue of applicability of Section 14A of the Act. The subsequent decisions of Madras High Court as well as Delhi High Court, namely in ***CHETTINAD LOGISTICS (P) LTD.***, *supra* and ***CHEMINVEST LTD.***, *supra*, have been affirmed by the Supreme Court subsequently. Therefore, taking into account the fact that ***MAXOPP INVESTMENT LTD***, *supra* does not deal with the issue with regard to applicability of Section 14A of the Act, we are in respectful agreement with the view taken by the High Court of Madras and High Court of Delhi. Since no exempt income has accrued to the

assessee, therefore we hold that the provisions of Section 14A of the Act do not apply to the fact situation of the case. In the result, the second substantial question of law is answered against the revenue and in favour of the assessee.

7. Now we may advert to the third substantial question of law. Rule 10B of the Income Tax Rules, 1962 provides the method in which comparability analysis is to be conducted under transactional net margin method. Under sub-clause (i) of Rule 10B(1)(e), the net profit margin realized by the tax payer from an international transaction is computed having regard to the relevant base that is costs incurred and sales effected, etc. Under sub-clause (ii) of Rule 10B(1)(e), the net profit margin is realized by an unrelated enterprise / comparable company is computed having regard to the same relevant base as was selected in sub-clause (i). Sub-clause (iii) of said Rule specifies that before a comparison of net margins realized under sub-clauses (1) and (ii) is done, the net margin realized under sub-clause (ii) must be adjusted to take into account the differences which could materially affect the net profit margin in the open market. So also, in

terms of Rule 10B(3), an uncontrolled transaction shall be considered comparable if none of the differences between the comparable companies and the controlled transaction are likely to materially affect the profit arising from such transactions in the open market or reasonably accurate adjustments can be made to eliminate the material effect of such differences. Since the respondent has a policy of charging a higher rate of depreciation as compared to the companies selected by the TPO, there is a definite impact on the net margins of the respondent as compared to the comparable companies. Thus, there is a need for making an adjustment to eliminate the differences in the accounting policies of the appellant and the comparable companies, in terms of the above Rules, especially given that in the bench marked international transaction is the sales by a captive service provider to its associated enterprises, on which depreciation would have no bearing and thus can be excluded altogether.

8. The Tribunal, by placing reliance on the Hyderabad Bench of the Tribunal in the case of ***MARKET RESEARCH***

TOOLS PVT. LTD. has held that the Dispute Resolution Panel erred in directing to exclude depreciation from the cost of tax payer as well as comparables. The aforesaid finding cannot be said to be perverse warranting interference of the Court in this appeal.

9. In view of preceding analysis, the third substantial question of law is answered against the revenue and in favour of the assessee.

In the result, we do not find any merit in this appeal. The same fails and is hereby dismissed.

Sd/-
JUDGE

Sd/-
JUDGE

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