IN THE INCOME TAX APPELLATE TRIBUNAL
BANGALORE BENCH " B "

BEFORE SHRI A.K. GARODIA, ACCOUNTANT MEMBER AND
SHRI VIJAY PAL RAO, JUDICIAL MEMBER

<table>
<tr><td colspan="3">I.T.(T.P) A. No.1364/Bang/2011
(Assessment Year : 2007-08)</td></tr>
<tr><td>M/s. Tally Solutions Pvt. Ltd.
Nos.23 & 24,
AMR Tech Park II,
Hongasandra, Hosur Main Road,
Bangalore-560 068
PAN AAACP 7879D</td><td rowspan="2">Vs.</td><td>Asst. Commissioner of Income Tax,
Circle 12(1), Bangalore.</td></tr>
<tr><td>Appellant</td><td>Respondent.</td></tr>
</table>

Appellant By : Shri Arvind Sonde, Senior Counsel.
Respondent By : Smt. Neera Malhotra, CIT-II (D.R)

Date of Hearing : 21.6.2016.
Date of Pronouncement : 19.8.2016.

O R D E R

Per Shri Vijay Pal Rao, J.M. :

This appeal by the assessee is directed against the assessment order dt.28.10.2011 passed under Section 143(3) r.w.s. 144C in pursuant to the directions of the Dispute Resolution Panel (in short 'DRP') dt.28.9.2011 for the Assessment Year 2007-08.

2. The assessee has raised the following grounds :

http://www.itatonline.org

" GROUNDS RELATING TO NATURAL JUSTICE

The learned Assessing Officer has erred in passing the order, without considering all the submissions and/or without appreciating properly the facts and circumstances of the case and the law applicable.

2. GROUNDS RELATING TO PROCEDURE

The learned Assessing Officer has erred in --

i) making a reference for the determination of the Arm's Length Price of the international transactions to the TPO without demonstrating as to why it was necessary and expedient to do so and
ii) passing the order without demonstrating that the appellant had any motive of tax evasion.

3. GROUNDS RELATING TO CHARGE OF INCOME TAX

The learned Assessing Officer has erred in not appreciating that:

(i) there is no amendment to the definition of the term "income" to include amounts computed under chapter X.

(ii) the charging or computation provision relating to income under the head "Profits & Gains of Business or Profession" do not refer to or include the amounts computed under chapter X.

(iii) there is no provision in chapter X indicating that it would override the computation provisions of business income or the normal understanding of the term "income".

4. GROUNDS ON DETERMINATION OF ARMS LENGTH PRICE & ADJUSTMENT MADE THEREON

The learned Assessing Officer has erred in -

i) making an adjustment to the extent of Rs.4,60,42,886/- towards the arms length price on the basis of the order of the TPO U/s.92CA of the Act, dated 26.10.2010 and the direction of Dispute Resolution Panel, dated 28.09.2011.

ii) making an adjustment towards the Arms length price without appreciating. the fact that the TPO while passing the order U/s.92CA of the Act has not met with the objections filed by the appellant.

iii) making an adjustment towards the Arms Length price without appreciating the fact that the DRP has given directions without specifically meeting with the objections filed by the appellant.

iv) ignoring the fact that the TPO has quantified an adjustment towards notional interest on debtors which is an issue which was not' referred to him for determining the arms length price and the action of the TPO is beyond jurisdiction.

v) ignoring the ratio laid down by the High Court of Delhi in the case of Commissioner of Income tax Vs Amadeus India (P) Ltd and Hon'ble ITAT, Mumbai bench IL' in the case of 3i Infotech Ltd Vs. DCIT, Circle - 10(3), Mumbai, wherein it has been held that, TPO cannot U/s.92CA(3) determine ALP in relation to an international transaction which is not referred to him by the Assessing Officer.

vi) ignoring the fact that the provisions of section 92CA(2A) which provides for TPO to consider any other international transaction for adjustment, which has not been referred to him also was introduced w.e.f 01.06.2011 which confirms the fact that prior to 01.06.2011 the TPO could not have' exercised such power.

vii) ignoring the fact that not charging interest on debtors cannot be considered as an international transaction within the meaning of section 928 of the Act and therefore no adjustment could be made towards arms length price.

viii) ignoring the fact that in the absence of any interest being charged, there is no international transaction within the meaning of section 928 of the Act and therefore no adjustment was warranted under chapter X of the Act.

ix) ignoring the fact that the TPO adopted the notional interest receivable at a rate as high as 14% p.a, which is totally arbitrary, to quantify an adjustment to the arms length price, towards interest receivable.

x) ignoring that the TPO adopted notional interest at 14% without any basis.

xi) ignoring the fact that though the TPO states that CUP method has been adopted there is no mention of any comparable uncontrolled transaction to substantiate the stand that such method has been adopted.

xii) ignoring the ratio laid down by the Hon'ble ITAT, Mumbai in the case of M/s.Nimbus Communications Ltd V. ACIT Circle 11(1), Mumbai (2010) 38 SOT 246 (Mum), wherein it has been held that no adjustment -towards interest can be quantified on bills outstanding for services rendered.

xiii) ignoring the ratio laid down by the Hon'ble ITAT, Murnbai in the case of M/s.Nimbus Communications Ltd for the A.Y.2004-05 in ITA No. 6597/Mum/09 relying on its own order for the A.Y.2003-04 wherein it has been held that no adjustment towards interest can be quantified on bills outstanding for services rendered.

xiv) not considering the reasons & objections submitted by the appellant in totality.

xv) not appreciating the spirit of the circular No.12 of 2001 dated 23.08.2001 issued by Central Board of Direct Taxes governing transfer pricing of an international transaction.

OTHER ISSUES

Ground No.5 - The learned Assessing Officer has erred in

i) disallowing Rs.6,76,598/- out of the electricity expenses claimed by the appellant.

ii) not appreciating the fact that Mr. Bharat Goenka for whose residence the electricity expenses were incurred, operates from the residence also for the reason that the product manufactured and marketed by the appellant is of such nature that it needs the intellectual input of Mr.Bharat Goenka who in fact invented the product being Tally Accounting Package.

Ground No.6 - The learned assessing officer erred in

i) disallowing the foreign exchange fluctuation loss of RS.5,42,999/- claimed as revenue in respect of advances made to subsidiary during the course of the business activity,

ii) not appreciating the fact that the advances in foreign currency made to the subsidiary were revenue in nature and consequently the loss on exchange fluctuation was also allowable as revenue.

Ground No.7 - The learned assessing officer erred in

i) making a disallowance of Rs.62,22,859/- out of the interest claimed as not revenue on the ground that on capital work in progress of Rs.5,07,98,8501- interest at 12.25% is required to be disallowed.

ii) ignoring the position of law laid down under the provisions of section 36(1)(iii) of the Act, wherein the interest on capital borrowed is allowable as revenue once such funds are utilized for the purpose of the business activity.

iii) quantifying an arbitrary disallowance at 12.25% on the amount of Rs.5,07,98,8501- shown as capital work in progress.

iv) quantifying an arbitrary disallowance on the total capital work in progress of Rs.5,07,98,850/- ignoring the fact that the addition to the capital work in progress during the previous year is RS.5 lakhs only and the balance was opening balances.

v) quantifying an arbitrary disallowance on the capital work in progress of Rs.5,07,98,850/- ignoring the fact that the opening balance was Rs.5,02,98,8501- and no such disallowance was made in the earlier years.

vi) quantifying an arbitrary disallowance ignoring the ratios laid down by various courts that unless supported by specific material evidence, the principle of res- judicata is required to be followed.

vii) quantifying a disallowance out of the interest expenses without establishing the nexus between the borrowed funds on which interest was claimed and the capital work -in-progress.

viii) quantifying a disallowance out of interest expenses ignoring the that the appellant company was: possession of funds like share capital, reserves and surplus to the extent of RS.141 ,03,34,117/- on which no interest was paid for application.

ix) ignoring the fact that the interest on capital work in progress was also to the same extent in the earlier years being A.Ys. 20t,·.;-06 and 2006-07 and no interest disallowance was made during the relevant years.

Ground No.8 - The learned Assessing Officer erred in

i) holding that an expenditure in the nature of business development expenses to the extent of Rs.39,86,733/- is capital in nature and allowable as revenue.

ii) ignoring the fact that expenditure to the extent of Rs.14,44,012/- out of the above represented expenses revenue in nature incurred in the process of development of a new accounting package which was shelved and therefore ought to be allowed as revenue.

iii) ignoring the fact that expenditure to the extent of Rs.20,92,721/- out of the above represented expenses revenue in nature in printing a reference manual in various languages for the purpose of operating Tally package in those languages and therefore ought to have been allowed as revenue.

iv) ignoring the fact that expenditure to the extent of Rs.4,00,000/-out of the above is towards development of website for providing information to tally customers and therefore ought to have been allowed as revenue.

v) ignoring the fact that during the proceedings before the Dispute Resolution Panel, himself had sent a report on this issue wherein the Assessing Officer has recommended that the expenditure of Rs.4,50,OOO/- be allowed and under the circumstances, the same could not have been disallowed in the assessment.

Ground No. 9.- The learned Assessing Officer erred in

i) disallowing foreign travel expenses to the extent of Rs.21 ,03,465/- Ion the ground that the same was incurred for the foreign travel of

http://www.itatonline.org

directors Mr.Bharat Goenka and Mrs. Sheela Goenka and therefore cannot be allowed as expenditure.

ii) not appreciating the fact that the product of the company, Tally package is invented by Mr. Bharat Goenka who alone can contribute to improve/update the package and therefore the expenditure on his travel ought to have been allowed as business expenditure, since the same is incidental to business.

Ground No.1 0 - The learned Assessing Officer erred in

i) disallowing an amount of Rs.16,25,61 ,749/- (net) claimed as bad debts on non realization of the trade debtors.

ii) not appreciating the fact that these are trade debtors were consequent to sale of Tally packages in the earlier years by the appellant and under law if not recovered are to be allowed as bad debts.

iii) ignoring the fact that M/s.Tally India Pvt Ltd is a subsidiary of the appellant and therefore under the provisions of section 47(iv) of the Act any transaction of transfer of asset is not regarded as a transfer and the debt continued to be the debts of the appellant.

iv) ignoring the fact that though the marketing division assets, current assets and liabilities were transferred by the appellant to subsidiary M/s.Tally India Pvt Ltd, under the provisions of section 47(iv) of the Act the' same is not regarded as transfer, the Assessing Officer has disallowed Rs.16,25,61 ,749/- under the presumption that, these transfers are covered by the definition of transfer under the provisions of section 2(42C) of the Act.

v) ignoring the fact that the debt was consequent to sale of products which was revenue in nature and offered for tax and the intermediary transaction of transfer and retransfer would not vary the nature of debt.

Ground No.11

In view of the above and the other grounds to be adduced at the time of hearing, the appellant prays that the Hon'ble Tribunal may kindly delete

i) the addition of Rs.4,60,42,886/- made consequent to adjustment of arms length price.

ii) the addition of Rs.6,76,599/- under electricity expenses.

iii) the addition of Rs.5,42,999/- out of foreign exchange loss.

iv) the addition of RS.62,22,589/- consequent to disallowance out of interest claimed.

v) the addition of Rs.39,86,733/- made on the ground that the expenditure is not revenue in nature.

vi) the addition of Rs.21 ,03,465/- consequent to disallowance out of travel expenses. vii) the addition of Rs.16,25,61 ,749/- made consequent to disallowance of bad debts claimed towards not realization of sundry debtors.

The appellant submits that each of the above grounds/sub-grounds are independent and without prejudice to one another.

The appellant craves leave to add, alter, vary, omit, substitute or amend the above grounds of appeal, at any time before or at the time of hearing of the appeal so as to enable the Income Tax Appellate Tribunal to decide the appeal according to law.

The appellant prays accordingly."

3. The **Ground Nos.1 to 3** are general in nature and does not require any specific adjudication.

4. **Ground No.4** is regarding Transfer Pricing Adjustment on account of interest on delayed realization of marketing expenses from Associated Enterprises (AEs).

4.1 The assessee is a private limited company engaged in the business of development and export of computer software specialized in financial management and accounting software. The profile of the assessee has been reproduced by the TPO in para 2 as under :

"2. Taxpayer's Profile.

M/s. Tally Solutions Pvt. Ltd. renders software research and development services and other related services to its AE, Tally Solutions FZ LLC, Dubai, UAE. The services are rendered on time and material basis.

2.1 Financial Results.

The financials of the company for the FY 2006-07 are as under :

Description	Rs.
Operating Revenue	28,16,18,522
Operating Cost *	15,48,26,006
PBIT	12,67,92,516
PBIT as % of Cost	81.89%

*Exceeding provision for doubtful advances, investment written off, forex loss and interest expenses.

http://www.itatonline.org

2.2 International transactions

The following are the new international transactions entered into by the taxpayer with its AE for the FY 2006-07.

Particulars	Amount Rs.
Marketing expenses met during the year not recovered and hence interest free loan	3,16,81,154
Technical services rendered to Tally Solutions FZ LLC, Dubai	28,16,18,522”

The assessee reported its financial results as well as international transactions which has been reproduced by the TPO in paras 2.1 and 2.2 as under :

“ For rendering software Research & development services to its AE, the taxpayer selected TNMM as the most appropriate method. But, the taxpayer selected gross profit to operating revenues as the profit level indicator. Under TNMM, it is the net profit that is realized from international transactions have to be compared with net profit realized by an uncontrolled enterprise. This office carried out a separate analysis for software development services and searched for suitable comparables in Prowess and Captialine databases by applying certain criteria. The search yielded 26 comparables with arithmetical mean margin of 25.14% on cost. As the margin of the taxpayer at 81.89% on cost is higher than the arithmetical mean margin, the price charged by the taxpayer for rendering software development services is treated as at arm’s length.
Significant debts are outstanding from its AE, Tally Solutions FZ LLC, Dubai. These transactions are analysed separately under CUP method as under.”

The TPO accepted the international transactions in respect of technical services rendered by the assessee to its AE of Rs.28,16,18,522 at arm’s length by noting the fact that the assessee’s margin at 81.89% in comparison to the mean

http://www.itatonline.org

margin of comparables at 25.14%. However the TPO proposed to proceed to apply the provisions of Chapter X by treating the outstanding due with the AE as international transaction. The TPO observed that the assessee has extended credit facility similar to a working capital loan to its AE without charging any interest. Similarly uncontrolled transaction would have provided for interest. Accordingly, the TPO was of the view that the international transactions representing extended credit facility without charging interest is not at arm's length price within the meaning of Section 92C(3)(a)(b)(c) of the Act r.w. Rule 10B(1)(a) of the I.T. Rules. Consequently, the arm's length interest is determined by the TPO by applying CUP method wherein the interest rate is determined @ 14% per annum being average outstanding balance as computed for the F.Y. 2006-07 as under :

" The taxpayer has extended credit facility similar to a working capital loan to its AEs without charging any interest. Similar uncontrolled transaction would have provided for interest. In view of this fact the international transaction representing extended credit facility without charging interest is not at arm's length price, within the meaning of section 92C(3)(a), (b) and (c) of the Income Tax Act read with Rule 10B(1)(a) of the Income Tax Act, the arm's length interest is determined by following CUP method wherein the interest rate is determined under the circumstances in which the tax payer and its associated enterprises are operating i.e. ;what is the interest that would have been earned if such credit in the form of working capital loan given to unrelated parties in similar situation as that of associated enterprises. Since the tested party is tax payer, the prevalent interest that could have earned by the tax payer by

advancing similar to an unrelated party in India with the same financial health as that of the tax payer's associated enterprises is considered.

In view of the above discussion, the interest rate of 14% p.a. (average yield on unrated bonds for the FY 2006-07) was proposed to be adopted as the uncontrolled interest rate to arrive at the interest charged at arm's length. The taxpayer in its letter dt.5.3.2010 did not raise any specific objection on the interest rate except arguing that no interest is chargeable on the receivables based on business income."

Accordingly, the TPO proposed an adjustment of Rs.4,60,42,886 as under :

" 6.4 Computation of Arm's Length Price :

Outstanding Closing Balance	*As per Annexure – A*
Arm's Length Interest Rate	*14% pa.*
Arm's Length Price @ 14% p.a. on the average outstanding balance as computed in Annexure-B.	*Rs.4,60,42,886."*

The assessee challenged the action of the TPO/A.O before the DRP but could not succeed.

4.2 Before us, the learned counsel for the assessee has submitted that allowing the credit period of realization of the sale proceeds to the AE does not constitute an international transaction. He has referred to the Section 92(1) of the Income Tax Act, 1961 (in short 'the Act') and submitted that the provisions of Chapter X can be applied only for computation of income arising from an international transaction having regard to the ALP. When a transaction does

not result any income or no income arises from the transactions then the same cannot be the subject matter of computation of ALP as per the provisions of Chapter X. The term " any income " arising from an international transaction therefore computation of income under this Chapter at "Arm's Length" is subject to the condition that an income arises from the international transaction. The transaction of extending credit period to the AE does not give rise to income to the assessee and therefore in the absence of any income arising from the transaction, the same cannot be computed having regard to the ALP. The assessee did not charge any interest or has any right to charge interest on the outstanding due to the AE then the question of computation of income having regard to the ALP does not arise as per the provisions of Chapter X of the Income Tax Act, 1961. For applying the provisions of Chapter X income must arise from the transaction. In the absence of any income arising from the transaction the computation of ALP is not mandated under Chapter X of the Act. In support of his contention, he has relied upon the decision of Hon'ble Bombay High Court in the case of Vodafone India Services Pvt. Ltd. Vs. UOI (2014) 368 ITR 1(Bom) and submitted that the Hon'ble High Court has held that income as understood in the Act must arises from an international transaction

http://www.itatonline.org

then only the measure is to be found on application of arm's length so far Chapter X of the Act is concerned. The computation of ALP does not convert non-income into income. The tax can be charged only on income and in the absence of any income arising the issue of completing the measure of ALP to the value for consideration of itself does not arise. There must be an international value which is chargeable to tax for invoking the provisions of Chapter X.

4.2.1 Alternately the ld. counsel has submitted that it is not an independent international transaction when the TPO has accepted the international transactions provided to the AE at arm's length. Therefore no separate adjustment can be made by treating the extension of the credit period to the AE as a separate international transaction. In support of his contention, he has relied upon the following decisions :

i. CIT Vs. Indo American Jewellery Ltd. (2014) 44 taxmann.com 310 (Bom)
ii. Goldstar Jewellery Ltd. Vs. JCIT (ITA No.6570/Mum/2012 Dt.14.1.2015)
iii. Avnet India P. Ltd. Vs. DCIT (IT(TP)A No.757/Bang/2011 Dt.18.11.2015)
iv. ACIT Vs. Information System Resource Centre P. Ltd. (ITA No. 7757/Mum/2012 Dt.29.5.2015).

4.3 On the other hand, the learned Departmental Representative has submitted that the transaction of allowing credit to the AE for abnormal period

is covered under the definition of international transactions under Section 92B r.w. Explanation. He has also referred to the service agreement between the assessee and AE and submitted that the assessee is entitled to charge interest on delayed payment from the AE therefore the transaction of extending the credit period for abnormal period is an international transaction and the income from the said international transaction has to be computed having regard to the ALP. He has relied upon the orders of the authorities below.

4.4 We have considered the rival submissions as well as the relevant material on record. As regards the first proposition put forth by the ld. counsel for the assessee that the extending credit period cannot be regarded as international transaction in the absence of any income arises from the said transaction, we do not agree with the said proposition advanced by the ld. counsel for the assessee. It is pertinent to note that if the argument advanced by the ld. counsel for the assessee is accepted then it would result to render the provisions of Chapter X redundant. The proposition advanced by the ld. counsel for the assessee would lead to the situation where in a case the assessee is charging less price in comparison to the arm's length price from its AE then the said transaction would be decided as per the provisions of Chapter

X by comparing the same with uncontrolled comparable prices. On the contrary if the assessee does not charge any price for any international transaction with the AE then the provisions of Chapter X cannot be applied as claimed by the ld. counsel for the assessee. Thus such a proposition would be inconsistent with the object and scheme of the Chapter X of I T Act and hence cannot be accepted. Even otherwise if the intent of the legislature was to introduce the provisions of Chapter X was to compute income from international transaction only in the case where the assessee is charging or receiving the price under the international transaction then there cannot be any computation of income having regard to the ALP where the related parties decided not to charge any price of the international transaction and consequently the said provision of Chapter X would be conveniently circumvented by each and every assessee having international transaction with the AE by not charging any price or receiving any price from the international transaction. We find that the reliance placed by the ld. counsel for the assessee on the judgment of Hon'ble Bombay High Court in the case of Vodafone India Services Pvt. Ltd. (supra) is misconceived and misplaced as the Hon'ble High Court has made such observations while dealing with the issue of application of

http://www.itatonline.org

TP provisions of Chapter X in respect a transaction in capital field being transfer of share without charging premium. The relevant observation of the Hon'ble High Court in paras 38 & 39 as under :

" 38. If the above provision is contrasted with the provisions of Chapter X of the Act and in particular Section 92 thereof, it would be noticed that the crucial words "shall be chargeable to income tax" which are found in Section 42(2) of the 1922 Act are absent in Chapter X of the Act. We pointed out this difference in the two provisions to the learned Solicitor General and he agreed that the above difference exists. However, according to him this was in view of the fact that Sections 4, 5, 14 and 56 of the Act does create a charge to income tax on deemed income earned from International taxation. Therefore, it is clear that the deemed income which was charged to tax under Section 42(2) of the 1922 Act was done away with under the Act. The charge of Income now has to be found in Section 4 of the Act. If it is income which is chargeable to tax, under the normal provision of the Act, then alone Chapter X of the Act could be invoked.
Sections 4 and 5 of the Act brings /charges to tax total income of the previous year. This would take us to the meaning of the word income under the Act as defined in Section 2(24) of the Act. The amounts received on issue of shares is admittedly a capital account transaction not separately brought within the definition of Income, except in cases covered by Section 56(2) (viib) of the Act. Thus such capital account transaction not falling within a statutory exception cannot be brought to tax as already discussed herein above while considering the challenge to the grounds as mentioned in the impugned order.

39. In tax jurisprudence, it is well settled that following four factors are essential ingredients to a taxing statute:-

a) subject of tax;
b) person liable to pay the tax;
c) rate at which tax is to be paid, and
d) measure or value on which the rate is to be applied.

Thus, there is difference between a charge to tax and the measure of tax (a) & (d) above. This distinction is brought out by the Supreme Court in Bombay Tyres India Ltd. Vs. Union of India reported in 1984 (1) SCC 467 wherein it was held that the charge of excise duty is on manufacture while the measure of the tax is the selling price of the manufactured goods. In this case also the charge is on income as understood in the Act, and where income arises from an International Transaction, then the measure is to be found on application of ALP so far Chapter X of the Act is concerned. The arriving at the transactional value/ consideration on the basis of ALP does not convert non-income into income. The tax can be charged only on income and in the absence of any income arising, the issue of applying the measure of ALP to transactional value/consideration itself does not arise. The ingredient (a) above is not satisfied

i.e. subject of tax is income which is chargeable to tax. The issue of shares at a premium is a capital account transaction and not income. The classical distinction between income and capital is that which exists between fruits and tree. Income is a flow while capital is a fund. The Privy Council in CIT v/s. Shaw Wallace & Co., Ltd. 6 ITC 178 (PC) has colourfully stated "Thus income has been likened pictorially to the fruit of a tree or the crop of a field. It is essentially the produce of something which is often loosely spoken of as capital."

It is clear from the above observation of the Hon'ble High Court that there is a classical distinction between the income and capital which has been explained by the Hon'ble High Court by comparing the distinction between the fruits and trees. Therefore the said decision of the Hon'ble High Court in the case of Vodafone India Services Pvt. Ltd. Vs. UOI (supra) would not support the contention raised by the ld. counsel of the assessee. The transaction is otherwise capable of generating income but due to the related parties decided not to charge or pay to each other the basic character and nature of transaction would not change. Hence we do not find any substance in the arguments and propositions raised by the ld. counsel for the assessee that provisions of Chapter X are not applicable in this case.

5. As regards the alternative plea, we find that an identical issue has been considered by this Tribunal in a series of decisions. In the case of M/s. Goldstar Jewellery Ltd. Vs. JCIT (supra), Mumbai Bench of the Tribunal while dealing with an identical issue has held in para 8 as under :

http://www.itatonline.org

" 8. We have considered the rival submissions and relevant material on record. The assessee has reported international transaction in its TP report regarding sale to its AE from manufacture of jewellery units and diamond trading unit. The TPO accepted the price charged by the assessee from AE at arm's length. However, the TPO has made the adjustment on account of notional interest for the excess period allowed by the assessee to AE for realization of dues. The TPO applied 18.816% per annum as arm's length on the over due amounts of AE and proposed adjustment of Rs. 2,49,95,139/-. The DRP though concurred with the view of the Assessing Officer/TPO on the issue of international transaction, however, the adjustment was reduced by applying the interest rate of 7% instead of 18.816% applied by the TPO. The first issue raised by the assessee is whether the aggregate period extended by the assessee to the AE which is more than the average credit period extended to the non-AE would constitute international transaction. We are of the view that after the insertion of explanation to section 92B(1), the payment or deferred payment or receivable or any debt arising during the course of business fall under the expression international transaction as per explanation. Therefore, in view of the expanded meaning of the international transaction as contemplated under clause (i) (e) of explanation to section 92B(1), the delay in realization of dues from the AE in comparison to non-AE would certainly falls in the ambit of international transaction. However, this transaction of allowing the credit period to AE on realization of sale proceeds is not an independent international transaction but it is a closely linked or continuous transaction along with sale transaction to the AE. The credit period allowed to the party depends upon various factors which also includes the price charged by the assessee from purchaser. Therefore, the credit period extended by the assessee to the AE cannot be examined independently but has to be considered along with the main international transaction being sale to the AE. As per Rule 10A(d) if a number of transactions are closely linked or continuous in nature and arising from a continuous transactions of supply of amenity or services the transactions is treated as closely linked transactions for the purpose of transfer pricing and, therefore, the aggregate and clubbing of closely linked transaction are permitted under said rule. This concept of aggregation of the transaction which is closely linked is also supported by OECD transfer pricing guidelines. In order to examine whether the number of transactions are closely linked or continuous so as to aggregate for the purpose of evaluation what is to be considered is that one transaction is follow-on of the earlier transaction and then the subsequent transaction is carried out and dependent wholly or substantially on the earlier transaction. In other words, if two transactions are so closely linked that determination of price of one transaction is dependent on the other transaction then for the purpose of determining the ALP, the closely linked transaction should be aggregated and clubbed together. When the transaction are influenced by each other and particularly in determining the price and profit involved in the

http://www.itatonline.org

transactions then those transactions can safely be regarded as closely linked transactions. In the case in hand the credit period extended to the AE is a direct result of sale transaction. Therefore no question of credit period allowed to the AE for realization of sale proceeds without having sale to AE. The credit period extended to the AE cannot be treated as a transaction stand alone without considering the main transaction of sale. The sale price of the product or service determined between the parties is always influenced by the credit period allowed by the seller. Therefore, the transaction of sale to the AE and credit period allowed in realization of sale proceeds are closely linked as they are inter linked and the terms and conditions of sale as well as the price are determined based on the totality of the transaction and not on individual and separate transaction. The approach of the TPO and DRP in analyzing the credit period allowed by the assessee to the AE without considering the main international transaction being sale to the AE will give distorted result by disregarding the price charged by the assessee from AE. Though extra period allowed for realization of sale proceeds from the AE is an international transaction, however, for the purpose of determining the ALP, the same has to be clubbed or aggregated with the sale transactions with the AE. Even by considering it as an independent transaction the same has to be compared with the internal CUP available in the shape of the credit allowed by the assessee to non AE. When the assessee is not making any difference for not charging the interest from AE as well as non-AE then the only difference between the two can be considered is the average period allowed along with outstanding amount. If the average period multiplied by the outstanding amount of the AE is at arm's length in comparison to the average period of realization and multiplied by the outstanding from non AEs then no adjustment can be made being the transaction is at arm's length. The third aspect of the issue is that the arm's length interest for making the adjustment. Both the TPO and DRP has taken into consideration the lending rates, however, this is not a transaction of loan or advance to the AE but it is only an excess period allowed for realization of sales proceeds from the AE. Therefore, the arm's length interest in any case would be the average cost of the total fund available to the assessee and not the rate at which a loan is available. Accordingly, we direct the Assessing Officer/TPO to re-do the exercise of determination of ALP in terms of above observation."

By following the said decision the Tribunal in the case of Information System Resource Centre P. Ltd. (supra), has again taken the same view and thereafter in the case of M/s. Avnet India P. Ltd. (supra), the Tribunal has again reiterated

http://www.itatonline.org

the same view. Even the Hon'ble Bombay High Court in the case of Indo American Jewellery Ltd. (supra) has upheld the order of the Tribunal in para 5 as under :

> *"5. On appeal filed by the Revenue, the ITAT upheld the order of CIT (Appeals). While, upholding the order of CIT (Appeals), the ITAT held that interest income is associated only with the lending or borrowing of money and not in case of sale. We express no opinion on the above reasoning of the ITAT and keep that reasoning open for debate in an appropriate case. However, in the facts of the present case, the specific finding of the ITAT is that there is complete uniformity in the act of the assessee in not charging interest from both the Associated Enterprises and non-Associated Enterprises debtors and the delay in realization of the export proceeds in both the cases is same. In these circumstances the decision of the Tribunal in deleting the notional interest on outstanding amount of export proceeds realized belatedly cannot be faulted."*

Following the earlier orders of this Tribunal, we hold that extending credit period for realization of sales to the AE is a closely linked transaction with the transaction of providing services to the AE and therefore cannot be treated as an individual and separate transaction of advance or loan. Accordingly, we direct the A.O/TPO to redo the exercise of determination of ALP by considering the credit period allowed in realization of sales proceeds as closely linked transaction with the transaction of providing services to the AE and therefore

http://www.itatonline.org

both has to be clubbed and aggregated for the purpose of determination of ALP.

6. **Ground No.5** is regarding disallowance of electricity expenses.

6.1 During the course of assessment proceedings, the Assessing Officer noted that the assessee has debited an amount of Rs.24,55,949 towards electricity expenses. On verification of record, it was found that the above electricity expenses also includes an amount of Rs.6,76,598 which has been paid towards electricity expenses of residence of Director Mr. Bharat Goenka. The Assessing Officer proposed to disallow the said expenses. The assessee contended before the Assessing Officer that the Director contributed to the activity of the business of the assessee from his residence. However the Assessing Officer did not accept this explanation of the assessee as the assessee did not furnish any supporting evidence. Accordingly, the Assessing Officer disallow the payment of electricity expenses and added to the total income of the assessee. The assessee challenged the action of the Assessing Officer before the DRP. The DRP has not given any specific finding except the confirmation of action of the Assessing Officer.

http://www.itatonline.org

6.2 Before us, the ld. counsel for the assessee reiterated the contentions raised before the authorities below and submitted that Director was working from his residence therefore the expenditure was incurred for the purpose of business of the assessee. He has relied upon the decision of Hon'ble Gujarat High Court in the case of Sayaji Iron & Engineering Co. Vs. CIT 253 ITR 749.

6.3 On the other hand, the learned Departmental Representative has submitted that there is no dispute that the payment in question was towards the electricity bill of the residence of the Director and therefore it cannot be allowed as an expenditure incurred wholly and exclusively for the purpose of business of the assessee. He has relied upon the orders of the authorities below.

6.4 We have considered the rival submissions as well as the relevant material on record. There is no such condition in the employment contract of the Director in question that the assessee company will bear the electricity expenditure of the residence of the Director. The Assessing Officer has emphatically stated in the assessment order that the assessee has failed to produce any evidence to show that as per the employment contract the assessee was under the obligation to pay the electricity bill of the residence of

http://www.itatonline.org

the Director. In the case of Sayaji Iron & Engineering Co. (supra), the Hon'ble Gujarat High Court has observed at page 751 & 752 as under :

" 9. In our opinion, as the directors of the assessee were entitled to use the vehicles of the assessee-company for their personal use as per the terms and conditions on which they were appointed, it was not proper on the part of the AO to disallow 1/6th of the expenditure incurred by the assessee on maintenance of its vehicles. Sec. 309 of the Companies Act, 1956, provides the modality for determining the remuneration payable to directors, including any managing or full-time director. Such remuneration is payable either as stated in the articles of association of the company or in accordance with the resolution or if provided by articles, by a special resolution which might be passed by the company in the general meeting. This payment of remuneration is subject to overall limits of managerial remuneration laid down in s. 198 of the Act. What is more material for the purpose of the present controversy is Explanation to s. 198 of the Companies Act which permits and provides that "remuneration" shall include (a) any expenditure incurred in providing any rent-free accommodation, etc., (b) any expenditure incurred in providing any other benefit or amenity free of charge or at a concessional rate, (c) any expenditure which would have been incurred by the director but for such expenditure having been incurred by the company, (d) any expenditure incurred by the company for the purpose of any insurance on the life, etc. Therefore, it is clear that the expenditure incurred by the assessee-company on maintenance of vehicles which were available to the directors for their personal use would fall within the meaning of "remuneration" as defined in the Explanation to s. 198 of the Companies Act, and once such remuneration is fixed as provided in s. 309 of the Companies Act, it is not possible to state that the assessee-company incurred an expenditure for the personal use of the directors i.e., even if there was any personal use by the directors, the same was as per the terms and conditions of service and insofar as the assessee-company was concerned it was a business expenditure and not disallowable as such."

Thus it is clear that the expenditure incurred by the assessee in the said case for maintenance of vehicle was part of the remuneration as well as terms and conditions of the employment/service contract. Therefore the same was considered as business expenditure. In the case of the assessee on hand, no such employment/service condition was relied upon or produced by the assessee either before the authorities below or before us to show that it was an

http://www.itatonline.org

obligation of the assessee company to pay the electricity bill of the residence of the Director. Accordingly, in the facts and circumstances of the case, we do not find any reason to interfere with the orders of the authorities below.

7.1 **Ground No.6** is regarding foreign exchange loss on advance to the subsidiaries. The Assessing Officer noted that an amount of Rs.7,30,389 debited as foreign exchange loss. On verification of record, it was found that the above amount includes a sum of Rs.5,42,999 was towards foreign exchange loss on loan to subsidiaries. The Assessing Officer observed that this foreign exchange loss on loan is capital in nature and therefore the claim of the assessee to the extent of the said amount was disallowed.

7.2 We have heard the learned Authorised Representative as well as learned Departmental Representative and considered the relevant material on record. The issue of allowability of foreign exchange loss has to be considered in view of the Hon'ble Supreme Court in the case of CIT Vs. Woodward Governor India Pvt. Ltd. 312 ITR 254 (SC). Accordingly, we set aside this issue to the record of the Assessing Officer for reconsideration of the same in the light of the judgement of Hon'ble Supreme Court (supra).

http://www.itatonline.org

8.1 **Ground No.7** is regarding disallowance of interest of capital work-in-progress. The Assessing Officer noted that the assessee has reflected an amount of Rs.5,07,98,850 as capital work in progress. The Assessing Officer observed that the assessee is not having interest free fund which could have been used for the purpose of capital work in progress. Accordingly, the Assessing Officer has disallowed the proportionate interest expenditure amounting to Rs.62,22,859 by applying 12.25% average prime lending rate.

8.2 Before us, the ld. counsel for the assessee has submitted that the expenditure of capital work in progress has been incurred for business asset therefore, the provisions of section 36(1)(iii) is applicable in respect of the claim of interest. He has further contended that the assessee is having its own sufficient fund for use of capital work in progress. Therefore no disallowance on account of interest is called for. He has referred the details of the assessee's own fund at page No.8 of the paper book and submitted that the assessee's own fund is much more than the balance shown in the capital work in progress. In support of his contention, he has relied upon the judgement of Hon'ble Bombay High Court in the case of CIT Vs. Reliance Utilities & Power Ltd. 313 ITR 340 (Bom).

8.3 On the other hand, the learned Departmental Representative has submitted that the Assessing Officer has given finding that the assessee is not having his own fund therefore the assessee has utilized the borrowed fund for capital work in progress. Accordingly the Assessing Officer is justified in disallowing the proportionate interest expenditure. He has relied upon the orders of the authorities below.

8.4 We have considered the rival submissions as well as the relevant material on record. There is no quarrel on the issue that if capital business asset is acquired by using the borrowed fund, then interest on such borrowed fund is allowable under Section 36(1)(iii) of the Act. However, in the case on hand it is not clear whether the capital work in progress is for acquisition of new capital asset or the extension of the existing business of the assessee. Further the assessee has claimed before us that the assessee is having sufficient non-interest bearing fund. Therefore no disallowance of interest was contended before us. Since the Assessing Officer has given only a passing reference without examining the details of the availability of the assessee's own fund therefore in the facts and circumstances of the case, we are of the opinion that this issue requires a proper examination and verification of the fact with regard

http://www.itatonline.org

to the availability of sufficient fund with the assessee for the purpose of capital work in progress. Accordingly, we set aside this issue to the record of the Assessing Officer for reconsideration and adjudication after considering the relevant facts as well as the contentions of the assessee.

9.1 **Ground No.8** is regarding disallowance of software expenditure as capital in nature. The Assessing Officer noted that the assessee has debited an amount of Rs.39,86,733. The details of which are given under para 11 of the assessment order as under :

"11. Capital Nature of Expenditure
11.1 The assessee company has debited an amount of Rs.39,86,733 towards the following :

a.	*System Development in relation to Tally Asset*	*Rs.14,44,012.*
b.	*Tally Dictionary and Reference Manual Translation (Hindi, Marathi, Gujarathi, Bengali, Punjabi, Tamil, Kannada, Telugu, Malayalam, English)*	*Rs.20,92,721.*
c.	*Web Consultancy and Development*	*Rs.4,50,000*
		Rs.39,86,733."

The Assessing Officer was of the view that the above expenditure was capital in nature and therefore it was disallowed. Before the DRP the assessee contended that the expenditure of Rs.14,44,012 was incurred in the process of development of new accounting system namely Tally Ascent and claimed that

the same is revenue in nature. An expenditure of Rs.20,92,721 was incurred in creating a reference manual and dictionary of words of various languages. Since the assessee company is in the business of Tally products, the expenditure incurred is in the nature of revenue. The next item of expenditure is Rs.4,50,000 was claimed towards subscription for web site for providing information to Tally customers. Such payment is made at Rs.50,000 per month. The expenditure is incurred in the business interest of the assessee and is an allowable expenditure. The DRP did not accept the contention of the assessee as regards the expenditure on system development in relation to Tally Ascent as well as Tally Dictionary and reference manual and held that the said expenditure has given enduring benefit to the assessee company which is not related to a single financial year. As regards the expenditure of Rs.4,50,000 towards web consulting and development, the DRP has observed that the details were not furnished during the appellate proceedings and therefore in absence of details the said expenditure of Rs.4,50,000 was allowed.

9.2 Before us, the learned counsel for the assessee has reiterated the submissions made before the authorities below. On the other hand, the learned Departmental Representative has relied upon the orders of the

authorities below and submitted that the enduring benefit would be received by the assessee on account of the said expenditure not limited to the financial year under consideration.

9.3 We have considered the rival submissions as well as the relevant material on record. We find that the expenditure incurred for system development in relation to Tally Ascent which is a tool for the assessee to develop further accounting software and therefore undisputedly the said expenditure is having an enduring benefit for a long period of time. Similarly, the expenditure on Tally dictionary and manual in various languages is also one time expenditure for creating/acquiring the software to be used in long run. Accordingly, we do not find any error or illegality in the order of the authorities below treating these expenditure as capital in nature. However, since the Assessing Officer has disallowed the claim by treating the same as capital in nature, consequently, the depreciation on the said amount is allowable as per the rate applicable. Accordingly, we direct the Assessing Officer to allow depreciation on this amount.

10.1 **Ground No.9** is regarding disallowance of foreign expenses. The Assessing Officer noted that the assessee has debited an amount of

http://www.itatonline.org

Rs.36,47,254 towards travel expenses. On verification of record, it was found that the said amount includes the sum ofRs.21,03,465 incurred towards travel of Mr. **Bharat Goenka** and Smt. **Sheela Goenka**, Directors of the assessee company. The Assessing Officer further noted that the above travel expenditure was incurred for the visits to Maritius, Male, London, South Africa, Alaska and Alaska Cruise. The Assessing Officer questioned the said amount of expenses and asked the assessee to substantiate the claim of the assessee that the expenditure was incurred wholly and exclusively for the purpose of business of the assessee. In the absence of satisfactory reply from the assessee that the said foreign travel of the Directors was for business purpose, the Assessing Officer disallowed the expenditure of Rs.21,03,465. The DRP has confirmed the disallowance made by the Assessing Officer.

10.2 Before us, the ld. counsel has reiterated the contentions raised before the authorities below and submitted that the expenditure has been incurred wholly and exclusively for the business purpose of the assessee as the travel was undertaken by the Directors of the assessee company.

10.3 On the other hand, the learned Departmental Representative has relied upon the orders of the authorities below and submitted that it is clear from the

facts recorded by the Assessing Officer that the expenditure was incurred for personal visits of the Directors.

10.4 We have considered the rival submissions as well as the relevant material on record. The assessee explained before the Assessing Officer as recorded by the Assessing Officer in paras 12.3 and 12.4 as under :

> *" 12.3 In response to the above, the assessee company vide its letter dt.29.11.2010 has contended that Mr. Goenka and Mrs. Sheela Goenka the Director of the assessee company travelled to get away from daily Hustle-Bustle.*
>
> *12.4 This enables them to recharge their Batteries and Provides tremendous opportunity for New Discovery and perspective. It further contends that they meet local customers and potential business partners."*

It is clear from the explanation furnished before the Assessing Officer that the foreign travel by the Directors was to break the monotony of the daily work and therefore it is not the case of the assessee that the foreign trip of the Directors were for any business purpose. In the absence of any terms and conditions of the service of the Directors that they will be allowed to travel for personal foreign trip, this expenditure cannot be considered as laid out wholly and exclusively for the purpose of business of the assessee as per section 37(1)

of the Act. Accordingly, we do not find any error or illegality in the orders of the authorities below.

11. **Ground No.10** is regarding disallowance of claim of bad debts.

11.1 During the Financial Year relevant to Assessment Year under consideration the assessee company transferred its software business division (sales and marketing of Packet software products and services and incidental thereto) to its wholly owned subsidiary Tally (India) Private Limited ('TIPL') on a going concern basis with effect from 1.2.2006 for a lumpsum consideration of Rs.121,42,46,954 vide Slump Sale Agreement Dt.11.12.2006. The said division was taken over by the TIPL which includes outstanding amount from sundry debtors. The payment of the slump sale consideration was allowed to be paid in instalments within a period of three years from the date of agreement. It was stated that there is no gain or loss on the transfer of said business. It was also agreed upon between the parties that TIPL to recognize eventual loss if any arising out of non-realisation of sundry debtors. The same would be transferred to the assessee as part of deal. On realization of the facts that TIPL would not be able to recover the sundry debtors transfer as part of software business division the sundry debtors amounting to Rs.37,94,44,180/-

were retransferred to the assessee by the TIPL. The assessee written off the entire amount of Rs.37,94,44,180 however in computation of income the assessee claimed only an amount of Rs.16,25,61,749 after an adjustment of amount of Rs.24,68,82,431 being sundry creditors no more payable. Since both these amounts were pertaining to the sundry debtors and sundry creditors of the software business division transferred to the subsidiary the assessee claimed only net amount as deduction being loss on account of non-realisation of sundry debtors (bad debts). The said claim of the assessee has been disallowed by the Assessing Officer by holding that the loss claimed by the assessee is not permissible as it is a capital loss. In alternative, capital loss of Rs.16,25,61,749 at the best is allowable in Assessment Year 2009-10 as per the agreed terms . Thirdly, the Assessing Officer observed that the claim of the assessee would be allowable if it prove beyond reasonable doubt that the sundry debtors were not realizable by TIPL after it has taken effective steps to recover the amounts. The assessee challenged the action of the Assessing Officer before the CIT (Appeals) but could not succeed.

11.2 Before us, the learned Authorised Representative of the assessee has submitted that the amount claimed as written off unrealizable debt pertain to

the sale made by the assessee in the earlier previous year to various parties which has been accounted in the books. Therefore this amount was already considered as income in the earlier assessment year. The receivable on account of the above sale have been shown as debtors in the books of accounts. In the immediate preceding year i.e. Assessment Year 2006-07 the assessee company transferred this sale and marketing division to its wholly owned subsidiary TIPL under Slump Sale Agreement and pursuant to the said sale the assets and liabilities including debtors and creditors have been transferred to TIPL with an understanding that if the debtors are not realized by the TIPL then same shall be transferred to the assessee. During the year under consideration as agreed between the parties the unrealized debts have been retransferred by the TIPL to the assessee. Thus on retransfer of the debtors by the TIPL to the assessee it again became debtors of the assessee. The debtors were transferred by the TIPL directly related to the sale in the preceding previous year. Hence when this debtors are written off, the assessee complied with the condition of Section 36(2) of the Act as it has duly recorded in the books of accounts in the earlier previous year. Alternatively, the learned Authorised Representative has submitted that the transfer of this sales and

marketing division was for the purpose of better control over the business on the core areas. Thus the transfer of the division has business purposes in view of the fact that a division was transferred to the wholly owned subsidiary. The losses having nexus with the business are allowable deduction under Income Tax Act. In support of his contention the learned Authorised Representative of the assessee has relied upon Hon'ble Rajasthan High Court in the case of **CIT Vs. Anjani Kumar** 259 ITR 11 and submitted that in the said case the advances given by the assessee to the agriculturists for acquisition of agricultural land were become unrecovered as the agriculturists refused to give the land. The Assessing Officer disallowed the claim of deduction of the said amount by treating the same as capital in nature. The matter was carried to the Hon'ble High Court and the Hon'ble High Court while confirming the order of the Tribunal allowing the claim has observed that the advance was paid to acquire agricultural land to set up a factory but when agriculture land was not acquired no asset was came into existence. Therefore there is no question of allowing depreciation on such asset. The learned Authorised Representative has relied upon the decision of Hon'ble Supreme Court in the case of **Badridas Daga** Vs. CIT 34 ITR 10 and submitted that when the employee of the assessee withdrew

http://www.itatonline.org

the money from the bank account and misappropriate the same, the claim of business loss was disallowed by the Assessing Officer. The Hon'ble Supreme Court has allowed the claim as business loss sustained by the assessee as a result of misappropriation by the employee which is incidental to carrying on his business. The learned Authorised Representative thus submitted that the assessee has disclosed in the notes to the accounts for the year ended 31.3.2006 that the assessee made to have recognized the loss if any arising within a period of three years due to non-realisation of sundry debtors. The learned Authorised Representative has pointed out that within a period of 3 years means any of the years between the first year to third year and not at the end of the third year. Thus once the assessee has written off the amount that being not-realisable/recoverable which has satisfied the requirement of claim as deduction as well as complied with the terms of transfer agreement. He has further contended that the assessee shall not be required to prove that the debts have become non-recoverable as held by Hon'ble Supreme Court in the case of TRF 323 ITR 397. Thus in view of the settled principle laid down by the Hon'ble Supreme Court, the books of accounts is sufficient to claim the deduction under Section 36(1)(vii) of the Act. He has further submitted that in

the Slump Sale Agreement no specific mode for disbursement of consideration was specified. Therefore the TIPL has paid the part consideration in money and pat consideration has been discharged by way of returning the sundry debtors as agreed upon between the parties. The assets and liabilities were transferred with clear understanding that unrealized debtors would be retransferred to the assessee within a period of three years. On retransfer of the sundry debtors, the consideration receivable from TIPL on slump sale has been reduced to the extent of unrealized debtors. Thus in effect the debtors were returned as part of settlement of consideration. The learned Authorised Representative has submitted that in order to claim the deduction as debt and part thereof the only condition need to be fulfilled is that the debt or part thereof must have been taken into account in computing the income of the assessee of previous year in which the amount of such debt or part thereof is written or in earlier previous year. Undisputedly the income pertaining to the debt has been recorded in the books of the assessee in the earlier year and hence it has duly fulfilled the condition specified under Section 36(2) of the Act. He has also relied upon the following judgments :

a) CIT Vs. T. Veerabhadra Rao & K. Koteswara Rao & Co. 155 ITR 152 (SC).

b) CIT Vs. Nainital Bank Ltd. (1965) 55 ITR 707 (SC).

11.3 On the other hand, the learned Departmental Representative has submitted that once the debts were transferred being part of the slump sale then the claim of the assessee is not allowable as it will be a capital loss being reduction of consideration of slump sale. Even the capital loss of the amount can be allowed only when the amount become unrecoverable after the expiry of three years as per the terms of the agreement. Once a slump sale is entered into and consequent thereto assets and liabilities are transferred, no such asset or liability can be taken back by the assessee subsequent to the completion of the sale transaction as it would violate slump sale as per Section 50B r.w.s. 2(19A) of the Act. The learned Departmental Representative has submitted that under the Slump Sale Agreement it is a condition that there could be transfer of entire undertaking or entity and therefore part of undertaking is not permissible. A slump sale includes a transfer of entire assets and liabilities and the consideration is lump sum consideration of the entire business an individual asset and liability is not permissible. The bad debts in any case does not belong to the assessee but to the transferee TIPL and therefore the assessee cannot

http://www.itatonline.org

claim the deduction of the bad debts written off. He has relied upon the orders of the authorities below.

11.4 We have considered the rival submissions as well as the relevant material on record. The undisputed fact giving raise to the dispute is that vide Slump Sale Agreement dt.1.2.2006, the assessee transferred its sale and marketing division to its wholly owned subsidiary. Under the said slump sale transfer all assets and liabilities including sundry debtors of Rs.186.87 Crores and sundry creditors of Rs.77.03 Crores pertaining to the said division were transferred to TIPL. The Assessing Officer has noted that the assessee has disclosed the arrangements between the assessee and its subsidiary in the accounts for the Assessment Year 2006-07 that it may have to recognize eventual loss if any arising out of non-realisation of the sundry debtors transferred to TIPL. The said note to accounts has been placed at page 53 of the paper book as under :

"1. Transfer of business to subsidiary

During the financial year, the company as ;authorized by the Board of Directors vide their resolution dated 19th January, 2006 for a lumpsum consideration of Rs.1,214,246,954 by entering into a Slump Sale Agreement dated 1st Feb., 2006. The assets taken over by Tally (India) Pvt. Ltd. as part of the Slump Sale Agreement include outstanding from sundry debtors. The company has agreed that Tally (India) Pvt.

Ltd. may make payment of the lumpsum sale consideration in parts within a period of three years from the date of Agreement. There is no gain or loss on the transfer of the said business.
In terms of Slump Sale Agreement dated 01st February 2006 between the company and its subsidiary, Tally (India) Pvt. Ltd., for the sale of the software business division of the company, the company may have to recognize eventual loss, if any arising out of non-realisation of sundry debtors (debtors not realized within three years from the date of the agreement). Transfer to Tally India Pvt. Ltd. a part of the slump sale."

However, the Assessing Officer did not accept the said disclosure in the notes of accounts for allowing deduction and observed that no such terms and conditions have been mentioned in the Slump Sale Agreement. It is not disputed by the Assessing Officer that the debt pertains to the sales effected by the assessee in the earlier year and were part of the income for the earlier assessment year of the assessee. The issue can be analysed with the angle that there is no hurdle or legal constrain of claim of such deduction by the wholly owned subsidiary of the assessee in respect of these debtors gone bad and becomes unrealizable as these debtors were transferred under the Slump Sale transaction. This proposition was considered by the Hon'ble Supreme Court in the case of **CIT Vs. T. Veerabhadra Rao & K. Koteswara Rao & Co.** (supra) wherein the Hon'ble Supreme Court has recorded the controversy involved in the case at page 155 as under :

*" **5.** It is not disputed that the assessee succeeded to the business of the predecessor firm and took over all its assets and liabilities, including the debt due from Laxmi Trading Company. The business carried on by the predecessor firm was now carried on by the assessee. The facts also show that the assessee paid income-tax on the interest income accruing on the debt for the asst. yr. 1963-64. It is also not disputed that the parties effected a settlement on 31st March, 1965, whereby a sum of Rs. 25,000 was accepted by the assessee in satisfaction of the debt and that the balance of Rs. 15,100 was written off by the assessee as irrecoverable. The question is whether money owed by a debtor under a transaction with a predecessor firm can be written off as irrecoverable in the accounts of its successor, the assessee, in a subsequent year and could be claimed as a bad debt under cl. (vii) of sub-s. (1) of s. 36 of the IT Act, 1961."*

As it is clear from the relevant facts of the said case that the assessee claimed the deduction on account of debts written off as irrecoverable in respect of the business which was succeeded by the assessee and the question arises for consideration of their Lordship is whether money owned by the debtor under a transaction with a predecessor can be written off as irrecoverable in the accounts of his successor (the assessee) in a subsequent year and could be claimed as a bad debt under Section 36(1)(vi) of the Act. The Hon'ble Supreme Court has observed that the recovery of debt is a right transfer along with the number of other rights comprising the subject of the transfer. If the law permits the transfer to treat the whole or part of the debt as irrecoverable and to claim as deduction on that account it seems difficult to accept that the same right should not be recognized in the transferee. It is merely an incident

http://www.itatonline.org

flowing from transfer of business together with its assets and liabilities from the previous owner to the transferee. The decision which should be on a proper appreciation of all i.e. employee in the transfer of business be recorded as belonging to the new owner. Thus the Hon'ble Supreme Court has finally held at page 157 as under :

> " ***7.*** *It seems to us that even if the debt had been taken into account in computing the income of the predecessor firm only and had subsequently been written off as irrecoverable in the accounts of the assessee, the assessee would still have been entitled to a deduction of the amount written off as a bad debt. It is not imperative that the assessee referred to in sub-cl. (a) must necessarily mean the identical assessee referred to in sub- cl. (b). A successor to the pertinent interest of a previous assessee would be covered within the terms of sub-cl. (b). The successor assessee, in effect, steps into the shoes of his predecessor."*

It is understandable that if the predecessor is entitled to reduction of the amount as bad debt, the successor shall also be entitled to claim the said deduction. If this analogy is applied to the facts of the present case then the undisputedly the claim of deduction of bad debts were allowable in the case of the assessee if the division had not been transferred to the subsidiary and further pursuant to the transfer the said deduction is also allowable in the hands of the subsidiary. Similarly when the debts were originally belonging to the assessee and relates to the sale effected by the assessee then retransfer of the said debts by the subsidiary to the assessee brings the situation to its

http://www.itatonline.org

original state where the assessee prior to the transfer of the debts to the subsidiary was eligible to have claimed the deduction of bad debts written off. It is not in dispute that the conditions as prescribed under section 36(2) has been satisfied in this case that the amounts of debts has already been considered as part of the income in the earlier year in the hands of the assessee. It is borne out from the record that the assessee has made provision of an amount of Rs.43,22,86,450 and amount of Rs.21,68,82,431 has written back as sundry creditors and further an amount of Rs.5,28,42,270 has been added back in the computation of income. Therefore the assessee has claimed only a net amount of Rs.16,25,61,749 after giving the adjustment of sundry creditors written back against the original provision of Rs.43,22,86,450 as recorded by the Assessing Officer in para 13.2 of the assessment order. The Assessing Officer has not distributed the amount of written back of sundry creditors to the extent of Rs.21,68,82,431 adjusted against the gross amount of the provision of Rs.43,22,86,450. Once the sundry creditors written back as well as sundry debtors written off are accepted on parity then the claim of written off amount cannot be given a different treatment by assigning the reason that it is a los in capital field. In any case when this amount of bad debt

written off was undisputedly allowable in the hands of the assessee prior to the transfer of division and also allowable in the hands of the subsidiary after the transfer then on retransfer of these debts by the subsidiary to the assessee as per their mutual agreement and arrangement at the time of slump sale would not change their character being sundry debtors of assessee as it was prior to transfer and the same status was also with the subsidiary of the assessee subsequent to the transfer. The Hon'ble Bombay High Court in the case of **CIT Vs. Shreyas S. Morakhia** (supra) by following the judgment of Hon'ble Supreme Court in the case of CIT Vs. T. Veerabhadra Rao & K. Koteswara Rao (supra) has held in paras 11 & 12 as under :

> *" 11. The view which we are inclined to take finds support from a decision of the Supreme Court inCommissioner of Income Tax v T. Veerabhadra Rao. (155 ITR 152) In that case the assessee succeeded to the business of a firm and took over all its assets and liabilities including a debt due from a third party. The assessee carried on the business of the firm and for Assessment Year 1963-64. Income tax was paid on the interest accrued on the debt due from the debtor. On 31 March 1965 a settlement was effected under which the assessee accepted a part of the amount due while the balance was written off as irrecoverable. The issue was whether the assessee could for Assessment Year 1965-66 claim the amount written off as a bad debt under section 36(1)(vii). The Revenue contended that the requirements of clause (i) of sub-section (2) of section 36 were not fulfilled. The Supreme Court held that the recovery of the debt was allowed to be transferred from the transferor to the transferree and if the law permits the transferor to treat the debt as irrecoverable and to claim a deduction on that account, the same right would be recognized as inhering in the transferee. For the purpose of present appeal, the judgment of the Supreme Court is of significance since it decides the issue as to whether the requirements of clause (i) of sub-section (2) of section 36 would be fulfilled. The Supreme Court held as follows:*
>
> *"... It is true that Clause (i) of sub-section (2) of section 36 declares that a deduction can be allowed only if the debt, or part thereof, has been taken into account in computing the income of the assessee of that previous year or an*

earlier previous year and that it has also been written off as irrecoverable in the accounts of the assessee for that previous year. In the present case, the debt was taken into account in the income of the assessee for the assessment year 1963-64 when the interest income accruing thereon was taxed in the hands of the assessee. The interest was taxed as income because it represented an accretion accruing during the earlier year on money owed to the assessee by the debtor. The item constituted income because it represented interest on a loan. The nature of the income indicated the transaction from which it emerged. The transaction was the debt, and that debt was taken into account in computing the income of the assessee of the relevant previous year. It is the same assessee who has subsequently, pursuant to a settlement, accepted part payment of the debt in full satisfaction and has written off the balance of the debt as irrecoverable in his accounts. It appears therefore that the conditions in both Sub-clauses (a) and (b) of Clause (i) of sub-section (2) of section 36 are satisfied in the present case, and the High Court as well as the Appellate Tribunal and the AAC are right in the view which they took."

12. The point to be emphasized from the above extract from the decision is that according to the Supreme Court, the debt was taken into account in the income of the assessee for Assessment Year 1963-64 when the interest income accruing thereon was taxed in the hands of the assessee. The Supreme Court noted that the transaction was a debt and that debt was taken into account in computing the income of the assessee of the relevant previous year."

In the case on hand undisputedly the debt was taken into account in the hand of the assessee for the earlier assessment year and thereafter it was transferred to the subsidiary and again retransfer to the assessee. Therefore, the character of debts will not change merely because it was transferred and retransferred when all other conditions are satisfied as required under Section 36(1)(vii) and under Section 36(2) of the Act. In view of the above facts and circumstances of the case as well as the various precedents stated above, we are of the considered opinion that when the claim of bad debts written off in

question was an allowable claim against the income of the assessee prior to the transfer and was also allowable claim in the hands of the subsidiary post transfer then the retransfer of the said debts to the assessee as per the agreement between the parties would not change its character from allowable deduction under Section 36(1)(vii) to a non-allowable capital loss. Accordingly, we hold that the claim of the assessee on account of non-realisable sundry debtors written off is allowable.

12. In the result, the appeal of the assessee is partly allowed.

Order pronounced in the open court on 19th day of Aug., 2016.

Sd/-	Sd/-
(A.K.GARODIA)	**(VIJAYPALRAO)**
Accountant Member	Judicial Member

http://www.itatonline.org