

**IN THE INCOME TAX APPELLATE TRIBUNAL
'A' BENCH : BANGALORE**

**BEFORE SMT. P. MADHAVI DEVI, JUDICIAL MEMBER
and
SHRI JASON P. BOAZ, ACCOUNTANT MEMBER**

**IT(TP)A No.1315/Bang/2010
(Assessment year:2006-07)**

M/s.Tellabs India Pvt. Ltd.
No.503, World Trade Centre, Brigade Gateway,
No.26/1, Dr.Rajkumar Road, Malleswaram West
Bangalore-560055. ... Appellant
PAN: AAAC79392B

Vs.

Deputy Commissioner of Income-tax,
Circle 12(4),
Bangalore. ... Respondent

Appellant by: Shri B.R.Sudheendra, CA.
Respondent by: Shri C.H.Sundar Rao, CIT (DR).

Date of hearing : 19/03/2015.
Date of pronouncement: 31/03/2015.

O R D E R

Per Smt.P.MADHAVI DEVI, JM:

This is an appeal filed by the assessee against the order of the Assessing Officer u/s 143(3) r.w.s.144C of the Income-tax Act, 1961 [hereinafter referred to as 'the Act' for short] dated 20/09/2010 for the assessment year 2006-07.

2. The assessee has raised as many as fourteen grounds of appeal. However, at the time of hearing, learned counsel for the assessee submitted that assessee does not wish to press the grounds No.1 to 5. They are accordingly rejected as not pressed.

3. As regards ground No.6.1, the learned counsel for the assessee submitted that the assessee is only agitating the sub ground of appeal No.(i), i.e. against treating the transaction entered into by the assessee with M/s.Power Grid Corporation of India Ltd.[PGCIL] as international transaction/deemed international transaction under chapter X of the Act. He submitted that the other sub grounds of ground No.6.1 and grounds 6.2 to 8 are all consequential to the finding on sub-ground (i) to ground No.6.1.

4. Brief facts of the case are as under: The assessee had taken a loan from its Associated Enterprise(AE) and treated it as an international transaction. The assessee filed its transfer pricing study before the AO/Transfer Pricing Officer(TPO). After going through the details filed by the assessee, the TPO noticed that the assessee had not disclosed two international transactions with its AE in Denmark. He observed that the AE in Denmark had entered into two contracts with PGCIL for supply and installation of tele-communication equipment for Delhi-Mumbai Link (Phase-I) on 27/3/2002 and that the AE also entered into one more contract with PGCIL on 23/5/2003 for

installation and commission of telecommunication equipment for the Rest-of-India Link. He observed that the AE of the taxpayer i.e. Tellabs, Denmark gave sub contract to the assessee in respect of both these projects. For the first project, the said contract was made for a consideration of Rs.9403 crores and the assessee was assigned the work of installation and commissioning, while for the second project, the said contract was given for a consideration of Rs.15.045 crores for the assignment of the work of installation and commission. Since the assessee did not mention these transactions in its 3CEB report, the TPO intimated this fact to the AO and asked him to refer these transactions to the TPO after obtaining approval of the CIT. These two transactions were also referred to the TPO for determination of the Arms' length price (ALP). The assessee took an objection stating that these transactions are not international transactions. However, the objections of the assessee were rejected and the TPO continued to determine the ALP and accordingly made ALP adjustment. Based on the same, the AO proposed the draft assessment order, against which the assessee preferred objections before the Dispute Resolution Panel (DRP) and pursuant to the order of the DRP confirming the draft assessment order, final assessment order was passed. It is against the final assessment order that the assessee is in appeal before us.

5. The learned counsel for the assessee submitted that the very same issue as to whether these transactions were international transactions had come up before this Tribunal in the assessee's own case for the assessment years 2003-04 and 2004-05 and 'A' bench of this Tribunal, by order dated 5/4/2013 in paras.31 to 36, held that there has been only an assignment of the portion of on-share contract by Tellabs, Denmark to the assessee and there has been no novation of the portion of the on-shore contract between Tellabs, Denmark and PGCIL and the consequence in the event of assigning and novation being different, the transaction of assigning between the assessee and Tellabs, Denmark cannot be said to be a transaction between two persons either or both of whom were non-residents. It was further held that the assignment agreement between Tellabs, Denmark and the assessee has all the ingredients of international transaction within the meaning of sec.92 of the Act and therefore, the ALP determined has to be of the assignment agreement and the comparables for an assignment agreement have to be considered and the most appropriate method for determination of such assignment agreement has to be adopted. The Tribunal has, therefore, set aside the issue to the file of the AO for a further reference to the TPO for determination of the ALP of the assignment agreement after affording an opportunity of hearing to the assessee with liberty to file a fresh TP analysis

and justify the price as its ALP. The learned counsel for the assessee has filed a copy of the said order before us.

6. The learned Departmental Representative, though did not leave his ground, has agreed that the issue is similar as in the case before the Tribunal for the assessment years 2003-04 and 2004-05 and the Tribunal has set aside the issue to the file of the AO/TPO for re-determination of the ALP of the assignment agreement.

7. Having regard to the rival contentions and the material on record and also the decision of the Tribunal, the relevant portion of which is reproduced hereunder:

"31. We have perused the terms of the assignment of portion of onshore contract by Tellabs Denmark to the Assessee and the terms subject to which such assignment was accepted by PGCIL. PGCIL has consented to the assignment of the portion of Onshore Agreement by Tellabs Denmark to the assessee with a specific condition that the Assignment will not amount to Novation of contract between PGCIL and Tellabs Denmark. Section 62 in The Indian Contract Act, 1872 lays down the effect of novation, rescission, and alteration of contract. It lays down that if the parties to a contract agree to substitute a new contract for it, or to rescind or alter it, the original contract need not be performed. Assignment involves the transfer of an interest or benefit from one person to another. However the 'burden', or obligations, under a contract cannot be transferred. If one wants to transfer the burden of a contract as well as the benefits under it, one has to novate. Like assignment, novation transfers the benefits under a contract but unlike assignment, novation transfers the burden under a contract as well. In a novation, the original contract is extinguished and is replaced by a new one in which a third party takes up rights and obligations which duplicate those of one of the original parties to the contract. Novation is only possible with the consent of the original contracting parties as well as the new party.

32. *It is clear from the various agreements that there has been only an assignment of the portion of onshore contract by Tellabs Denmark to the Assessee and there has been no novation of the portion of on shore contract between Tellabs Denmark and PGCIL. The consequences in the event of an assignment and novation are different. Since there has only been an assignment and not novation of the contract in the present case, the transaction of assignment between Assessee and Tellabs Denmark cannot be said to be a transaction between two persons either or both of them were not non-residents.*

33. *It is a very strange situation where had Tellabs Denmark not assigned the portion of onshore contract, the provisions of Sec.92 of the Act would not have been applicable because Tellabs Denmark and PGCIL are not Associated Enterprises. The assignment of the portion of onshore contract has taken place exactly at the same consideration for which Tellabs Denmark agreed to render services to PGCIL. Nevertheless, the assignment agreement between Tellabs Denmark and the Assessee has all the ingredients of an international transaction within the meaning of Sec.92 of the Act. It was an agreement between two or more Associated Enterprises (there is no dispute that Tellabs Denmark and the Assessee are Associated enterprises) where one of both the parties to the transaction i.e., Tellabs Denmark is a Non-Resident. The transaction relates to provision of services or a transaction which has a bearing on profits, income, losses or assets. Therefore the price paid for such transaction had to pass the ALP test u/s. 92 of the Act.*

34. *However, we find that the revenue has proceeded on the basis that there is a deemed international transaction u/s.92B(2) of the Act between Assessee and Tellabs Denmark, which in our view is not correct. In this regard, we agree with the submission of the learned counsel for the Assessee that PGCIL is a Government of India entity, performing a governmental functions in a restricted sector. Its policies are directly controlled by the Central Government. It can neither be accused of entering into tainted agreements or exercising undue influence for the purpose of avoiding taxes. PGCIL is neither part of a prior agreement as stipulated in the first limb of section 92B(2) nor has in substance determined the terms of the transaction with the appellant as stipulated in the second limb of section 92B(2). It has followed all the prescribed norms for calling international bids for awarding contracts, and thus cannot be accused of acting as an intermediary between Tellabs Denmark and the appellant for such purpose.*

35. *Even if the contract between Tellabs Denmark and PGCIL, prior to assignment, is treated as a separate agreement, it only deals with execution of work by Tellabs Denmark in relation to both the onshore and offshore part of the work. The transaction being with a Government of India entity, it cannot be regarded as tainted with the object of avoiding taxes. Nor does it have any reference to the current transaction nor was the current transaction contemplated at that time. Therefore it cannot be regarded as being in relation to the present transaction and does not have any reference to it. Therefore, there is no prior agreement as required under the first limb of section 92B(2).*

36. *As a result, the preconditions to attract section 92B(2) of the Act have not been satisfied in the instant case. It cannot be deemed that the transaction between the assessee and PGCIL is one between associated enterprises.*

37. *The decision of the Hyderabad Bench of ITAT in the case of Swarnandhra IJMII Integrated Township Development Company Pvt. Ltd. v. DCIT for AY 2007-08, ITA No. 2072/Hyd/2011 dated 31st December 2012 relied upon by the learned counsel for the Assessee is not relevant in the present case because in that case the transactions were between two related parties both of whom were residents, though the two related parties had a common holding company which was non-resident. The Tribunal in the aforesaid decision held that Section 92B(2) of the Act applies to cases where two AEs intend to have an international transaction but want to avoid transfer pricing provisions by interposing a third party as an intermediary. The legal form of the transaction was ignored and the substance of the transaction was given effect by deeming the transaction with the intermediary itself to be one with an AE. This deeming provision needs at least one of the parties to the transaction to be non-resident. In that case, both the taxpayer and IJMII are residents the provisions would not be applicable. Further the transaction in question does not involve transfer of goods or services either directly or indirectly from the taxpayer to its AE or any other non-resident using IJMII as an intermediary. The factual background in the present case, as we have already seen, is different. In fact, it is quite the opposite in the sense that the original contract was not with an AE and therefore the provisions of section 92 were not attracted. The assignment agreement however attracted the provisions of section 92 of the Act.*

38. *For the reasons given above, we uphold the orders of the revenue authorities holding that provisions of Sec.92 were applicable to the assignment of the portion*

of the onshore contract by Tellabs Denmark to the Assessee.

39. We will now deal with the merits of the addition made by the TPO which was confirmed by the DRP. The first aspect which was highlighted by the learned counsel for the Assessee was that there was no opportunity of being heard by the TPO before proposing the adjustment.

40. The proceedings before the Additional Director (Transfer Pricing)-II, Bangalore commenced with a letter dated 1st June, 2006. The first and final date of hearing was 17-11-2006. Various details relevant to the said proceedings were filed by the assessee as under:-

- (i) Vide letter dated 15.06.2006 : Audited accounts , Copy of Form 3AB with the Transfer Pricing report and the agreements entered with associate enterprises was submitted.
- (ii) Vide letter dated 09.08.2006: Brief background of the company with details of the revenue streams were provided along with the cost break up and the FAR analysis on the Project Income was submitted.
- (iii) Vide letter dated 17.08.2006 : Income and expenses split based on the nature of revenue, objection to why the PGCIL Contract will be outside the purview of transfer pricing with the comparable details was provided.
- (iv) Vide letter dated 31.08.2006 : Copy of the contracts entered with PGCIL was submitted.
- (v) Vide letter dated 20.11.20.06 : objection against the proposed order u/s 92CA and the basis on which the objections were raised was submitted. In this letter the assessee also gave a working of the net margin of the comparable companies.

41. The assessee had, in the letter, broadly stated the following:

- (i) the transaction under consideration was not an international transaction;
- (ii) comparables chosen by the TPO were inappropriate.

42. A personal hearing was afforded to the assessee on 17-11-2006. During the personal hearing, it was stated that in view of the findings drawn in the earlier years, the same would be sustained for the present year also. The personal hearing lasted for a very minimal time of less than 15 minutes. Without affording a further opportunity of being heard, an order of 20-12-2006 has been passed under section 92CA of the income-tax Act. In the order under section 92CA of the Income-tax Act, the adjustment as proposed originally in the letter dated 03.11.2006 has been sustained in its entirety. It was submitted that the letter dated 03.11.2006 was drafted even without an opportunity of being heard personally being given to the assessee and even without the requisite details being on record. In other words, the letter was drafted merely on the basis of the preliminary details submitted by the assessee. All the objections through assessee's various letters have been disregarded. The order as ultimately passed is a reproduction of the letter dated 03.11.2006 with some cosmetic changes. The same comparables as originally chosen have been broadly retained. The reason why the transaction was not an international transaction has been only briefly addressed. No reference was made to the workings of net margin submitted by the assessee.

43. Thus the assessee has not been afforded a proper opportunity of presenting its case. Thus the assessee was not afforded any opportunity to substantiate its case or rebut the proposals of the Additional Director (Transfer Pricing)-II, Bangalore. The dragging of the proceedings to the fag end of the limitation period is in no way attributable to the assessee.

44. The CIT(A) however did not deal with this objection specifically but went on to uphold the order of the TPO. We find that the Assessee has been pursuing its ground that the transaction in question cannot be regard as one falling within the ambit of Sec.92 of the Act and has not been addressed on the merits of the adjustment to the ALP. The Assessee had reported two transactions in Form 3CEB viz., Transaction of rendering Marketing, sales and customer services support to Tellabs International Inc. USA and transaction of loan with Tellabs Enterprises B.V. In respect of the first transaction the Assessee adopted TNMM. In respect of the second transaction the Assessee adopted CUP method. Those transactions were accepted as at Arm's Length by the TPO. The TPO thereafter proceed to hold that the Transaction which was assigned by Tellabs Denmark to the Assessee was of the same nature as that of rendering marketing, sales and customer services support of Tellabs International Inc. USA and thereafter took the very same comparables.

45. *As we have already seen, the ALP adjustments are counter measures to ensure that the prices at which international transactions are entered into by the associated enterprises are not arranged so that the taxes legitimately attributable to income accruing in India are not adversely affected. This basic principle should not be lost sight of. The Transactional profit methods (i.e. Transactional Net Margin Method and Profit Split Method) are treated as methods of last resort which are pressed into service only when the standard methods, which are also termed as 'traditional methods', (i.e. Comparable Uncontrolled Price Method, Resale Price Method and Cost Plus Method) cannot be reasonably applied. The CIT(A) despite plea of the Assessee that the TPO did not afford proper opportunity of being heard, did not seek any fresh TP study from the Assessee, but however proceeded to confirm the order of the TPO. We deem it appropriate to afford opportunity to the Assessee to explain its stand on the ALP of the assignment agreement. The analysis done by the TPO and CIT(A) in our view is on the basis that the agreement for rendering onshore services was between the Assessee and PGCIL. This is not the international transaction in dispute but the assignment agreement. This difference, in our view, will have consequences in as much as the FAR analysis would be different. We therefore set aside the orders of CIT(A) and remand the issue of determination of ALP afresh to the Assessing Officer, who will make a reference to the TPO, who will after affording opportunity of being heard to the Assessee with liberty to file a fresh TP analysis and justify the price as at Arm's Length. The TPO will keep in mind that the assignment of the portion of onshore contract had taken place due to business restricting of the Tellabs group worldwide and also the fact that the assignment had taken place on the same terms agreed between Tellabs Denmark and PGCIL. As to whether this transaction itself would constitute a comparable uncontrolled transaction is also a question which will need consideration by the TPO. With the aforesaid observations, the order of AO is set aside and the appeal of the Assessee is treated as allowed for statistical purposes."*

Respectfully following the decision of the co-ordinate bench in the same set of facts, we also set aside the findings of the AO and remand the issue to the file of the AO for making a reference to the TPO for redetermination of the ALP of the assignment agreement as directed by the Tribunal in ITA

Nos.1037 & 1038/Bang/2008. This ground of appeal is accordingly allowed and other ground i.e. sub-ground 2 of ground No.6.1 to ground NO.8 are also set aside to the file of the AO for consequential relief, if any, to the assessee.

8. As regards ground No.9.1 to 9.3, the learned counsel for the assessee submitted that the assessee company had debited an amount of Rs.4,78,416/- towards work contract tax. He submitted that various clients of the assessee deducted works tax while making payment to the assessee and remitted the same to the respective States Sales tax department and in order to claim refund, the assessee-company has to registered itself with respective State Governments sales-tax department as a venture and file returns to claim the said refund of work contract tax. Since registering itself with multi State Governments Sales Tax Department was an onerous job, the assessee did not complete the registration process to be able to claim refund of works contract tax. Since the assessee has incurred the said expenditure on account of its business, the same was allowable u/s 37 of the Act but the AO holding that the assessee is not fulfilling its responsibility of claiming and receiving refund of works contract tax, has disallowed the same and brought it to tax. The learned counsel for the assessee submitted that as long as the expenditure is for the purpose of business of the assessee, the same cannot be disallowed.

The learned Departmental Representative, however, supported the orders of the authorities below.

9. Having heard the rival contentions and the material on record, we find that the works contract tax claimed by the assessee as a deduction is an amount deducted by the various clients of the assessee-company and remitted to the respective State Governments Sales Tax Departments. Therefore, it is clearly for the purpose of assessee's business. It is also not in dispute that the assessee is entitled to claim refund of the said works contract tax provided it is registered with the respective State Government Sales Tax Department. It is not the case of the Revenue that the assessee has registered itself and has not claimed the refund. If the assessee is registered with the respective State Government Sales Tax Department and claims and is awarded the refund, the same would be taxable u/s 41(1) of the Act. Therefore, we see no merit in the finding of the AO that merely because the assessee is not claiming and receiving the refund, the same cannot be allowed as an expenditure in the hands of the assessee. In view of the same, we allow the assessee's ground of appeal Nos.9.1 to 9.3.

10. As regards ground No.10, brief facts are that the assessee-company had debited a sum of Rs.337415/- towards capital expenses. On verification of records including Form 3CEB report of the assessee-company, the AO found that the above has been debited to the profit and loss account of the assessee

and when the assessee's representative was unable to substantiate the reasons for debiting it to the Profit & Loss account of the assessee-company, the AO disallowed the same and brought it to tax. Before the DRP, the assessee had raised an objection stating that during the relevant previous year, the assessee had paid 'hire furnishing allowance' to its employees which was nothing but re-imbusement made to enable the assessee to purchase furniture and fixtures and these were considered as 'perquisites' in the hands of the employees and tax was deducted at source u/s 192 of the Act. It was stated that the said allowances or reimbursement were stated as capital expenditure in Form 3CED since tax auditor was of the opinion that they constituted capital expenditure but the said expenditure was claimed as deduction in computing the business income. It was submitted that the furniture and fixtures were not purchased by the assessee and not owned by it and therefore it did not result in any creation/acquisition of any asset and the assessee did not become owner of any capital asset. He placed reliance upon the decision of the jurisdictional High Court in the case of 166 ITR 836 wherein it was held that the expenditure incurred towards employees' welfare is allowable as deduction u/s 37 of the Act. The DRP however confirmed the order of the AO and the assessee is in appeal before us.

The learned Departmental Representative supported the orders of the authorities below.

11. Having regard to the rival contentions and the material on record, we find that the assessee has not made any submission before the AO resulting in the AO making the disallowance. However, the assessee had raised specific objections before the DRP but without verifying the objections of the assessee, the DRP has merely confirmed the assessment order. Therefore, we set aside the order of the AO on this issue and remand the same to the file of the AO for verification of the claim made by the assessee and re-computation of the income of the assessee in accordance with law. This ground of appeal is accordingly allowed for statistical purposes.

12. Ground No.11 is against the disallowance of deduction claimed in respect of foreign exchange loss on restatement of loan amounting to Rs.9,19,928/-. The learned counsel for the assessee submitted that the foreign exchange loss has been claimed on account of revaluation of ECB loan account and the AO has disallowed the same holding that the said loss is only on a notional basis. The learned counsel for the assessee placed reliance upon the judgment of the Hon'ble Supreme Court in the case of *CIT vs. Woodward Governor India Pvt. Ltd.* reported in (2009) 312 ITR 254 (SC) wherein it has been held that loss suffered by the assessee on account of fluctuation in the rate of foreign exchange as on the date of the balance-sheet is an item of expenditure u/s 37(1) of the Act. The learned Departmental

Representative, however, supported the orders of the authorities below.

13. Upon considering the rival contentions and the material on record, we find that facts narrated by the assessee have not been properly appreciated or verified by the AO or the DRP. While the assessee states that foreign exchange is on account of revaluation of the ECB loan, the AO has stated that it is on account of advance received by the assessee-company for its holding company for work to be executed. Thus it is clear that facts have not been properly verified by the AO. In view of the same, we deem it fit and proper to set aside the same to the file of the AO for verification of the facts and reconsideration of the issue in accordance with law. Needless to mention that the assessee shall be given a fair opportunity of hearing on all the issues which are set aside to the file of the AO/TPO for re-consideration.

14. In the result, the assessee's appeal is partly allowed for statistical purposes.

Pronounced in the open court on 31st March, 2015.

Sd/-
(Jason P Boaz)
ACCOUNTANT MEMBER
eksrinivasulu

sd/-
(Smt. P.Madhavi Devi)
JUDICIAL MEMBER

Copy to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.
6. Guard file

By order

Assistant Registrar
Income-tax Appellate Tribunal
Bangalore