

**IN THE INCOME TAX APPELLATE TRIBUNAL
BANGALORE BENCHES "B", BANGALORE**

Before Shri Chandra Poojari, AM & Shri George George K, JM

IT(TP)A No.506/Bang/2016 : Asst.Year 2011-2012

M/s.Praxair India Private Limited Mercury 2B Block, 6 th Floor Prestige Technology Park Outer Ring Road, Marathahalli Bangalore – 560 103. PAN : AAACP9993J.	v.	The Deputy Commissioner of Income-tax (LTU), Circle – 1 Bangalore.
(Appellant)		(Respondent)

Appellant by : Sri.T.Suryanarayana, Advocate
Respondent by : Dr.Manjunath Karkihalli.CIT-DR

Date of Hearing : 02.12.2021	Date of Pronouncement : 06.12.2021
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ORDER

Per George George K, JM

This appeal at the instance of the assessee is directed against final assessment order dated 20.01.2016. The relevant assessment year is 2011-2012.

2. The assessee has raised thirteen grounds and several sub-grounds. However, the learned AR during the course of hearing, had argued only on the following issues:-

“(i) Transfer pricing ("TP") adjustment of Rs.18,36,20,541/- made by the Transfer Pricing Officer in respect of the international transaction of payment of royalty by the assessee to its Associated Enterprises ("AEs") by restricting the same to 1 %;

(ii) TP adjustment of Rs 33,27,95,258/- made by the TPO in respect of the international transaction of payment of interest on Compulsorily Convertible Debentures ("CCDs") by re-characterizing the same to be external commercial borrowing ("ECB");

(iii) Disallowance of Rs.7,37,96,498/- made under Section 14A of the Act;

(iv) Disallowance of Rs.14,32,50,701/- made under Section 40(a) of the Act; and

(v) Recharacterizing the suo moto disallowance of Rs.5,42,35,783/- made by the assessee under Section 40(a) of the Act as a disallowance under Section 37 of the Act.”

3. Brief facts of the case are as follows:

The assessee is a company, engaged in the manufacture and supply of industrial gas. The assessee is a subsidiary of Prazair Pacific Limited, Mauritius. During the relevant assessment year, the assessee entered into certain international transactions with its Associated Enterprises (AEs). Two of the international transactions the assessee entered with its AEs were payment of royalty and payment of interest on Compulsory Convertible Debentures (CCDs). The assessee in its Transfer Pricing (TP) study, had aggregated the transaction of payment of royalty with certain other transactions and benchmarked on application of Transactional Net Margin Method (TNMM). The assessee concluded the international transaction of payment of royalty at 4% as being at arm's length. In respect of the transaction on payment of interest on CCDs at 9% amounting to Rs.61,50,22,027, the assessee benchmarked the same using independent CCD benchmarking study and concluded the transaction to be at arm's length.

4. During the course of assessment proceedings, reference was made to the Transfer Pricing Officer (TPO) to determine

the Arm's Length Price (ALP) of the international transactions undertaken by the assessee with its AEs. The TPO passed an order dated 30.01.2015 u/s 92CA of the I.T.Act determining the TP adjustment in respect of international transactions of payment of royalty and payment of interest of CCDs aggregating to Rs.51,64,15,799 (Royalty - Rs.18,36,20,541 plus interest on CCD's = Rs.33,27,95,253). The Assessing Officer passed draft assessment order dated 10.03.2015 incorporating the aforesaid TP adjustments made by the TPO. The A.O. also made certain other additional / disallowances on corporate tax issues.

5. Aggrieved, the assessee filed objections before the Dispute Resolution Panel (DRP). The DRP vide its directions dated 28.12.2015 granted partial relief to the assessee. Pursuant to the directions of the DRP, final assessment order was passed on 28.01.2016.

6. Aggrieved by the final assessment order, the assessee has filed this appeal before the Tribunal. We shall adjudicate the above issues argued before us as under:

TRANSFER PRICING ADJUSTMENT

Payment of royalty (Ground 3)

7. The assessee benchmarked the transaction of payment of royalty by aggregating it with certain other transactions. The TPO rejected the method adopted by the assessee. The TPO applied CUP as the most appropriate method and

determined the ALP of the transaction at 1% (refer page 18 and 19 of the TPO's order).

7.1 Aggrieved, the assessee filed objections before the DRP. The DRP rejected the objections of the assessee by relying on the directions issued in assessee's own case for assessment year 2010-2011 (refer page 2 of the DRP's directions).

7.2 Aggrieved, the assessee has raised this issue before the Tribunal. The learned AR submitted that the Tribunal in assessee's own case for assessment years 2009-2010 and 2010-2011 had restored the matter to the TPO to re-determine the ALP of the royalty payment. It was submitted that the TPO while giving effect to the ITAT's order, had accepted the payment of royalty of 4% to be at arm's length (for both the assessment years 2009-2010 and 2010-2011). The copies of the order of the Tribunal for assessment years 2009-2010 and 2010-2011 and the orders of the TPO in giving effect to the Tribunal's order are placed on record.

7.3 The learned Departmental Representative was duly heard.

7.4 We have heard rival submissions and perused the material on record. The Tribunal in assessee's own case for assessment year 2009-2010 in IT(TP)A No.315/Bang/2014 (order dated 31.03.2017) and for assessment year 2010-2011 in IT(TP)A No.361/Bang/2015 (order dated 04.06.2018) had restored the issue of determination of ALP for payment of

royalty to the files of the TPO. The TPO, pursuant to the Tribunal's order, passed orders accepting the payment of royalty at 4% to be at arm's length. The relevant portion of the TPO's order for assessment year 2009-2010 reads as follows:-

“3. In view of above direction of the ITAT, the assessee was asked to submit the details with respect of all comparables vide letter dated 19.06.2017. In response of the same the submission was filed by the assessee on 11.06.2017 which have been considered.

As per submission, assessee has stated that out of the total 17 comparable agreements, the related party relationship between licensor and licensee existed in 07 comparable agreements and remaining 10 comparables agreements have unrelated party relationship for which the average royalty rate is computed at 4.10. Submission of the assessee has been considered. As the average rate of royalty paid by the comparables is more than payment made by the assessee, i.e. at 4%, payment towards royalty is being treated to be at arm's length.”

7.5 The relevant portion of the TPO's order for assessment year 2010-2011, reads as follows:-

“6. In view of above direction of the ITAT, the assessee was asked to submit the details with respect of all comparables vide letter dated 27.11.2018. In response of the same the submission was filed by the assessee on 12.12.2018 which have been considered. As per submission, assessee has stated that out of the total 17 comparable agreements, the related party relationship between licensor and licensee existed in 07 comparable agreements and remaining 10 comparables agreements have unrelated party relationship for which the average royalty rate is computed at 4.10%. Submission of the assessee has been considered. As the average rate of royalty paid by the comparables is more than payment made by the assessee, i.e., at 4%, payment towards royalty is being treated to be at arm's length.

7. Taking all these into consideration, the Royalty payment @ 4% made by the taxpayer to its AE is considered at Arm's Length, hence no adjustment on account of royalty payment is required to be made.”

7.6 In view of the above orders of the TPO, accepting the payment of royalty at 4% to be at arm's length, we hold that the payment of royalty at 4% in the year under consideration is to be treated as being at arm's length. Accordingly ground 3 is allowed.

Payment of Interest on Compulsory Convertible Debentures (Ground 4) (Transfer pricing issue)

8. During the financial year 2009-2010, the assessee had entered into a debenture subscription agreement with its AEs, Praxair International Finance. As per the terms of the debenture subscription agreement, the assessee issued unsecured and compulsory convertible debentures bearing interest at the rate of 9% per annum of the issue price. For the relevant assessment year, the assessee paid interest amounting to Rs.61,50,22,027. In the TP study, the assessee benchmarked the transaction of payment of interest by applying CUP method. Using the CCD benchmarking study, the assessee selected two companies as comparables and since the arithmetical mean of interest paid by the two companies stood at 9.5%, the assessee concluded the international transaction of payment of interest at 9% to be at arm's length.

8.1 The TPO treated the CCDs as External Commercial Borrowings (ECB) and benchmarked the interest rate paid against LIBOR rate of 4.13% (being LIBOR + 350 basis points). (Refer page 25 to 29 of the TPO's order).

8.2 Aggrieved, the assessee filed objections before the DRP. The DRP rejected the assessee's objections and upheld the TPO's order (refer pages 3 and 4 of the DRP's directions).

8.3 Aggrieved, the assessee has raised this issue before the Tribunal. It is submitted that the TPO and DRP grossly erred in treating the CCDs as ECBs and benchmarking the interest rate against LIBOR rate. It was submitted that CCDs being a hybrid instrument, cannot be treated as an ECB/loan. Reliance in this regard is placed on the order of the Hyderabad Bench of the Tribunal in the case of ADAMA India (P.) Ltd. v. DCIT ([2017] 78 taxmann.com 75 (Hyderabad-Trib.)). It is further submitted that the CCDs having been denominated in INR, the interest having been paid in INR, and the CCDs having been repaid in INR, the same cannot be benchmarked against LIBOR. In this context, the learned AR relied on the following case laws:-

- (i) CIT v. Cotton Naturals (I) (P.) Ltd. (2015) 65 taxmann.com 523 (Delhi).
- (ii) PCIT v. India Debt Management (P.) Ltd. (2019) 106 taxmann.com 55 (Bombay)
- (iii) Adams India (P.) Ltd. v. DCIT (2017) 78 taxmann.com 75 (Hyderabad-Trib.).

8.4 Therefore, it was submitted that the transaction of payment of interest of CCDs ought to be treated as being at arm's length.

8.5 The learned Departmental Representative supported the findings of the Income Tax Authorities.

8.6 We have heard rival submissions and perused the material on record. The assessee during the financial year 2009-2010, entered into a debenture subscription agreement with its AEs, Praxair International Finance. In the agreement, the term “issue price” is defined as “CCD will be issued at par at Rs.10 each”. Further, the subscription considered shall be converted into INR as per the prescribed exchange rate and the number of CCDs allotted to the holders will be the subscription consideration as converted into INR, divided by face value of the CCD instrument. The debenture certificates issued clearly reflect the face value of debenture at INR at Rs.10 each. The CCDs are recorded in the financial statements in INR. The CCDs were also subsequently repaid in INR. The true copy of the statement setting out the details of payment and demand deposit transaction clearly demonstrate that the remittance is in INR.

8.6.1 The TPO and DRP erred in treating CCDs as ECBs and benchmarked the interest rate against LIBOR rate. The CCDs is a hybrid instrument and cannot be *per se* treated as ECB / loan. The Hyderabad Bench of the Tribunal in the case of Adama India (P.) Ltd. v. DCIT (supra) had held that CCDs cannot be categorized as a loan. The relevant finding of the Tribunal reads as follows:-

“8. We have considered the issue and examined the rival contentions. There is no dispute with reference to the fact that the CCDs were issued in Indian Rupees. Accordingly, following the principles laid down by the Co-ordinate Benches and the Hon'ble High Court as relied on by the assessee in the submissions, we have to hold that TPO has wrongly treated the issuance of CCDs as a loan, by treating it as an external commercial borrowing, ignoring the fact that loan is a debt, whereas CCD is hybrid instrument in nature basically categorised as equity in nature. It was

accepted by the Hon'ble Supreme Court in the case of Sahara India Real Estate Corporation Limited and Sahara Housing Investment Corporation Limited & Ors. Vs. Securities and Exchange Board of India & Anr. in Civil Appeal No. 9813 of 2011 dt. 31-08-2012 (supra) while assigning the jurisdiction to SEBI as an 'equity instrument'. Further, the policy of Govt. of India and also RBI effective from 01-04-2010 also indicate that issuance of CCD is part of FDI being quasi-equity in nature and considering the same as a loan would be completely against regulations laid by DIPB, RBI and FEMA. It is to be reiterated that issuance of CCDs was denominated in Indian Rupees and not foreign currency. Therefore, TPO has erred in considering LIBOR as benchmark rate which is in complete contradiction to the principles on the issue. The following judicial precedents supports that the rate interest has to be considered in the currency in which loan has originated:

- i. India Debt Management Pvt. Ltd., IT(TP)A No. 7518/Mum/2014;*
- ii. CIT Vs. Cotton Naturals (I) Ltd., ITA No. 233/2014 (Del.HC);*
- iii. M/s. Brahma Center Development Pvt. Ltd., Vs. ITO, ITA No. 373/Del/2016 (ITAT Del).*

By respectfully following the Co-ordinate Bench and Hon'ble High Court decisions, we agree with the assessee's contentions that the CCDs cannot be categorised as a loan and LIBOR plus two hundred basis points benchmark cannot be accepted on the facts of the case."

8.6.2 The Hon'ble Delhi High Court in the case of *CIT v. Cotton Naturals (I) Pvt. Ltd. (supra)* had held that the interest rate should be the market determined interest rate applicable to the currency concerned in which the loan has to be repaid. The relevant finding of the Hon'ble High Court reads as follows:-

"39. The question whether the interest rate prevailing in India should be applied, for the lender was an Indian company/assessee, or the lending rate prevalent in the United States should be applied, for the borrower was a resident and an assessee of the said country, in our considered opinion, must be answered by adopting and applying a commonsensical and pragmatic reasoning. We have no hesitation in holding that the interest rate should be the market determined interest rate applicable to the currency concerned in which the loan has to be repaid. Interest rates should not be computed on the basis of interest payable on the currency or legal tender of the place or the country of residence of either party. Interest rates applicable to loans and deposits in the national currency of the borrower or

the lender would vary and are dependent upon the fiscal policy of the Central bank, mandate of the Government and several other parameters. Interest rates payable on currency specific loans/ deposits are significantly universal and globally applicable. The currency in which the loan is to be repaid normally determines the rate of return on the money lent, i.e. the rate of interest. Klaus Vogel on Double Taxation Conventions (Third Edition) under Article 11 in paragraph 115 states as under:-

"The existing differences in the levels of interest rates do not depend on any place but rather on the currency concerned. The rate of interest on a US \$ loan is the same in New York as in Frankfurt-at least within the framework of free capital markets (subject to the arbitrage). In regard to the question as to whether the level of interest rates in the lender's State or that in the borrower's is decisive, therefore, primarily depends on the currency agreed upon (BFH BSt.B 1. II 725 (1994), re 1 § AStG). A differentiation between debt-claims or debts in national currency and those in foreign currency is normally no use, because, for instance, a US \$ loan advanced by a US lender is to him a debt-claim in national currency whereas to a German borrower it is a foreign currency debt (the situation being different, however, when an agreement in a third currency is involved). Moreover, a difference in interest levels frequently reflects no more than different expectations in regard to rates of exchange, rates of inflation and other aspects. Hence, the choice of one particular currency can be just as reasonable as that of another, despite different levels of interest rates. An economic criterion for one party may be that it wants, if possible, to avoid exchange risks (for example, by matching the currency of the loan with that of the funds anticipated to be available for debt service), such as taking out a US \$ loan if the proceeds in US \$ are expected to become available (say from exports). If an exchange risk were to prove incapable of being avoided (say, by forward rate fixing), the appropriate course would be to attribute it to the economically more powerful party. But, exactly where there is no 'special relationship', this will frequently not be possible in dealings with such party. Consequently, it will normally not be possible to review and adjust the interest rate to the extent that such rate depends on the currency involved. Moreover, it is questionable whether such an adjustment could be based on Art. 11 (6). For Art. 11 (6), at least its wording, allows the authorities to 'eliminate

hypothetically' the special relationships only in regard to the level of interest rates and not in regard to other circumstances, such as the choice of currency. If such other circumstances were to be included in the review, there would be doubts as to where the line should be drawn, i.e., whether an examination should be allowed of the question of whether in the absence of a special relationship (i.e., financial power, strong position in the market, etc., of the foreign corporate group member) the borrowing company might not have completely refrained from making investment for which it borrowed the money.

40. The aforesaid methodology recommended by Klaus Vogel appeals to us and appears to be the reasonable and proper parameter to decide upon the question of applicability of interest rate. The loan in question was given in foreign currency i.e. US \$ and was also to be repaid in the same currency i.e. US \$. Interest rate applicable to loans granted and to be returned in Indian Rupees would not be the relevant comparable. Even in India, interest rates on FCNR accounts maintained in foreign currency and different and dependent upon the currency in question. They are not dependent upon the PLR rate, which is applicable to loans in Indian Rupee. The PLR rate, therefore, would not be applicable and should not be applied for determining the interest rate in the extant case. PLR rates are not applicable to loans to be re-paid in foreign currency. The interest rates vary and are thus dependent on the foreign currency in which the repayment is to be made. The same principle should apply.”

8.6.3 In the instant case, admittedly, the CCDs are issued in INR, interest is paid in INR and CCD's are repaid also in INR. Therefore, placing reliance on the judgment of the Hon'ble Delhi High Court in the case of *CIT v. Cotton Naturals (I) Pvt. Ltd. (supra)*, we hold that the TP study of the assessee to justify the interest rate by arriving at average rupee cost and comparing the same with SBI prime lending rate is correct. It is ordered accordingly.

8.6.4 Hence, ground 4 is allowed.

Disallowance u/s 14A of the Act (Ground 5.4)
(Corporate Tax Issue)

9. The Assessing Officer made a disallowance u/s 14A of the Act of Rs. 7,37,96,498 computed as per Rules 8D(ii) and (iii) of the Income-tax Rules, 1962. The DRP rejected the objections of the Appellant and affirmed the disallowance.

9.1 Aggrieved, the assessee has raised this issue before the ITAT. The learned AR submitted that the assessee did not earn any exempt income during the relevant assessment year. Therefore, it was submitted that no disallowance can be made u/s 14A of the Act. The learned AR relied on the judgment of the Hon'ble Karnataka High Court in the case of CIT & Anr. v. Quest Global Engineering Sources Pvt. Ltd. (ITA No.133/2015, judgment dated 15.02.2021) and the judgment of the Hon'ble Bombay High Court in the case of India Debt Management (P) Ltd. reported in (2019) 106 Taxmann.com 55 (Bombay).

9.2 We have heard rival submissions and perused the material on record. It is an undisputed fact that the assessee did not earn any exempt income during the year under consideration. It is a settled position that in the absence of any exempt income, no disallowance can be made u/s 14A of the Act. In this context, reliance is placed on the judgment of the Hon'ble jurisdictional High Court in the case of CIT and Anr. v. Quest Global Engineering Services Pvt. Ltd. (supra), wherein it was held as follows:-

“14. Now we may advert to the second substantial question of law. It is pertinent to note that for Assessment Year 2009-10 the assessee has not earned dividend income. The aforesaid fact has not been disputed by the revenue. It is also relevant to mention that Circular No.5/2014 dated 11.02.2014 is not applicable in the instant case as the instant case pertains to Assessment Year 2009-10. The aforesaid Circular has no retrospective operation. It is noteworthy that aforesaid Circular was not even relied by the parties. This court in **COMMISSIONER OF INCOME TAX VS. KINGFISHER INVESTMENT INDIA LTD.** vide judgment dated 29.09.2020 inter alia held that disallowance under Section 14A read with Rule 8D has to be made even when taxpayer in a particular year has not earned any exempt income. This court relied on the decision of the Supreme Court in **MAXOPP INVESTMENT LTD** supra which was reproduced in Paragraph 5 of the decision and reliance was also placed on Circular dated 11.02.2014 issued by Central Board of Direct Taxes (CBDT). However, the aforesaid decision was subsequently considered by this court in judgment dated 16.01.2021 passed in I.T.A.No.271/2017 (**PRINCIPAL COMMISSIONER OF INCOME TAX VS. NOVEL SOFTWARE DEVELOPMENT**) in which it was held that decision of this court in **KINGFISHER FIN VEST LTD.** was distinguishable as the basis of the aforesaid decision of this court was the decision of the Supreme Court in **MAXOPP INVESTMENTS LTD.** supra and it was held that the aforesaid decision does not deal with applicability of Section 14A of the Act. However, eventually this court agreed with the view taken by High Court of Madras in **CIT VS. CHETTINAD LOGISTICS P LTD., (2017) 80 TAXMANN.COM 221 (MAD.) AND KEM INVEST LTD. VS. CIT, (2015) 16 TAXMANN.COM 118 (DELHI)** and held that since no exempt income has accrued to the assessee therefore, the provisions of Section 14A of the Act do not apply to the fact situation of the case. Therefore, it has become necessary for us to clarify the view taken in the two decisions viz., **KINGFISHER FINVEST INDIA LTD. AND MIS NOVEL SOFTWARE INDIA (P) LTD.** supra. At this stage, we may refer to Paragraph 40 of the decision of the Supreme Court in **MAXOPP** supra, the relevant extract of which reads as under:

It is to be kept in mind that in those cases where shares are held as ‘stock-in-trade’, it becomes a business activity of the assessee to the deal in those shares as a business proposition. Whether dividend is earned or not becomes immaterial. In fact, it would be a quirk of fate that when the investee company declared dividend, those shares are held by the assessee, though the assessee has to ultimately trade those shares by selling them to earn profits. The situation here is therefore, different from the case like Maxopp Investment Ltd. where the assessee would continue to hold those shares as it wants to retain control over the investee company. In that case, whenever dividend is declared by the investee company that would necessarily be earned by the assessee and the

assessee alone. Therefore, even that the time of investing into those shares, the assessee knows that it may generate dividend income as well and as and when such dividend income is generated that would be earned by the assessee. In contrast, where the shares are held as stock-in-trade, this may not be necessarily a situation. The main purpose is to liquidate those shares whenever the share price goes upon order to earn profits. In the result, the appeals filed by the revenue challenging the judgment of the Punjab and Haryana High Court in State Bank of Patiala also fail, though law in this respect has been clarified hereinabove.

15. From perusal of the relevant extract of the Supreme Court, it is evident that the decision in **MAXOPP IN VESTMENT LTD.** supra deals with applicability of Section 14A of the Act. Therefore, the observations made with regard to applicability of Section 14A in **MIS NOVEL SOFTWARE INDIA (P) LTD.** are factually incorrect and we hasten to clarify the same. However, from relevant extract of Paragraph 40, it is evident that only expenses proportionate to earning of exempt income could be disallowed under Section 14A of the Act and the decision of MAXOPP INVESTMENT LTD is an authority for the aforesaid proposition that the provision is relatable to earning of actual income. The object of Section 14A is to curb the practice to claim deduction of expenses incurred in relation to exempt income against taxable income and at the same time avail of the tax incentive by way of exemption of exempt income without making any apportionment of expenses incurred in relation to exempt income. The High Court of Madras has relied on the decision of the Supreme Court in **COMMISSIONER OF INCOME TAX VS. WALFORT SHARE AND STOCK BROKERS (2010) 326 ITR 1** wherein it has been held that Section 14A is relatable to income of actual income or not notional or anticipated income. Therefore, the conclusion arrived at by us in **MIS NOVEL SOFTWARE INDIA (P) LTD.** is affirmed but for different reasons. It is also clarified by us that while recording the conclusion in **KINGFISHER FIN VEST LTD.** that disallowance under Section 14A has to be made even taxpayer has not earned any exempt income, this court has misread the ratio of the decision of the Supreme Court in **MAXOPP INVESTMENT LTD** supra and therefore, the aforesaid view being contrary to the law laid down by the Supreme Court is not a binding precedent.

In view of preceding analysis, the second substantial question of law is also 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."

9.3 The Hon'ble Bombay High Court in the case of India Debt Management (P.) Ltd. (supra) has held that when the

assessee does not receive any dividend income, no disallowance can be made u/s 14A of the Act. The relevant finding of the Hon'ble High Court of Bombay, reads as follows:-

“7. Regarding question (b) :-

The issue is no longer res-integra. The facts are that the assessee had not earned any exempt, income during the year under consideration. As held earlier Delhi High Court which judgment is also followed repeatedly by our Court, in case of Cheminvest Ltd. v. CIT [2015] 61 taxmann.com 1181234 Taxman 761/375 ITR 33 (Delhi), in such a case disallowance of expenditure under section 14A of the Act would not be permissible. The decision of Delhi High Court was carried in the appeal by the revenue. The SLP has been dismissed by the Supreme Court.”

9.4 In the light of the aforesaid judicial pronouncements, the disallowance made u/s 14A of the Act, ought to be deleted, since the assessee was not in receipt of any exempt income during the relevant assessment year.

Disallowance of expenditure of Rs.10,04,41,779 (ground 6.2) (Corporate Tax Issue)

10. The assessee claimed deduction u/s 40(a)(ia) of the Act of an amount of Rs.10,04,41,779 since the tax was deducted and remitted during the relevant year under consideration. The details of the assessment year it pertains to and the amounts are as follows:-

Sl. No.	Pertaining to AY	Amount (Rs.)
1	2009-2010	5,23,71,553
2	2010-2011	4,80,70,246

10.1 The TPO, however, did not allow deduction of Rs.10,04,41,779.

10.2 Aggrieved, the assessee filed objections before the DRP. The DRP allowed the claim of the assessee. The DRP directed the AO to verify whether the assessee had deducted tax and remitted the same during the relevant assessment year. In the event, the assessee has remitted the TDS during the relevant assessment year, the expenditure claimed (for which TDS was submitted) was directed to be allowed as a deduction. However, the directions of the DRP was not given effect by the A.O. in the final assessment order.

10.3 Aggrieved by the final assessment order, the assessee has raised this issue before the ITAT. The learned AR submitted that the A.O. has grossly erred in not giving effect to the DRP's directions. Therefore, it was submitted that the disallowance made are liable to be set aside on implementation of the DRP's directions.

10.4 The learned Departmental Representative was duly heard.

10.5 We have heard rival submissions and perused the material on record. The DRP's directions with reference to the disallowance of expenditure of Rs.10,04,41,779 reads as follow:-

"4.4 As regards amounts of Rs.5,23,71,553/- as in (a) above and Rs.4,80,70,246/- as in (b) above are concerned, there is merit in the submissions of the assessee. From the

assessment orders and income tax returns it is evident that the disallowance is on account of non deduction of tax at source and has never been disputed by the AO while framing assessment for the said years. The conclusion of the AO that the reversal of a provision means expenses are not longer required itself is faulty as the provision is reversed when the provision itself is no longer required. This can be due to actual booking of expenses, for which the provision was made in books or this can also be due to excessive estimation of likely expenses when provision was made. In the present case the audit report shows that the TDS has been short deducted in relation to certain payments to contractors / sub-contractors / professionals / rent / interest etc. So these are actual expenses unless until the genuineness of transaction itself is doubted. Since the AO has not examined the issue by following this approach, he is directed to allow these expenses in the year under consideration after verifying that the tax at source has actually been deducted on such payments paid to the Government and since the expense is being claimed in the year under consideration, the AO can also verify the genuineness of transaction and the payment. Further AO is free to inform the concerned TDS authorities regarding non deduction of Tax at source by the assessee at the relevant time of making provision in view of provisions of section 194C(2) / 194I explanation (ii) / 194J explanation (c)/ explanation to sec.194A etc. so that appropriate action can be taken by such authorities for such default. The objection A of the assessee is decided in above terms.”

10.6 The assessee is entitled to claim the deduction of expenditure (as per first proviso to section 40(a)(ia) of the Act) in the year the tax on the same has been deducted at source and remitted to the Government account. Therefore, we reiterate the directions to the DRP and remit the matter to the A.O. The A.O. is directed to grant deduction of aforesaid expenditure, if it is found that tax on the same has remitted to the Government account during the relevant assessment year. It is ordered accordingly.

10.7 Hence, ground 6.2 is allowed for statistical purposes.

Disallowance u/s 40(a)(ia) of the Act of Rs.4,28,08,922 (ground 6.3)

11. During the year the assessee had claimed deduction of a sum of Rs.4,28,08,922 u/s 40(a)(ia) of the Act. Admittedly, the expenditure pertains to assessment year 2010-2011.

11.1 The DRP rejected the claim of the assessee on the ground that the expenses do not pertain to the year under consideration. The relevant finding of the DRP reads as follows:-

“4.3 As far as amount of Rs.4,28,08,922/- in part (c) as above is concerned, the same can certainly be not claimed as an expenditure or deduction in AY 2011-12 as the same does not pertain to the year under consideration. The Act does not provide for claiming the amount wrongly shown as income in one year as deduction or expenditure in any subsequent year. So the objection of assessee in relation to this amount cannot be accepted.”

11.2 Aggrieved, the assessee has raised this issue before the Tribunal. It was submitted that the amount was offered to tax u/s 40(a)(ia) of the Act inadvertently in the assessment year 2010-2011, when no corresponding expenses was claimed as deduction. It was stated that the amounts so inadvertently offered to tax in the previous year is being claimed as a deduction in the year under consideration. The assessee also produced the assessment order for assessment year 2010-2011, wherein the AO had accepted the assessee's computation of disallowance of sum of Rs.4,28,08,922.

11.3 The learned Departmental Representative strongly supported the orders of the Income Tax Authorities.

11.4 We have heard rival submissions and perused the material on record. As rightly pointed out by the DRP, the expenditure claimed as deduction amounting to Rs.4,28,08,922 does not pertain to the year under consideration. If at all there is an inadvertent offer to tax in the previous year, namely, assessment year 2010-2011, the assessee ought to have taken correctional steps for the assessment concluded for assessment year 2010-2011 and not for the relevant assessment year. There is no statutory provision which provide for claiming amount wrongly shown as income in one year as deduction / expenditure in any subsequent year (unlike first proviso to section 40(a)(ia) of the Act, whereby the assessee is permitted to claim deduction of the expenditure in the year in which the tax has been deducted on such expenditure and remitted to the Government account). Therefore, we affirm the view taken by the DRP.

11.5 Hence, ground 6.3 is rejected.

Disallowance of expenditure u/s 40(a)(ia) of the Act of Rs.5,42,35,783 (ground 7)

12. The assessee *suo moto* had disallowed a sum of Rs.5,42,35,783 for non-deduction of tax at source. (refer page 2139 of the paper book Vol.III). The Assessing Officer re-characterized the same as a disallowance u/s 37 of the Act. The DRP held that the objections of the ground do not arise out of variation in the returned income and rejected the objections of the assessee. (refer page 5 of the DRP's order).

12.1 Aggrieved, the assessee has raised this issue before the Tribunal. It was submitted by the learned AR that the Assessing Officer has erred in characterizing the disallowance u/s 37 of the Act. It was submitted that the AO's finding that the expenditure is not an admissible expenditure u/s 37 of the Act is erroneous and without any basis. It was stated that as a consequent of disallowance u/s 37 of the Act, the assessee cannot claim the same as a deduction in the year in which the tax is remitted to the Government account.

12.2 The learned Departmental Representative strongly supported the orders of the Income Tax Authorities.

12.3 We have heard rival submissions and perused the material on record. The assessee had created a provision for the expenditure incurred for the current assessment year and *suo moto* disallowed the same as taxes were not deducted. The Assessing Officer held the expenditure is not an admissible expenditure u/s 37 of the Act. The DRP has not adjudicated the issue holding that the objection of the assessee does not arise out of the variation in the returned income. The issue whether the impugned expenditure can be disallowed u/s 37 of the Act has not been dealt with either by the AO nor by the DRP. The A.O. has authority to hold that expenditure (though provision expenditure) is not an allowable deduction u/s 37 of the Act. Only those expenditure otherwise allowable u/s 30 to 38 of the Act is deductible as per proviso to section 40(a)(ia) of the Act. Therefore, any expenditure not for the purpose of

business, the A.O. can certainly re-characterize the same as not allowable expenditure u/s 37 of the Act. However, as mentioned earlier, the A.O. nor DRP has not examined whether the said expenditure is allowable business expenditure u/s 37 of the Act. The A.O. held that provision of Rs.5,42,35,783 disallowed by the assessee u/s 40(a)(ia) of the Act cannot be allowed as deduction in the subsequent assessment year, since, the expenditure does not pertain to the subsequent year. The DRP did not adjudicate the issue by observing that there is no variation to the returned income on this count. Therefore, the matter needs to be reconsidered by the AO afresh. It is ordered accordingly.

12.4 Hence, ground 7 is allowed for statistical purposes.

13. In the result, the appeal filed by the assessee is partly allowed.

Order pronounced on this 06th day of December, 2021.

Sd/-
(Chandra Poojari)
ACCOUNTANT MEMBER

Sd/-
(George George K)
JUDICIAL MEMBER

Bangalore; Dated : 06th December, 2021.
Devadas G*

Copy to :

1. The Appellant.
2. The Respondent.
3. The DRP-2, Bangalore.
4. The CIT(TP-2), Bangalore.
5. The DR, ITAT, Bengaluru.
6. Guard File.

Asst.Registrar/ITAT, Bangalore