IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCHES "A" : HYDERABAD

BEFORE SHRI B. RAMAKOTAIAH, ACCOUNTANT MEMBER
AND SMT. ASHA VIJAYARAGHAVAN, JUDICIAL MEMBER

ITA.No.115/Hyd/2011
Assessment Year 2006-2007

Infotech Enterprises Limited, Hyderabad PAN AAACI4487J (Appellant)	vs.	Addl. CIT, Range-2, Hyderabad (Respondent)

ITA.No.2184/Hyd/2011
Assessment Year 2007-2008

Infotech Enterprises Limited, Hyderabad PAN AAACI4487J (Appellant)	vs.	Asst. CIT, Circle 2(1), Hyderabad (Respondent)

For Assessee : Shri MVR Prasad
For Revenue : Shri P.Somasekhar Reddy

Date of Hearing : 29.10.2013
Date of pronouncement : 16.01.2014

ORDER

PER SMT. ASHA VIJAYARAGHAVAN, J.M.

These appeals are filed by the assessee against the Order of the Disputes Resolution Panel, Hyderabad Dated 29.09.2010 for the assessment years 2006-2007 and 2007-2008. Since, common issues are involved in these appeals, the appeals are clubbed and heard together and are being disposed of by the single consolidated order for the sake of convenience.

2. First, we will take-up ITA.No.115/Hyd/2011 for the assessment year 2006-2007. Brief facts of the case are that the assessee-company filed its return of income for the assessment year

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2006-2007 on 29.11.2006 admitting total income of Rs.16,37,87,601/-. The return was processed under section 143(1) on 28.03.2008. Subsequently, the case was converted into scrutiny and notice under section 143(2) was issued on 17.10.2007. Thereafter, notices were also issued under section 142(1) and 143(2) along with questionnaire calling for information.

3. The issue of international transaction entered into by the assessee was referred to the TPO after obtaining the prior approval from the CIT-II, Hyderabad. The Transfer Pricing Officer (in short "TPO") in his order dated 30.10.2009 has determined the difference in arms length price at Rs.13,04,00,900/-. With regard to adjustment in respect of loan transaction and guarantees a letter was addressed to the assessee on 18.11.2009 proposing to make additions on account of shortfall in loan transaction and guarantees. The assessee-company reiterated its submissions which were already put-forth before the Disputes Resolution Panel (in short "DRP") and after considering, the DRP has passed the order under section 92CA(3) of the Act. As per the Order of the DRP, the difference in Arms Length Price (in short "ALP") at Rs.27,68,740/- was added to the total income of the assessee. The draft assessment order under section 143(3) read with section 144C of the Income Tax Act, 1961 was passed on 30.12.2009 and the assessee filed its objections before the DRP under section 144C of the I.T. Act, 1961. The DRP passed an order under section 144C(5) dated 29.09.2010 granting relief of Rs.9,03,674/- on the adjustment made by the TPO in respect of ALP determined on interest. The A.O. passed the final assessment order under section 143(3) read with section 92CA and 144C of the I.T. Act, 1961 on 29.11.2010.

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4. Aggrieved, the assessee is in appeal before us. Ground No.1 and 9 are general in nature and it needs no adjudication. Ground No.2 reads as follows :

> *"2. The Dispute Resolution Panel has erred in granting relief of only Rs.9,03,674/- from the Arms Length Price determined by the Transfer Pricing Officer at Rs.27,68,740/- in respect of interest charged on the loan granted to the subsidiary company IEAI (USA).*
>
> *(b) The Dispute Resolution Panel ought to have applied the LIBOR of India and not that of USA. The LIBOR in India at the material time was 4.17% only as against the LIBOR in USA of 5.2476%.*
>
> *(c) The addition of 2% over LIBOR rate is not justified. LIBOR rate alone should have been applied.*
>
> *(d) The Dispute Resolution Panel (DRP) and the Transfer Pricing Officer (TRP) erred in applying the ALP for a twelve months period while the loan is in existence only for a period of 9 months during the previous year.*
>
> *(e) Even otherwise, the provisions of Sec. 37(1) apply and the concessional rate if any is dictated by commercial expediency. Provisions of Chapter X do not override provisions of Sec. 37(1) of the I.T. Act.*

5. The facts are that the assessee had advanced loan to its subsidiary of US $ 3,00,000 and charged interest @ 4.29% per annum. A transfer pricing adjustment has been made by the A.O. and the TPO adopting the Indian rate of interest as the comparable under the Comparable Uncontrolled Price (in short "CUP") Method. The TPO determined the ALP at 14% p.a. which worked out to Rs.18,73,620/- resulting in an adjustment of Rs.14,90,045/-. The DRP has given partial relief adopting a rate at 7.247% (the US inter Bank offered rate of 5.2476% + 2%).

6. The learned Counsel for the assessee submitted before us that the DRP should have adopted only the LIBOR of 4.17% as the

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base in the light of decision of the Hyderabad 'A' Bench of the Tribunal in the case of Four Soft Limited, Hyderabad vs. DCIT in ITA.No.1495/Hyd/2010 dated 09.09.2011. It was further submitted that differential interest was charged by all the authorities for the entire period of one year whereas, the loan was advanced on 27th July, 2005 and so the differential interest should be levied only for the relevant period.

7. The learned D.R. on the other hand relied on the orders of the revenue authorities.

8. We have heard both Parties and perused the matter available on record. The issue in Four Soft Ltd.(supra) relied upon by Assessee was the rate of LIBOR, with the actual LIBOR rate as per Assessee being 4.42% whereas DRP had taken LIBOR at 5.7%, The Tribunal has directed the AO to examine the correct rate of LIBOR and adopt LIBOR + rate in that case. The coordinate benches such as *Dr.Reddy's Laboratories Ltd. vs. ACIT (MA No. 217/Hyd/2013 in ITA No.1605/Hyd/2010 dated 29-11-2013), Siva Industries 59 DTR 182 (Che), Tech Mahindra 46 SOT 141 (Mum) & Tata Autocomp Systems 73 DTR 220 (Mum)* are approving on different factual situation, LIBOR + 1% to 3% and considering that, we feel that reasonable rate would be LIBOR + 2% and direct the AO to adopt the same.

9. We also direct the Assessing Officer to examine and calculate the differential interest to be levied for the relevant period instead of charging differential interest for the entire period of one year. With this direction, we set aside the issue to the file of the Assessing Officer. Ground No.2 is allowed for statistical purposes.

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10. Grounds No. 3 and 4 are reads as follows :

> *"3. The Assessing Officer and the DRP have erred in holding that the guarantees offered by the assessee to the Bankers of its subsidiaries in USA and Germany come under the provisions of Chapter Assessee of the IT Act.*
>
> *4. The DRP and the TPO erred in estimating 2% of the amount as the ALP for which the assessee offered guarantee to the Bankers of subsidiaries by relying on an isolated transaction."*

11. It was submitted before us by the learned Counsel for the assessee that the A.O. and DRP have held that the corporate guarantees issued by the assessee to City Bank of India for the benefit of its US subsidiary, is an international transaction within the meaning of section 92B and made an addition towards arms length price of Rs.12,78,695/- worked out at 2% of the guaranteed amount. The learned Counsel for the assessee also filed written submissions before us contending inter alia that even the retrospective insertion of the Explanation to Sec. 92B by the Finance Act, 2012 w.e.f. 01.04.2002 does not help the revenue for the reason that this is not a transaction between the assessee and its US Subsidiary but it's a transaction between the assessee and the CITI Bank India, even though it is meant for the benefit of the US subsidiary. One of the parties to the transaction has necessarily to be a non resident for it to be categorized as an "International Transaction" within the meaning of sec. 92B in the light of the decision of Hyderabad Bench of the Tribunal in the case of Swarnaandhra Ijmii Integrated Township Development vs. DCIT (Top 100 Income Tax Rulings of 2012 (CCH) (Tax Sutra) (A Wolters Kluwer Business) (Page 208). As the assessee and the CITI bank India are both residents of India, the corporate guarantee in question cannot be regarded as an international

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transaction. A copy of Board resolution towards guarantee is also filed in the paper book at page 142 before the Tribunal.

12. The learned Counsel further submitted that the corporate guarantee approved by the assessee-company does not fall within the definition of international transaction in the light of decision of the Coordinate Bench of the Tribunal in the case of Four Soft Limited (supra).

13. We have heard both the parties and perused the material available on record. In the present case though the immediate transaction is that of the assessee and CITI Bank India the benefit of the guarantee is for the US Subsidiary and hence the assessee has rendered a service to its US subsidiary for which it must charge fees at an arm's-length. This same logic was applied in Nimbus Communications vs. ACIT (34 taxmann.com 298 Mumbai Trib.). We also note the introduction of retrospective amendment in Section 92B Explanation (i)(c) which specifically covers such guarantee payments. Furthermore the decision of Swarnadhara Ijmii Integrated Township Development vs. DCIT (Top 100 Income Tax Rulings of 2012 (CCH) (Tax Sutra) was in an altogether different factual matrix concerning the assessee (an Indian Joint Venture) *reimbursing* corporate guarantee fees paid by its Malaysian AE. We draw support from the order of Mumbai Tribunal in Glenmark Pharmaceuticals vs. ACIT (ITA No.5031/Mum/2012 dated 13.11.2013) which has analyzed this issue in detail and held that 0.53% corporate guarantee rate in that case was appropriate. We therefore set aside the issue to the TPO to decide the quantum of corporate guarantee rates in the instant case following the method adopted in *Glenmark (supra).*

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14. Ground No. 5 reads as under :

5.(a) The AO has erred in holding that the amount of Rs. 52,55,881/- paid to GE Network Solutions, the Netherlands based company towards purchase of its product Small World Software to cater to the requirements of the Indian customers is a payment of Royalty.

(b) The A.O. has erred in holding that there was any patent, invention, model design, secret formula or process or trade mark or similar property involved in purchase of the small world software.

(c) The software purchased from GE Network Solutions and passed on to the GIS based companies in India for their permanent use without any limitation does not constitute mere obtaining of license for the same. The transaction is an outright purchase of Small World Software.

(d) Even otherwise, the software purchased does not involve use of any copy right but it is outright purchase of a copy of the copy righted article or thing.

(e) Having held that the facts of the case are exactly similar to those in Sonata Information Technology Limited Vs Addl. CIT (103 ITD 324) (Bang) the DRP is not justified in not giving a decision holding that it is sub judice before the Karnataka High Court. The DRP should have applied the decision of the ITAT in that case.

15. Through this ground No.5, the assessee objects to the addition of Rs.52,55,881/- under section 40(a)(i) of the I.T. Act. Brief facts are that the assessee purchased the software called 'Small World Software' from the Dutch company and bundled it with its own software and thus customized it and sold it to its own

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customers, both in India and abroad. As the payment is made to a non-resident company, the A.O. held that the payment represented, not the purchase price of the software but, actually, royalty payment to the Dutch company. The A.O. noticed that the tax was not deducted at source on the alleged royalty payment under section 195(1) of the Income Tax Act, and so invoked the provisions of section 40(a)(i) and, accordingly, disallowed the expenditure on the said royalty payment. The learned Counsel for the assessee contended before the DRP that the A.O. erred in holding that the amount of Rs.52,55,881/- paid to M/s. GE Network Solutions, Netherlands is disallowable under section 40(a)(i) of the I.T. Act, 1961. The Learned Counsel for the assessee further objected to the disallowance proposed by the A.O. as follows :

i) *that the tax payer offers software solutions to its customers in India and abroad. These solutions include supply of product software marketed by other companies bundled with its software services.*

ii) *It entered into an agreement with GE Network Solutions, a Netherlands based company which had developed and was marketing 'small world software'. By the above agreement, it was appointed the sole distributor for marketing such software in India.*

iii) *It was entitled to a margin upto 30% of the listed price.*

iv) *It procured orders from customers for supplying modules of the software and placed orders on GE Network Solutions.*

v) *The software was licensed to the end customer. License was in the nature of perpetual license and*

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the ownership was transferred to the end customer. As such, there was no royalty payment for using the software considering that the ownership is transferred to the end customer permanently.

vi) *By any stretch of imagination, it cannot be treated as a payment made in respect of a patent or invention or scientific work or secret formula or process that amounts to payment of royalty chargeable to tax within the scope of section 9(1)(vi) of the I.T. Act.*

vii) *As there was no income chargeable to tax under the provisions of Income Tax Act, no TDS was required to be made. Hence, the provisions of section 195 of the LT. Act do not have ·any application to its case. In the absence of applicability of section 195 of the I.T. Act, the provisions of section 40(a)(i) of the I.T. Act do not come into operation.*

viii) *The Department was aware of the payments made to the concerns in the earlier years also. The stand of the taxpayer was accepted by not initiating any proceedings or not making any disallowance in this regard.*

ix) *Reliance is placed reliance on the following decisions :*

- *Sonata Information Technology Ltd. vs. AddI.CIT, 103 ITD 324 (Bangalore).*

- *Lufthansa Cargo India (P1 Ltd. vs. DCIT, 274 ITR 20 (AT) (Delhi).*

16. Aggrieved, the assessee filed objections before the DRP. The DRP observed as follows :

"We have considered the order of the AO and the submissions made by the taxpayer. The issue involved in the present case is identical to the issue in the case of Sonata Information Technology Ltd. vs. AddI.CIT. In this case, the AO found that the assessee was a distributor of software for a foreign company. The AO found that the assessee was liable to deduct tax u/s. 195 of I.T. Act and

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failed to do so inviting disallowance u/s 40(a)(i) of the IT Act. The CIT(A) upheld the finding of the AO. The ITAT held that such sum paid by the assessee to the foreign software supplier was not a 'royalty' and that the same did not give raise to any 'income' taxable in India and therefore, the assessee was not liable to deduct tax at source. However, the High Court concluded that tile moment there was remittance, an obligation to deduct tax at source arose and accordingly overruled the decision of the ITAT.

The matter was considered by the of Hon'ble Supreme' Court in the case of GE Technology Centre Pvt. Ltd. vs. CIT and Another (Civil Appeal Nos.7541, 7542 of 2010) dated 09.09.2010. The Supreme Court held that the High Court did not go into the merits of the case on the question of payment of royalty, ie., whether the amount was chargeable to tax under the provisions of the Income Tax Act. It set aside the judgment of the High Court for de novo consideration on merits. It had even framed the ground for decision by the. High Court as under:

"Whether on facts and circumstances of the case the ITAT was justified in holding that the amount(s) paid by the appellant(s) to the foreign software suppliers was not royalty and that the same did not give rise to any 'income' taxable in India and, therefore, the appeltent/s) was not liable to deduct any tax at source ?"

The matter was considered by the High Court and the Supreme Court and is now pending before the High Court of Karnataka. As the matter is sub judice, and the decision of the ITAT having been overruled, we refrain from allowing the claim of the taxpayer. The ground of the taxpayer is rejected."

17. Aggrieved, the assessee filed appeal before the Tribunal. The learned Counsel for the assessee relied on the decision of GE India Technology Centre Pvt. Ltd. vs. CIT 327 ITR 456 wherein it has been held as follows :

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> *“The expression “Chargeable under the provisions of the Act” in section 195(1) shows that the remittance has got to be of trading receipt, the whole or part of which is liable to tax in India. If tax is not so assessable, there is no question of tax at source being deducted.*”

18. The learned Counsel for the assessee further submitted that the issue of taxability of Rs.52,55,881/- has to be considered both in terms of section 9(1)(i) and 9(1)(vi) of the I.T. Act and also DTAA between India and Netherlands. It was submitted that the assessee cannot meddle with the source code of the software in the process of customisation and it can bundle only its own software with the Small World Software utilising available facilities in the said Small Word Software. It was further submitted that the assessee has to purchase the said software each time it wanted to sell the bundled software to its customers and the assessee did not get any rights to the copyright to the said software. Further, the assessee did not obtain any license in respect of software purchased from GE Network Solutions, Netherland. It was submitted that there is no business connection at all between the assessee and the Netherlands company and they are not Associated Enterprises (AE) and the amount of Rs.52,55,881/- is simply the purchase cost of trading goods and not royalty payment and hence, there is no liability to deduct tax at source and section 40(a)(i) is not attracted.

19. Further it was submitted that the assessee is entitled for benefit of DTAA agreement between India and Netherlands and relied on the decision of Asia

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Sattelite Telecommunication Company Limited vs. DCIT 332 ITR 340. The assessee submitted that there is a distinction between the right to copyright of an article/work/programme and the right to a copyrighted article/work/ programme and relied on the decisions in the cases of Lucent Technologies Ltd. 91 ITD 366 (Bang.) (2) Samsung Electronics Co. 94 ITD 91 (Bang.) (3) Sonata Information Technologies Limited vs. Addl. CIT 103 ITD 324 (4) Motorola Inc. vs. DC 95 ITD 269 (Del.)(SB).

20. It was further submitted that the purchases effected by the assessee from GE, Netherlands are of copyrighted articles and not purchases of copyright and there cannot be as in the present case, multiple purchase of copyright. It was also submitted as follows :

> *"Further, software is not included in the list of items mentioned in Article 12 of the DTAA. The Article covers the copyright of items like literary, artistic or scientific work etc., It does not cover the copy right of software. So, the payment of Rs.52,55,881/- to M/s. GE Network Solutions, Netherlands cannot be regarded as royalty income in the hands of said non-resident in terms of the said DTAA."*

> *"In the domestic law, in the Copyright act 1957, the definition of "literary work" has been amended with effect from 1994 (wide act 38 of 1994) to include Computer programs. This amendment in the domestic law is subsequent to the date of DTAA with Netherlands and so cannot be read into the DTAA in the light of the decision of the jurisdictional High Court in the case of M/S Sanofi Pasteur Holding SA vs. The Dept. of Revenue (WP No. 14212 of 2010 etc) in which it was held that "retrospective amendments to the Income Tax Act (vide the Finance Act 2012) have no impact on interpretation of DTAA".*

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Analogously, retrospective amendments in other domestic laws also have no impact on interpretation of a DT AA. The said amendment to the definition of "literary work" is not even retrospective. It is simply subsequent to the date of the DTAA. Similar is the ratio of the decision in WNS North America Inc. vs Assistant Director of Income Tax(International Taxation). Similarly, Explanation 4 to clause (vi) of section 9(1) which has been retrospectively introduced by the Finance Act 2012 with effect from 01.06.1976 cannot be read into the DTAA as it is an unilateral action of the Indian legislature. Further, this Explanation is applicable in the context of only "royalty" income and not business income and what the Vendor company derived, as claimed hereinabove, is business profit and not royalty income. So, the amount of Rs.52,55,881/- is not taxable in the hands of the non-resident".

21. It was further submitted that Paragraph 2 of Article 3 of the DTAA between India and Netherlands reads as under :

"As regards the application of *the convention by one* of *the States any term not defined herein shall, unless the context otherwise requires, have the meaning which it has under the law* of *that State concerning the taxes to which the convention applies."*

22. The Term "royalty" is defined in the DTAA with Netherlands and so, in the light of the above provision, changes in domestic law, like the Indian Copyright Act, 1957, have no bearing on the definition of the term "royalty." Actually, we cannot go beyond the definition of "royalty" given in the said DTAA. As already mentioned, the said definition of "royalty" in the DTAA does not cover software. It was further contended that if the said amount is held to be taxable royalty income it has to be taxed in terms of para 2 of Article 12 at only 15% of the said amount as against the assessee as it adopted by the A.O. and the rate which is more beneficial to the assessee is to be adopted.

23. The learned D.R. on the other hand, relied on the Order of the Disputes Resolution Panel.

24. We have heard the parties and perused the material available on record. We find that the decision in the case of GE India Technology Centre Pvt. Ltd. vs. CIT 327 ITR 456 has clearly stated that the obligation to deduct tax at source is however limited to appropriate proportion of income chargeable under the Act forming part of the gross sum of money payable to the non-resident. In other words, if the tax is not so assessable, there is no question of tax at source being deducted. Hence, the short point is that one has to see whether the amount of Rs.52,55,881/- represents amount chargeable to tax in the hands of the non-resident both in terms of sec.9(1)(i) and 9(1)(vi) of the I.T. Act and also DTAA between India and Netherlands.

25. We find that the amount in question is not taxable u/s 9(1)(i) because even assuming for a moment there is a business connection between the assessee and the foreign software supplier there are no operations in India of the foreign company to which income may be reasonably attributed to as required under Explanation 1(a) to section 9(1)(i). Hence we find there is no applicability of S.9(1)(i) in the instant case.

26. Now we address the issue of characterization of these payments as Royalty so as to fall under Section 9(1)(vi) or Article 12 of India-Netherlands DTAA. We find that the assessee has purchased the Small World Software from Netherlands and bundled it with its own software and thus customised it and sold it to its own customers both in India and abroad. The assessee cannot meddle with the copies of the software in the process of its customization. We also observe that the assessee has to purchase the said software each time it wanted to sell the bundled software to its customers and

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if it had got any right to the copyright to the said software it would not have bought it every time when it wanted to sell. Further, perusing the books of the assessee at pages 170 to 175 of the paper book, we find that there are multiple purchases of software during the year and each purchase of single item on software is merely one thousand rupees and not huge amount. Hence, we are of the opinion that they are simply purchase cost of trading goods especially when the licence in respect of software is not obtained by the assessee and the perpetual licence is given directly to the end customer by the vendor company. Copies of the invoice raised by Net Work Solutions on the assessee and at paper book 176 to 178 support the view of the assessee where the invoice mentioning name of the end customer supports our view. Hence, in our opinion, when there is no transfer of even the license to the assessee even though it is the purchaser, it cannot be said that there is any royalty payment by the assessee to the vendor company. The amount of Rs.52,55,81/- is simply the cost of imported trading goods and not royalty payment.

27. It is therefore clear that the payments made by assessee to the Netherlands company will not fall under the ambit of Royalty as per Article 12 of the India-Netherlands DTAA. Hence there is no question of tax withholding required by the assessee and hence S.40(a)(i) disallowance is erroneous. Accordingly, ground No.5 is allowed.

28. Ground No.6 reads as under :

> *6(a) The learned AO is not justified In disallowing the expenditure of Rs. 19,48,02,907/- (which includes Rs. 7,02,62,853/- relatable to Non-10A undertakings) by applying the provisions of Sec 40(a)(ia) r.w.s 9(l)(i) and 9(l)(vii) of the IT Act.*
>
> *(b) The learned AO is not justified in holding that the provisions of Explanation 2 to Sec 9(1)(i)*

apply without appreciating that the assessee did not habitually book orders in India for its subsidiary. Therefore there is no business connection within meaning of Explanation to Sec 9(l)(i) as held by the A.O.

(c) *Even assuming without admitting that there is a business connection, since the foreign subsidiaries do not have P.Es in India their incomes are exempt under the provisions of DTAAs (Double Taxation Avoidance Agreements) with the foreign countries. The DTAAs are treaties which over ride the provisions of the I.T. Act.*

(d) *The learned DRP has erred in holding that the payments by the assessee to its subsidiaries are to be considered as technical services coning u/s 9(i)(vii) of the IT Act read with explanation there-under whereas the AO did not invoke provisions of that sub-section.*

(e) *Under Section 9(1)(vii)(b), the payments for technical services abroad for earning income abroad are excepted by the provisions of Sec 9(l)(vii) of the IT Act.*

(f) *The DRP has erred in holding that the explanation to sec 9(l)(vii) incorporated through the Finance Act 2010 applies to the facts of the case. The income must be first deemed to accrue or arise before the Explanation can be invoked. U/s 9(1)(vii)(b), the income from a source outside India is excepted from the deeming provision of accrual or arisal.*

(g) *At any rate the DRP and the AO failed to notice that under the DTAAs the payments made to the foreign subsidiaries are taxable in those countries.*

(h) *The learned AO is not justified in doubting the inclusion of the receipts by the foreign subsidiaries in their returns filed in those countries. He should have given opportunity to prove the inclusion of the said receipts if he had*

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a doubt. The DRP has also committed the same error.

(i) *The DRP's order is vague. On one hand it says all the evidence could not be obtained for lack of time. On the other it invokes explanation to Section 9(1)(vii) without reference to evidence.*

29. The assessee takes objection to the disallowance of Rs.19,48,02,907/- under section 40(a)(i) of the I.T. Act. During the year, the taxpayer incurred an expenditure of Rs.19,48,02,907/- towards technical consultancy charges paid in foreign exchange to the concerns (AEs) outside India. The payments made are as under :

S. No.	Party	Unit 1 (Rs.)	Unit 3 Rs.)	Bangalore (Rs.)	Total (Rs.)
1.	Infotech Enterprises America Inc. (IEAI), USA	5,70,34,785	11,91,05,050	57,65,916	18,19,05,752
2.	Infotech Enterprises GmbH, (IEG), Germany	90,97,638			90,97,638
3.	Infotech Enterprises Europe Ltd. (IEEL), UK	15,01,875			15,01,875
4.	Vargis LLC, USA	22,97,641			22,97,641
	Total	6,99,31,940	11,91,05,050	57,65,916	19,48,02,906

30. The A.O. disallowed the entire expenditure. Consequent to the disallowance, Income of the respective units had increased by the corresponding amounts. Unit 3 and Unit at Bangalore are eligible for exemption u/s. 10A of the I.T. Act. The A.O. allowed exemption relating to the above disallowances to the 2 units as under :

i) Unit 3	Rs.11,89,85,945/-
ii) Bangalore Unit	Rs. 55,54,109/-
Total	Rs. 12,45,40,054/-

As a result, out of the disallowance of Rs.19,48,02,907/-, made by the A.O., Rs.12,45,40,054/- got allowed as exemption u/s. IOA of I.T. Act. The remaining amount of Rs. 7,02,62,853/-' got added to the total Income.

The A.O. found that during the past few years, the taxpayer entered into agreements with foreign concerns for supply and services of computer software. It had habitually engaged its subsidiaries, the four companies mentioned in the above table, to render software services and consultancy services to the foreign parties abroad. The foreign subsidiaries were paid periodically by the taxpayer for the services rendered. The AO on these facts held that the income of the subsidiaries had deemed to have been accrued or arisen in India during the year. He applied the provisions of section 9(1)(i) of the LT. Act to hold that the non-resident companies had business connection with the taxpayer and the income arose due to such business connection. While dealing with the communication expenses, the AO opined that the payments made by the taxpayer are in the nature of fees for technical services. Once the payments either arising through business connection or with reference to technical services, such amounts are chargeable to tax under the provisions of the Income Tax Act. Consequently, the provisions of section 195 of the I.T.

Act are applicable. The A.O. found that the, taxpayer did not deduct tax at source and consequently applied the provisions of section 40(a)(i) of the I.T. Act and disallowed the entire amount. The taxpayer objected the treatment given by the AO in respect of the claim of Rs.19,48,02,907/-. The submissions are briefly as, under :

- Even though the AO held that there was business connection between the non-resident subsidiary and the payment made, no such business connection existed with reference to explanation (2) to section 9(1)(i) of the I.T. Act.
- It furnished a copy of the agreement between the taxpayer and Infotech Enterprises America Inc. (IEAI) which governs the transactions between the taxpayer and the subsidiary in USA.
- It furnished copies of returns of IEAI filed in USA for the calendar years 2003 and 2005.
- No profits arose to the non-resident subsidiaries In India because they did not carry out any business activity either by themselves or through the taxpayer.
- The A.O. proceeded under the mistaken impression that even though the payments might not be taxable in India yet tax was deductible unless a certificate u/s. 195(2) of the I.T. Act was applied for and obtained.
- Even under the provisions of DTAA with the respective countries in which the subsidiaries are located, the payment in respect of technical services are subject to tax in the state of residence and hence, the same are taxable in the respective country and not under the Indian Law.
- So far no proceedings for assessment of the non-resident companies were initiated by the department because of the reason that the non residents are not liable to tax in India.

31. The DRP Held as follows :

"We have considered the submissions made by the taxpayer. It is clear from the assessment order as well as the submissions made by the taxpayer that the taxpayer had 'habitual' business relations with the non-

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resident subsidiaries over several years and payments of similar nature are being paid over all these years. From the facts placed before us, it is not clear whether the taxpayer is booking orders for the non-residents in respect of work given to them. Copies of the master agreements entered into by the taxpayer with the US concerns for execution of the work are not available. At the same time, purchase orders given by the taxpayer in respect of each such order received by the tax payer are also not placed before us. Once these agreements are available, an opinion could be formed whether the entire agreement entered into by the taxpayer with the US clients was executed by the non-resident subsidiaries and whether the tax payer entered into such agreements on behalf of the subsidiaries. Moreover, agreement with only one out of 4 subsidiaries is produced. The tax payer could not produce the corresponding invoices received from the subsidiaries vis-a-vis the invoices raised by it on foreign clients in respect of the work due to time constraint.

The copies of returns and the agreement between one of the subsidiaries in USA furnished by the taxpayer were forwarded to the A.O. for his comments. He has stated that nothing is discernable from the documents so filed. The agreemne4ts speak about the purchase orders though which orders were given to the subsidiaries. Such purchase orders were not furnished along with the agreement. Without such purchase orders, it is not possible to understand the nature of work given to the subsidiaries by the taxpayer. Further, the A.O. stated that the copies of returns do not reflect whether the payments made by the taxpayer were reflected in such returns in the absence of any reconciliation and working, in terms of rupees considering that the returns in USA were filed in US Dollars and on calendar year basis :

The AO has given a finding that the taxpayer has been having a 'habitual' business connection with the subsidiaries. In the absence of all the relevant facts before us, we are unable to examine the issue and give a finding. The AO has considered the payments as fee for technical services while dealing with the communication expenses. Though elaborate

discussion was not made about the applicability of section 9(1)(vii)(b) of the LT. Act, such provision is applicable in respect of fee for technical services. It requires to be examined whether the case of the taxpayer falls within the exceptions provided in the said section. The first exception is in respect of services utilized in a business or profession carried on by the taxpayer outside India. In the present case, the business of the taxpayer is carried out in India and it was only getting orders from USA for execution. It has enough capacity and capability to execute such orders from/in India. In such a case, whether it could be said that business or profession was carried on by the taxpayer outside India. The other exception provided is in respect of the purpose of the payment for making or earning any income from any source outside India. Whether the orders received by the taxpayer for execution of tile work from clients located in USA could be said to be a source of the taxpayer outside India. All these aspects require a much deeper examination of all the related facts, which are not available to us in the limited time. It is incidentally mentioned here that the case came up for hearing on 22.09.2010 just a week prior to the time limit for passing the order.

The provisions of section 9(1)(vii) of the IT Act 'are to be read with Explanation to section 9 which is incorporated at the end of the section through the Finance Act 2010 with retrospective effect from 01.06.1976. As per the Explanation, it is immaterial whether non-resident has a residence or place of business or business connection in India or the non-resident has rendered services in India, for the purpose of section 9(1)(vii) of the IT Act. In view of the Explanation, the payment made by the taxpayer would be subject to the provisions of Income Tax Act. As such, it attracts the provisions of section 195 of the I.T. Act warranting deduction of tax at source. Failure to comply with the provisions of section 195 of the I.T. Act attracts the provisions of section 40(a)(i) or the I.T. Act warranting disallowance of the entire payment.

Considering all the circumstances, we uphold the decision of the AO in making the disallowance of the entire payment u/s. 40(a)(i) of the I.T. Act.

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32. Aggrieved, assessee is in appeal before us. It was submitted that the assessee has not habitually secured orders for its foreign subsidiary IEAI, USA. It had only parcelled out portion of the work entrusted it PRATT & WHITNEY (PWC) to IEAI USA. It was submitted that Explanation 2 to Section 9(1)(i) can be invoked only when the Indian company secured orders for the benefit of non-resident. Whereas, that is not the fact in the present case. One of the reasons for sub-contracting to IEAI is that IEAI has its office in California which is near to PWC delivery centre. It was also submitted that each-work order shall be supported by the end customers order copy. Further, the foreign subsidiary did not work exclusively for the assessee and they have their own orders obtained from other foreign parties. It was also pointed out that the A.O. / T.P.O. has found that the operational transactions were effected at arms length price. Further it was submitted that there is no operations have been undertaken by foreign subsidiaries in India and so no income of the foreign subsidiary is taxable in India in terms of either section 9(1)(i) of the I.T. Act or the concerned articles relating to business profits in the respective DTAAs. It was submitted that Circular 29 dated 23.07.1969 it is mentioned that "forming a local subsidiary company to sell the products of the non-resident parent company" is one of the indicative factors for the existence of "business connection" within the meaning of section 9 of the I.T. Act. It was pointed out that in the example given by the Board, the non-resident is the parent company which is altogether a different matter. The appellant has

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not sold the products of its US subsidiary or any other foreign subsidiary. So, the present case does not fall within the example given by the Board. Further, the Board proceeded to clarify as under at item 2 of the said circular. Further, it was submitted that there is no incentive for the assessee to divert its profits by way of payment of fees for technical services to foreign group companies because the rate of corporate tax in USA is higher than in India. It is further submitted that section 9(1)(i) and 9(1)(vii) of the I.T. Act cannot be invoked simultaneously as various clauses of section 9(1) and 9(1)(vii) of the I.T. Act cannot be invoked simultaneously as the various clauses of section 9(1) are mutually exclusive. With respect to section 9(1)(vii) it was submitted that payments to foreign subsidiaries have been made to earn income from PRATT & WHITNEY which is a source outside India and as such is covered by the exclusionary part of clause (b) of section 9(1)(vii). The assessee relied for this proposition on the decisions of Titan Industries vs. ITO 11 SOT 206 (Bang), Hindalco Industries Ltd. vs. ITO 91 ITDS 64 (Mum.) CIT vs. Aktiengesellschaft Kuhnle Kopp and Kausch W. Germany 125 Taxmann 928 (Mad.) and IBM World Trade Corpn. vs. DDIT 54 SOT 39 (Bang.)

33. It was further submitted that the assessee is also entitled for the benefit of DTAA between India and the concerned country. Since the foreign subsidiary have no permanent establishment in India within the meaning of Article 5 of the respective DTAA agreement, the payment of Rs.19,48,02,907/- cannot be regarded as

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business profits of the non-resident in terms of Article 7 of the respective agreements. It was submitted that the said payment can also not be regarded as payment for technical services under the DTAA. Article 12 of the agreement with USA deals with royalties and included services. Payment made in question by the assessee to its US subsidiary is not technical services even within the meaning of Article 12(3)(a). Actually the payment is only business profit of recipient company by it has been wrongly described by the assessee as consultancy fees. It was submitted that no technical knowledge has been made available (by the non-resident to the assessee) and only non-resident has simply excluded portion of work parcelled out to it by the assessee. The assessee relied on the decision of Inter Tech Testing Services India Pvt. Ltd. 307 ITR 418. It was submitted that provisions of section 40(a)(ia) are not attracted in the light of decision of the Tribunal in the case of GE India Technology Pvt. Ltd. vs. CIT 327 ITR 456 wherein it was held that an amount of Rs.19,48,02,907/- paid to the non resident, cannot be held to be taxable in India either as business profits or income by way of technical services if either under the domestic law or DTAA with USA.

34. The learned D.R. on the other hand relied on the Order of the Disputes Resolution Panel.

35. We have heard both the parties. We find that the A.O. disallowed the amount of Rs.19,48,02,907/- on the ground that there is a business connection in terms of Explanation 2 to Section 9(1)(i) of the I.T. Act

between the assessee and its concerned foreign subsidiaries to whom the said amount has been paid. He held that the assessee has been "habitually/ securing orders in India for the benefit of non-resident in terms of clause (c) of the said Explanation.

36. With respect to IEAI USA, we find that factually the assessee has secured the orders from PRATT (PWC) for its own benefit and it only parcelled out a portion of the work entrusted to it by PRATT & WHITNEY to IEAI USA. The said Explanation to Section 9(1)(i) can be invoked only when the Indian company secures orders for the benefit of non-resident. In the present case, the assessee has not canvassed / secured any orders for its non resident subsidiaries. Hence, section 9(1)(i) cannot be invoked.

37. We have gone through the copy of the "Master Terms Agreement" (in short "MTA") entered into by the assessee with United Technology Corporation (PWC) which is filed at pages 179 to 196 of the paper book. Similarly, we have perused intercompany agreement entered into by the assessee with its subsidiaries placed in the paper book at page 197 to 222. This proves that the assessee obtained orders on its own behalf and it has only parcelled out a portion of its work to its foreign subsidiaries. As per the terms of the agreement, the assessee "shall release the work order" before the commencement of the work by IEAI USA and each work order shall be supported by end customers order copy. Clause 3 of the agreement reads as under :

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> *"Commencing on the date(s) specified in each Work Order, IEAI will allocate qualified personnel through Software Services requirements statements and regular project meetings, which may be modified from time to time by IEL. IEAI shall inform IEL at the time of the request, or as soon thereafter as that the information becomes available, should it be unable to deliver the qualified personnel specified in the Work Order. Parties shall within 30 days negotiate in good faith a revised Work Order mutually agreeable to both parties, however if no such agreement can be reached either party may terminate that work order according to provisions of section 1. Obligations of IEL and IEAI under this agreement are detailed in the Annexure."*

38. Further, we find that the TPO has found that the operation transaction were effected at arms length price. We also observe that the foreign subsidiaries do not work exclusively for the assessee and they obtain orders on their own from other foreign parties and also sub contract the work to the assessee depending on exigencies.

39. We also find that no operations have been undertaken by foreign subsidiaries in India and no engineers have been deputed by them to India and even they do not have permanent establishment in India. In terms of the respective DTAA, no income of the foreign subsidiary is taxable in India in terms of either section 9(1)(i) of the I.T. Act or the concerned Articles relating to business profits (Article 7 r.w. Article 5) in the respective DTAAs. As submitted by the assessee, the Board Circular No. 29 dated 27.3.1969 is inapplicable to the present case as the example given by the Board, the non-resident is the parent company whereas, in

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the present case, the Indian Company is the parent company and the assessee has not sold the products of its US subsidiaries or any other foreign subsidiaries. The contention of the assessee that the rate of tax in India is lesser than the rates in USA is also well taken. Hence there is no income taxable in India u/s 9(1)(i) and hence no requirement for TDS and there can be no application of S.40(a)(i).

40. The AO seems to have invoked S.9(1)(vii) only on the communication expenses incurred and in such a case the assessee is right in as much as said amount of communication expenses should be excluded while assessing the purview of taxability of income u/S.9(1)(i). However, we point out that the DRP in its order seem to have held that the entire amount paid by assessee to its foreign companies may be regarded as Fees for Technical Services u/S.9(1)(vii). So while we have held already that S.9(1)(i) is inapplicable in the instant case, we now have to deal with the alternate of the entire amount being disallowed u/S.9(1)(vii) (or Article 12) as Fees for Technical Services.

41. Firstly, under the Act, the payments made to the subsidiaries may indeed be construed as Fees for Technical Services. However this is only due to the fact of the retrospective amendment by Finance Act 2010. Prior to that, the Hon'ble Supreme Court in *Ishikawajima-Harima Heavy Industries Ltd., Vs DIT (2007)[288 ITR 408]* had held that Section 9(1)(vii) as it stood then envisaged two conditions which need to be met simultaneously namely that services have to be rendered in India and said services have to be utilized in India. The Apex Court held that merely the "source"

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of income being located in India would not render sufficient nexus to tax the income from that source. The Apex Court held that there must be a direct live link between the services rendered and India. The Government subsequently introduced a retrospective amendment in Finance Act 2007 which read-

> *"for the removal of doubts, it is hereby declared that for the purposes of this section, where income is deemed to accrue or arise in India under clause (v), (vi) and (vii) of sub-section (1), such income shall be included in the total income of the non-resident, whether or not the non-resident has a residence or place of business or business connection in India"*

-to overcome the effect of the *Ishikawajima-Harima* decision (supra) but in the decisions of Clifford Chance vs. DCIT (176 Taxmann 458) as well as Jindal Thermal Power Company vs. DCIT (182 Taxmann 252 Karnataka HC) it was held that the Finance Act 2007 amendment did not change Ishikawajima's (supra) application. In response, the Government subsequently introduced a modified Explanation to S.9(1) via Finance Act 2010 and it stands till date reading as under:

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

42. Thus, it is seen clearly that at the time of the payment in the instant case *Ishikawajima-Harima* (supra) was the law of the land and the twin condition laid down of rendering and utilizing the technical service in India was clearly not satisfied in the assessee's case as the foreign subsidiaries rendered the service which was utilized by the clients (such as PWC). Thus the assessee could have been of the bonafide belief that TDS was not necessary on payments to the foreign subsidiaries. Furthermore, the assessee could not have been expected to know that TDS should have been deducted in accordance with a law that was to be brought in subsequently. Hence any disallowance u/s 40(a)(i) based on the application of a retrospective amendment which the assessee could not have foreseen is wholly erroneous. This rationale is upheld by various decisions of the Tribunals which we rely on such as *Channel Guide (139 ITD 49)* & *Sterling Abrasives (IT No.2243, 2244/Ahd/ 2008 dated 23-12-2010)* and *Metro & Metro vs. ACIT (ITA No.393/Agra/2012 dated 1-11-2013)*. Hence under the Act the disallowance u/s 40(a)(i) for FTS payments cannot be upheld.

43. We also point that even under the India-USA and India-UK treaties (not the India-Germany treaty though) due to the presence of the "make available" clause in these two Treaties the payments made by the assessee will not fall under FTS. This is because no technical knowledge has been made available by the non-resident to the assessee. Further, no technical plan or technical design placement has been transferred by US subsidiary to the assessee. What IEAI did was only in fulfilment of contractual requirement with PRATT & WHITNEY and not for the benefit of the assessee. The non-

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resident has simply executed the portion of work parcelled out to it by the assessee. The Karnataka High Court in CIT vs. De Beers India Minerals Pvt. Ltd. (ITA No.549 of 2007 dated 15th May 2012) lucidly explained the concept of "make available" as follows:

> *"What is the meaning of 'make available'. The technical or consultancy service rendered should be of such a nature that it "makes available" to the recipient technical knowledge, know-how and the like. The service should be aimed at and result in transmitting technical knowledge, etc., so that the payer of the service could derive an enduring benefit and utilize the knowledge or know-how on his own in future without the aid of the service provider. In other words, to fit into the terminology "making available", the technical knowledge, skills, etc., must remain with the person receiving the services even after the particular contract comes to an end. It is not enough that the services offered are the product of intense technological effort and a lot of technical knowledge and experience of the service provider have gone into it. The technical knowledge or skills of the provider should be imparted to and absorbed by the receiver so that the receiver can deploy similar technology or techniques in the future without depending upon the provider. Technology will be considered "made available" when the person acquiring the service is enabled to apply the technology. The fact that the provision of the service that may require technical knowledge, skills, etc., does not mean that technology is made available to the person purchasing the service, within the meaning of paragraph (4)(b). Similarly, the use of a product which embodies technology shall not per se be considered to make the technology available. In other words, payment of consideration would be regarded as "fee for technical included services" only if the twin test of rendering services and making technical knowledge available at the same time is satisfied."*

44. In the instant case, the UK and USA subsidiaries did only contractual work parcelled out to it whose results

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were given to clients directly and no technical knowledge was made available to assessee. Hence, even under the respective DTAA, the payments made to UK and US subsidiaries/companies would not fall under the ambit of FTS.

45. In any case, as we have shown above, under the IT Act, none of the payments made by the assessee can be disallowed u/s 40(a)(i) based on effect of retrospective amendment of Explanation to S.9(1). Accordingly, ground No.6 is allowed in favour of the assessee.

46. Ground No.7 reads as under :

> *"7. The A.O. is not justified in excluding the communication expenses of Rs.1,16,67,429 from the export turnover.*
>
> *(b) As the assessee did not provide technical services but only developed computer software for its clients abroad, the provisions that the communication expenses should be reduced from the turnover does not apply.*
>
> *(c) Whether it is for development of software as claimed by the assessee or for providing technical services as held by DRP. The communication expenses have not been included in the export invoices on which the export turnover is based. Therefore, there can be no question of exclusion of the communication expenses paid in foreign exchange.*
>
> *(d) alternatively*
>
> *The said amount should have been excluded from the total turnover also.*
>
> *(e) Having noticed several judicial decisions on the issue, the DRP is not justified in not granting relief on the ground that the Department is in appeal before the High Court/s on the issue."*

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47. It may be noticed that the so-called telecommunication charges are actually soft link charges for availing a dedicated cable line from the internet service provider. What is to be excluded in terms of the definition of the "export turnover" in clause (iv) of Explanation 2 to section 10A is "telecommunication charges" and not soft link charges. It was further submitted that Telecommunication charges cannot be identified with soft link charges. The former relates to telephonic expenditure whereas the latter relates to internet. Strictly, they are different and so the soft link charges incurred by the assessee are not liable to be excluded in terms of the said definition. Evidently, the said amount of Rs.1,16,67,429/- doesn't represent freight, telecommunication charges or insurance for it to have to be reduced from the export turnover. If at all, it has to be considered as expenses incurred in foreign exchange in providing the technical services outside India. The objection against such consideration is that the assessee has not provided any technical services. The assessee has only rendered software development services or exported software to its customers outside India and has not rendered any technical services. The allegation of the Assessing Officer is that the assessee has received the technical services from it's US subsidiary (IEAI) and paid Rs.19,48,02,907/-. So, if at all, the appellant has received technical services and not rendered any so as to attract the disallowance of Rs.1,16,67,429/- from the export turnover. In case of Patni Telecom (P) Ltd. Vs ITO 120 ITD 105, the Coordinate Bench of the Hyderabad Tribunal has made the following distinction :

> *"The assessee did not render any independent technical services. It developed software on contract basis* as *per the agreement and handed over the same to the customer........ There is software development agreement between the client and the assessee. The expenditure incurred is for development* of *Software .... Such*

> *expenses incurred cannot be said to be expenditure for technical services. If the technical services are rendered independently which are being agreed to be separately charged in addition to the price* of *the goods, in such circumstances, expenditure incurred could be in the nature* of *expenditure for the purpose* of *technical services...... Such expenditure is not in the nature* of *expenditure for technical services. Since the expenditure is not for technical services, there is no need to exclude these expenditures from consideration received in convertible foreign exchange for the purpose* of *calculating 'export turnover'* as *defined in cl. (iv)* of *Expln* 2 *to* S. *10A".*

48. It was further submitted by the learned Counsel for the assessee that more importantly, the amount of Rs.1,16,67,429/- is a payment made by the assessee which has not been charged to the customers. It is not included in the invoices raised by the assessee on the customers. It is separately debited to the P&L account. It is not included in the export turnover. What is not included in the export turnover cannot be reduced from it for working out the deduction under Sec.10A. In the case of Patni Telecom Pvt Ltd. vs. Income Tax Officer (supra), the Tribunal held that expenses which are not included in the consideration received in convertible foreign exchange cannot be reduced from the export turnover. Further, when the A.O. excluded the said amount of Rs.1,16,67,429/- from export turnover, the A.O. should have, in the interest of fairness, excluded it from the total turnover also for computing the deduction under section 10A(4). In this context, the learned Counsel for the assessee relied upon the Judgment of Hon'ble High Court of Karnataka in the case of Commissioner of Income Tax vs. Tata Elxsi Ltd. [2012] 17 Taxmann.com 100 (Kar.) which follows the decision of the Apex Court in the case of CIT v. Lakshmi Machine Works ([2007] 290 ITR 667 / *160* Taxman 404).

49. In view of the decision of of the Hyderabad ITAT in Patni Telecom Pvt. Ltd. vs. ITO (120 ITD 105), we direct the AO to not reduce the figure of Rs. 1,16,67,429/- from the export turnover while computing deduction u/S. 10A

50. Accordingly, ground No.7 is allowed for statistical purposes.

51. Ground No. 8 reads as under :

> *"8. The learned A.O. and the learned DRP are not justified in holding that the profit of Rs.8,52,831/- resulting on account of the foreign exchange fluctuation to Tele Atlas, (a company acquired by assessee in the previous year) has to be reduced from the Export Profits. They failed to notice and apply the ratio of the decision of the Supreme Court in the case of Woodward Governor".*

52. The assessee is in appeal contending that the learned DRP is not justified in holding that the profit of Rs.8,52,831/- being the foreign exchange fluctuation gain in the hands of the assessee has to be reduced from both the "profit of the business" and the "total turnover" for working out the deduction under section 10A of the I.T. Act. It is so held on the ground that this gain accrued on the conversion of EURO EEFC account balance belonging to a merged company into Indian Rupees and, as such, it did not have anything to do "with the business operations of the tax payer". It was submitted that this reasoning is untenable. EEFC is the acronym for Exchange Earners Foreign Currency i.e. the foreign currency allowed by the RBI to be retained abroad by an earner. Evidently, the earner is one who earned the exchange by exports. So the source of the EEFC balance could only be sale proceeds by way of exports. It was further submitted that the deposit of currency in foreign exchange has

everything to do "with the / business operations of the tax payer". So the said gain of Rs.8,52,831/- should not be reduced from the business profit in the light of the decision of Sanyo LSI Technology India Private Ltd. vs. Deputy Commissioner of Income Tax ITA No.977/Bang/2010 dated 13.5.2011

53. We have heard both the parties and perused the material available on record. We find that the Order in the case of Sanyo LSI Technology India Private Limited (supra) is squarely applicable to the facts of the present case and the relevant observations are extracted below:

> *"8.1.4 ….*
>
> *(iii) With regard to the foreign exchange fluctuation is a part of 'profits from business and profession, the Hon'ble Apex Court in its ruling in the case of Sutlej Cotton Mills Ltd. v. CIT cited supra, had held thus –*
>
>> *"The law may, therefore, now be taken to be well settled that where profit or loss arises to an assessee on account of appreciation or depreciation in the value of foreign currency held by it, on conversion into another currency, such profit or loss would ordinarily be trading profit or loss if the foreign currency is held by the assessee on revenue account or as a trading asset or as part of circulating capital embarked in the business. But, if on the other hand, the foreign currency is held as a capital asset or as fixed capital, such profit or loss would be of capital nature."*
>
> *In consonance with the above ruling, the Hon'ble Supreme Court in its subsequent verdict in the cases of (i) CIT v. Woodward Governor India (P) Limited and (ii) in CIT v. Honda Siel Power Products Limited reported in (2009) 312 ITR 254 (SC) observed thus –*
>
>> *"15. For the reasons given hereinabove, we hold that, in the present case, the "loss" suffered by the assessee on account of the exchange difference as on the date of the*

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balance sheet is an item of expenditure under s. 37(1) of the 1961 Act.

8.1 .5. Taking into account the facts of the issue and also in conformity with the legal position of various judiciaries referred in the fore-going paragraphs, we observe that –

(i) the foreign exchange gain was income derived by export business of the assessee, and, hence, eligible for deduction u/s 10A of the Act; &

(ii) the foreign exchange gains has to be taxed under the head 'income from business and profession'.

It is ordered accordingly."

54. Accordingly, ground No. 8 of the assessee is allowed.

55. In the result, appeal of the assessee ITA.No.115/Hyd/2011 is partly allowed for statistical purposes.

<u>ITA No.2184/Hyd/2011</u> : Asst year 2007-08

56. In this appeal for assessment year 2007-08, grounds No.1 and 9 are general and need no adjudication.

57. Ground No.2 relates to an addition of Rs.12,13,868 and the contention of the assessee is that the learned DRP erred in sustaining the adoption of the rate of 14% on the loan transaction between the assessee and the associated enterprise thereby sustaining the disallowance of Rs.12,13,868 computed by the Transfer Pricing Officer. Ground No.2 (consisting of 2(a) and 2(b)) is identical to Ground No. 2 of ITA No.115/Hyd/2011 for AY 2006-07 wherein we have held as under in PARA 8 *"8. We have heard both Parties and perused the matter available on record. The issue in Four Soft Ltd.(supra) relied upon by Assessee was the rate of LIBOR, with the actual LIBOR rate as per Assessee being 4.42% whereas DRP had taken LIBOR at 5.7%, The Tribunal has directed the AO to examine*

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the correct rate of LIBOR and adopt LIBOR + rate in that case. The coordinate benches such as Dr.Reddy's Laboratories Ltd. vs. ACIT (MA No. 217/Hyd/2013 in ITA No.1605/Hyd/2010 dated 29-11-2013), Siva Industries 59 DTR 182 (Che), Tech Mahindra 46 SOT 141 (Mum) & Tata Autocomp Systems 73 DTR 220 (Mum) are approving on different factual situation, LIBOR + 1% to 3% and considering that, we feel that reasonable rate would be LIBOR + 2% and direct the AO to adopt the same" The same directions as above extracted shall apply for this Ground 2 in ITA No. 2184/Hyd/2011 for AY 2007-08. Hence this Ground is allowed for statistical purposes.

58. Ground No. 3 (consisting of 3(a), 3(b) and 3(c)) relates to addition of Rs.13,04,400/- in respect of the corporate guarantee given by the assessee in favour of the bankers of the AE (Associated Enterprise). This is similar to Grounds No. 3 and 4 of ITA No.115/Hyd/2011 for AY 2006-07 wherein we have held as under in PARA 13 as follows :

> *"13 ...... We therefore set aside the issue to the TPO to decide the quantum of corporate guarantee rates in the instant case following the method adopted in Glenmark (supra)".*

The same directions as above extracted shall apply for this Ground i.e., Ground 3 in ITA No. 2184/Hyd/2011 for AY 2007-08. Hence this Ground is allowed for statistical purposes.

59. Ground No.4 (consisting of 4(a) to 4(e)) relates to disallowance of Rs.45,88,384/- by apply provisions of S.40(a)(i) r.w.s. 9(1)(vi) of the IT Act. We have discussed an identical issue in paras 24 to 27 in ITA No. 115/Hyd/2011 (AY 2006-07) and concluded that

> *"27. It is therefore clear that the payments made by assessee to the Netherlands company will not fall under the ambit of Royalty as per Article 12 of the India-Netherlands DTAA. Hence there is no question of tax withholding required by the assessee*

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> *and hence S.40(a)(i) disallowance is erroneous. Accordingly, ground No.5 is allowed.".*

Hence following the above, the assesse's Ground is allowed.

60. Ground No. 5 (consisting of 5(a) to 5(g)) relates to disallowance of Rs.3,96,96,366/- paid to foreign subsidiaries (out of Rs.28,83,74,256/-(which is inclusive of the exemptions allowed u/s 10A of the Act. We have discussed an identical issue in Paras 35 to 45 relating to Ground 6 of ITA No. 115/Hyd/2011 (AY 2006-07) and concluded as follows :

> *"45. In any case, as we have shown above, under the IT Act, none of the payments made by the assessee can be disallowed u/s 40(a)(i) based on effect of retrospective amendment of Explanation to S.9(1). Accordingly, ground No.6 is allowed in favour of the assessee".*

We therefore follow the same and allow this Ground in favour of the assessee.

61. Ground No. 6 (consisting of 6(a) to (e)), relates excluding the softlink charges of Rs.1,74,60,398/- booked under the head communication expenses of Rs.3,49,44,783/- from the export turnover. We have discussed an identical issue in ITA No 115/Hyd/2011 (AY 2006-07) wherein we had discussed the same in Paras 49 to 50 and held as follows:

> *"49. In view of the decision of of the Hyderabad ITAT in Patni Telecom Pvt. Ltd. vs. ITO (120 ITD 105), we direct the AO to not reduce the figure of Rs..1,16,67,429/- from the export turnover while computing deduction u/S. 10A*
>
> *50. Accordingly, ground No.7 is allowed for statistical purposes".*

Following the above, we issue the same directions in this Ground to the AO to not reduce the softlink charges of Rs.1,74,60,398/- booked under the head communication expenses of Rs.3,49,44,783/- from the

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export turnover and hence this ground is allowed for statistical purposes

Ground No. 7 is general and we are not adjudicating the same.

62. Ground No. 8 relates to the disallowance of picnic expenses of Rs.8,40,444/- on the ground that relevant vouchers were not produced. We set aside this issue to the AO to give one more opportunity to the assessee to substantiate its claim and the AO on the satisfaction of evidence produced shall give appropriate relief.

63. In the result, this appeal is allowed for statistical purposes.

64. To sum up, appeal in ITA No. 115/Hyd/2011 is partly allowed for statistical purposes and ITA No. 2184/Hyd/2011 is allowed for statistical purposes.

Order pronounced in the open Court on 16/01/2014

Sd/-	Sd/-
(B. RAMAKOTAIAH)	**(ASHA VIJAYARAGHAVAN)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

Hyderabad, Date 16th January, 2014

VBP/-
Copy to

1. Infotech Enterprises Limited, 4th Floor, 'A' Wing, Plot No.11, Software Units Layout, Infocity, Madhapur, Hyderabad. C/o. Shri MVR Prasad, Advocate, Flat No.603, 6th Floor, Cyber Heights, Road No.2, Banjara Hills, Hyderabad – 500 033.
2. Addl. Commissioner of Income Tax, Range-2, Hyderabad.
3. Disputes Resolution Panel, 4A, I.T. Towers, A.C. Guards, Hyderabad – 500 004.
4. Addl. CIT (Transfer Pricing), Hyderabad
5. D.R. 'A' Bench, ITAT, Hyderabad.

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