

IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH "I-1" NEW DELHI
BEFORE SHRI S.V. MEHROTRA : ACCOUNTANT MEMBER
AND
SHRI A.T. VARKEY: JUDICIAL MEMBER

ITA no. 4359/Del/2009

Asstt. Yr: 2004-05

ACIT, Circle 3(1),
New Delhi.

Vs. M/s Conexant Systems Pvt. Ltd.,
11-A, Sucheta Bhawan,
Vishnu Digambar Marg, New Delhi.
PAN: AAACF 2723 N

AND

C.O. No. 37/Del/2010

(In ITA no. 4359/Del/2009)

Asstt. Yr: 2004-05

M/s Conexant Systems Pvt. Ltd.,
11-A, Sucheta Bhawan,
Vishnu Digambar Marg, New Delhi.

Vs. ACIT, Circle 3(1),
New Delhi.

(Appellant)

(Respondent)

Department by : Sh. Vijay Kumar Chadha CIT (DR)
Assessee by : Sh. Piyush Chawla Adv.

Date of hearing : 30/09/2015.
Date of order : 27/11/2015.

ORDER

PER S.V. MEHROTRA, A.M.:

The captioned appeal by the department and the cross objection by the assessee have been preferred against the order dated 23-9-2009 passed by the Id. CIT(A)-XX, New Delhi in appeal no. 153/2007-08, relating to assessment year 2004-05.

2. The assessee, a 100% subsidiary of Globespan Virata Inc. ('GSV'), in the relevant assessment year, was involved in software development at various levels to be used in GSV's products. It provided hardware drivers, system software, communication protocol, stacks etc. The assessee also developed management software which helped in managing the chip or even the whole system. The assessee also provided market support services to GSV in the Asia Pacific region.

3. The assessee had filed return of income declaring total income of Rs. 1,63,04,536/-. During the year under consideration, the assessee had entered into following international transactions:

S. No.	International Transactions	Method	Value (in Rupees)
1	Software research & development of services	TNMM	16,74,24,534
2.	Marketing Support Services	TNMM	1,51,51,899
3.	Receipt of interest free loan	-	7,02,47,285

4. The assessee company had adopted TNMM to benchmark the international transaction of the segments by taking operational profit over operating cost (OP/OC) a profit level indicator in both the segments. The PLI of software development segment of the assessee was 27.28% and in the marketing service segment assessee had OP/OC of 9.11%.

5. Ld. TPO examined the calculation of PLI of comparables on the basis of current years data, vis a vis the assessee's mode of computation. There being differences in these workings, based on the financial of the comparable companies, ld. TPO rejected the assessee's contentions and

worked out the calculation of OP/OC of the comparables using the following definitions as per capitaline plus database:

“Operational Income (OI)=[Net Sales]+ [Export Incentives]+ [Import Entitlements]+[Sale of Scrap]+ [Provision Written Back]+ [Miscellaneous Income]+[Stock Adjustments]

Operational Expenses (OE)=[Raw Materials]+ [Power & Fuel Cost]+ [Other Manufacturing Expenses]+ [Employee Cost]+ [Selling and Administration Exp.]+ [Loss on forex transactions]+ [Other Miscellaneous Expenses]+ (Depreciation)
Operation Profit (OP)=OI-OE

6. OP/OC of the Comparables of the assessee with FY 2003-04 data is reproduced below:

S. No	Co Name	Year End	Net Sales	OP	TC	OP/TC%
1	Besant Raj Intl	200403	0.29	0.08	0.21	38.10
2.	Engineers India	200403	1281.84	303.38	978.46	31.01
3.	Mahin Acre Cons	200403	2.62	0.19	2.49	7.63
4.	Priya Intern.	200403	5.49	0.32	5.32	6.02
5.	Rites	200403	266.95	82.56	176.94	46.66
6.	Ujjwal	200403	7.42	0.33	7.15	4.62
7.	Water & Power consulting	200403	64.67	8.31	53.46	15.54
						21.36

7. He, therefore, directed for addition of Rs. 12,96,513/- as under:

Arm's length margin on cost 21.36%	
Total costs incurred in marketing services	Rs. 1,05,87,025
Arm's length price (121.36% of the costs)	Rs. 1,28,48,414
Remuneration received	Rs. 1,15,51,899
Difference (in Rs. And in % of ALP)	Rs. 12,96,515

8. The AO determined the total income assessee at Rs. 1,89,57,669/- after making following additions:

Interest paid to NOIDA Authority	Rs. 17,78,441
Depreciation on computer peripherals	Rs. 43,011
Transfer pricing adjustment	Rs. 12,96,515

9. Ld. CIT(A), after detailed consideration of submissions, observed in para 13.1 to 14 as under:

“13.1. I have considered the above submission of the appellant and it is observed that following two issues are involved:

- i. Whether Provision Written back should be considered as operating income?*
- ii. Whether Provision for doubtful debts/ bad debts/ provision made be treated as operating expense?*

13.2. In this respect, it is interesting to note that TPO has treated provision written back as operating income, however provision created during the year has been considered as non operating by the TPO in his order. In my view the TPO has totally failed in applying the Matching Concept, which is one of the primary principles of Accounting.

In this respect, I quote the recent judgment of M/s Sony India (P) Limited Vs. DCIT (I.T.A.Nos.1181/Del/2005, 1257/Del/2007 & 1656/Del/2007), wherein the Delhi Tribunal held that "creation. of unpaid liability and write back is normal incident of business operations". Based on this judgment, I hold that provision written back should be considered as operating income and provisions created during the year should be treated as operating expenditure instead of non operating expenditure as done by the TPO.

13.3 In view of the above, I hold that in case of Engineers India Ltd., Mahindra & Acres Consulting Engineers Ltd., Priya Intl. Ltd. and Rites Ltd., provision made j Bad debts should be considered as operating expenses in nature.

14. Based on the above, the average OP/TC of the comparables comes to 14.27% (details as per Annexure 2) as against 9.11 % that of appellant.

10. Ld. CIT(A) further deleted the disallowance made by AO in respect of interest paid to NOIDA Authority and also allowed the assessee's appeal in regard to depreciation on computer peripherals @ 60% as claimed by assessee as against 25% allowed by AO.

11. Being aggrieved with the order of ld. CIT(A), the department is in appeal before us and assessee has filed cross objections.

12. Grounds raised by the department in it appeal, read as under:

1. Whether in the facts and circumstances of the case, the Ld.CIT(Appeals) was right in treating the provisions written back during the year as operating income?

2. Whether in the facts and circumstances of the case, the Ld.CIT(Appeals) was right in treating the provisions created during the year as operating expenditure?

On Corporate Addition

3. Whether in the facts and circumstances of the case, the Ld.CIT(Appeals) was right in deleting addition of Rs.177844 1/- made by the AO on account of interest paid to NOIDA Authority by holding same as revenue expenditure which the AO capitalized by treating same as part of cost of plot(a capital asset)?

4. Whether in the facts and circumstances of the case, the Ld.CIT(Appeals) was right by allowing the depreciation @ 60% on computer peripherals amounting to Rs.430 I 1/- though the IT Rules allows 60% depreciation only on computer and computer software?

5. The Appellant craves leave for reserving the right to amend, modify, alter, add or forego any ground(s) of appeal at any time before or during the hearing of this appeal.

13. As far as ground no. 1 is concerned, we find from the observations of Id. CIT(A), reproduced earlier, that the TPO himself had treated the provision written back as operating income. Therefore, this ground is misconceived and, accordingly, dismissed.

14. As far as ground no. 2 is concerned, we do not find any reason to interfere with the observations of Id. CIT(A), noted above, because provision created during the year being normal incidence of business, has to be treated as operating expenditure instead of non-operating expenditure, as done by the TPO. We, accordingly, dismiss ground no. 2 also.

15. As far as ground no. 3 is concerned, brief facts are that during the year assessee had paid Rs. 17,78,441/- on account of interest to NOIDA Authority towards the allotment of plot to the assessee and claimed the same as deduction. Before AO, the assessee's explanation was that it had capitalized the cost of the premises in the books and the interest accrued on the deferred installments towards the premium of the premises amounting to Rs. 17,78,441/-, had been treated as revenue expenditure. The AO, however, did not accept the assessee's contention observing that since interest was paid towards the capital asset, the same had to be capitalized to the cost of the land and could not be allowed as revenue expenditure.

16. Before Id. CIT(A) the assessee had, inter alia, submitted that the assessee had been allotted the land including super structure by NOIDA on lease for a period of 90 years for which the assessee was required to pay upfront 30% of the premium/cost of the said premises and the balance 70% was payable in 10 equal half yearly instalments along with interest @ 12% per annum. It was pointed out that the expenditure was incurred to facilitate the project of establishing the development centre for manufacture and export of software. It was pointed out that the interest payable by the

assessee to the NOIDA Authority was for the period after acquisition of land including superstructure which was put to use on acquisition. Therefore, the interest pertaining to the period, post acquisition and putting into use of such land including super-structure, could not be capitalized along with the cost of land in terms of section 43(1) read with Explanation 8 thereto. Ld. CIT(A), after considering the assessee's contention, allowed the claim in terms of section 36(1)(iii), observing that as per section 43(1) read with Explanation 8, interest payable on asset for the period, after such asset was put to use, could not be capitalized. He also relied on following decisions:

- Bombay Steam Navigation Co. (P) Ltd. Vs. CIT 56 ITR 52 (SC)
- CIT Vs. Sivakami Mills Ltd. 227 ITR 465.

17. We have considered the submissions of both the parties and perused the record. The facts are not disputed that the interest claimed by assessee was in respect of deferred instalments after the land including the superstructure was put to use on acquisition. Therefore, ld. CIT(A) rightly held that the interest pertaining to the period post acquisition and putting of such land including the superstructure in use, could not be capitalized along with the cost of land. We are in agreement with the view taken by ld. CIT(A), which is also fortified by the decision of Hon'ble Supreme Court in the case of Bombay Steam Navigation Co. (P) Ltd. (supra). Ground is dismissed.

18. Ground no. 4: As far as ground no. 4 is concerned, the said issue is covered by the decision of Hon'ble Delhi High Court in the case of CIT Vs. BSES Yamuna Powers Ltd. 358 ITR 47, holding that the depreciation on computer accessories and peripherals such as, printer, scanners and server was to be allowed @ 60% the same being part of computer system. Respectfully following the decision of Hon'ble Jurisdictional High Court we

see no reason to interfere in the order of Id. CIT(A) on the issue in question.
Ground fails.

19. Revenue's appeal stands dismissed, accordingly.

Assessee's C.O. No. 37/Del/2010:

20. In its cross objection, the assessee has raised following grounds:

1. That on the facts and circumstances of the case and in law, the Ld. CIT(A) is not justified in holding that current year (i.e. FY 2003-04) financial information of comparable companies is to be used for comparability analysis, which was not available to the assessee company at the time of filling its return of Income.

2. Without prejudice to Objection 1 above, the financial information of the company viz. Esquires Engineers & Consultants ought to be considered in the final comparable company set in view of the fact that its current year data is available.

3. (a) That on the facts and circumstances of the case and in law, the Ld CIT(A) erred in not directing the Ld AO/TPO to consider certain 'operating' expenses, which have been wrongly classified as 'non- operating for the purpose of comparability analysis done in the order passed by the Ld TPO

3. (b) That on the facts and circumstances of the case and in law, the Ld CIT(A) erred in not directing the Ld AO/TPO to disregard certain non-operating' expenses, which have been wrongly classified as 'operating' expenses for the purpose of comparability analysis done in the order passed by the Ld TPO

21. As far as ground no. 1 is concerned, the issue is no more res-integra and it is well settled law that only current year's financial information of

comparable companies is to be used for comparability analysis. Accordingly, this ground is dismissed.

22. As far as ground no. 2 is concerned, the main contention of Id. counsel is that financial information of the company viz. Esquires Engineers & Consultants for current year is available and, therefore, the matter is restored back to the file of Id. TPO for considering the inclusion of this comparable de novo in the list of comparables, selected by him. Ground is allowed for statistical purposes only.

23. As regards ground no. 3, the main contention of assessee is that while computing the PLI of various comparables, some of the operating expenses have been considered as non-operating while some of the non-operating expenses have wrongly been classified as operating expenses. In this regard, in the synopsis, filed by the assessee, it is pointed out that as far as Water & Power Consultancy Services Ltd. (WAPCOS) is concerned, the Id. TPO has not considered power and fuel expenses as operating expenses while computing operating margin. This aspect was not adjudicated by Id. CIT(A) pointing out that the same was academic in nature.

24. After considering the submissions of both the parties, since the OP/OC of each comparable affected the average margin, on the basis of which addition is made, therefore, computation of correct OP/OC of each comparable is of paramount importance. We, therefore, restore this issue to the file of Id. TPO to examine the assessee's contention. Ground is allowed for statistical purposes.

25. The next objection is in regard to taking into consideration the misc. income as operating income in computing the operating margins of Mahindra Acres Consulting Engineers Ltd. and Rites Ltd. The assessee's reliance is on the decision of the ITAT in the case of M/s Robst India Pvt.

Ltd. Vs. ACIT (ITA no. 512 and 557/PN/2012), in which it has been held that any item of income or expenditure, which is not linked to the international transactions under review has to be excluded from the computation of net operating profits and operating revenues.

26. We find that this plea has not been taken before Id. CIT(A) and, therefore, we refrain from making any comment on this aspect, particularly because if this principle is to be applied, then it is to be applied in respect of all the items of income and expenditure, which aspect has not been examined by lower revenue authorities. Since this issue does not arise out of the CIT(A)'s order, we refrain to adjudicate the same. Ground is dismissed.

27. In the result, revenue's appeal is dismissed and the assessee's cross-objection is partly allowed for statistical purposes.

Order pronounced in open court on 27/11/2015..

Sd/-
(A.T. VARKEY)
JUDICIAL MEMBER
Dated: 27/11/2015.

Sd/-
(S.V. MEHROTRA)
ACCOUNTANT MEMBER

MP

Copy of order to:

1. Assessee
2. AO
3. CIT
4. CIT(A)
5. DR, ITAT, New Delhi.

-+		Date	Initial	
1.	Draft dictated on	6-11.2015		PS
2.	Draft placed before author	9.11.2015		PS
3.	Draft proposed & placed before the second member			JM/AM
4.	Draft discussed/approved by Second Member.			JM/AM
5.	Approved Draft comes to the Sr.PS/PS			PS/PS
6.	Kept for pronouncement on			PS
7.	File sent to the Bench Clerk			PS
8.	Date on which file goes to the AR			
9.	Date on which file goes to the Head Clerk.			
10.	Date of dispatch of Order.			