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

BEFORE SMT. P. MADHAVI DEVI, JUDICIAL MEMBER
and
SHRI ABRAHAM P GEORGE, ACCOUNTANT MEMBER

ITA No.20/Bang/2014
(Assessment year: 2010-11)

M/s.Eka Software Solutions Pvt.Ltd.
Building 2A, East Tower, Vrindavan
Tech Village, Outer Ring Road,
Devarabeesanahalli, Varthur Hobli,
Bangalore-560037 … Appellant
PAN:AABCE3660Q

Vs.

Deputy Commissioner of Income-tax,
Circle 11(3),
Bangalore. … Respondent

Appellant by: Shri Ajay Rotti, CA.
Respondent by: Shri P.Dhivahar, JCIT(DR).

Date of hearing : 05/01/2015.
Date of pronouncement: 30/01/2015.

O R D E R

Per Smt. P.MADHAVI DEVI, JM:

This is an appeal filed by the assessee against the order of the CIT(A)-I, Bangalore, dated 27/09/2013 for the assessment year 2010-11.

2. The assessee is aggrieved by the order of the CIT(A) confirming the disallowances made by the Assessing Officer (AO) of :

i. business service charges paid by the assessee to M/s.Eka Software Solutions Inc.;

ii. tele-communication charges for computation of deduction u/s 10A and 10AA of the Income-tax Act, 1961[hereinafter referred to as 'the Act'];

iii. computation of deduction u/s 10A on the basis of assessed income; and

iv. levy of interest u/ss.234B and 234C of the Act.

3. Brief facts of the case are that the assessee-company, which is engaged in the business of developing and licensing of software products and consultancy services, filed its return of income for the assessment year 2010-11 on 30/09/2010 declaring a total income of Rs.27,94,820/-. During the assessment proceedings u/s 143(3) of the Act, the AO observed that the assessee has paid a sum of Rs.4,82,62,511/- as business-service marketing charges to M/s. Eka Software Solutions Inc. USA [Eka, USA]. The AO asked the assessee to justify and substantiate the claim and submit copies of the agreement, invoices, etc. The assessee submitted the same and on verification of the assessee's statements, the AO observed that the assessee has incurred unreasonably high expenditure which is not commensurate with the revenue declared on account of this expenditure. He, therefore, observed that the expenditure has to be allowed proportionately in relation to revenue to sales which had increased around 26% during the year. He, accordingly allowed only 26% of the marketing service charges paid to Eka Solutions, USA. Additionally, while

computing deduction u/s 10A of the Act, the AO reduced the tele-communication expenses/lease rent charges incurred by the assessee from only the export turnover and brought it to tax.

4. Aggrieved by these disallowances and the consequential additions, the assessee filed an appeal before the CIT(A) who confirmed the order of the AO. However, as regards the computation of deduction u/s 10A of the Act, the CIT(A) directed the AO to reduce tele-communication expenses both from the export turnover as well as total turnover. As regards the disallowance of marketing charges paid to Eka Solutions, USA, the CIT(A), in addition to confirming the addition, has also held that the same is to be disallowed u/s 40(a)(i) of the Act since assessee has not applied the provisions of sec.195 of the Act. Against these findings of the CIT(A) against the assessee, the assessee is in second appeal before us.

5. As regards the disallowance of business expenditure/marketing service charges is concerned, the learned counsel for the assessee submitted that there was an agreement entered into by the assessee with its AE in USA for rendering of marketing services and the assessee has received these services in view of the said agreement and has also benefitted in the form of increase in revenue. He submitted that all the details were filed before the AO and the CIT(A), but, none of the authorities have appreciated the same. He submitted that the AO has gone on the premise that there has to be proportionate

increase in the revenue in comparison to the expenditure which, finding according to him, is erroneous. In support of his contentions, he placed reliance upon the decision of the Hon'ble Delhi High Court in the case of *CIT vs. EKL Appliances Ltd.* (345 ITR 241)(Del) and the decision of the Hon'ble Supreme Court in the case of *CIT vs. Rajendra Prasad Moody* (115 ITR 519)(SC). He submitted that the CIT(A) has further held that the said payment made by the assessee is chargeable to tax in India and since the assessee has failed to deduct tax while making remittance to non-resident, the disallowance u/s 40(a)(i) is also called for. He submitted that this finding of the CIT(A) is also unsustainable since the CIT(A) has not even examined as to whether the said payment to non-resident is taxable in India or not. Thus, according to him, both the authorities below have made disallowances without proper appreciation of facts and material on record.

5.1 As regards the reduction of tele-communication charges from the export turnover is concerned, the learned counsel for the assessee submitted that they are not to be reduced from the export turnover as these expenses are incurred for export of software. However, since the CIT(A) has followed the decision of the Hon'ble Karnataka High Court in directing for exclusion of the same from the total turnover also, the learned counsel submitted that the assessee does not wish to press the same seriously. As regards the deduction u/s 10A is

concerned, the learned counsel for the assessee submitted that the same should be granted on the assessed income and not on the returned income of the assessee and in the event the disallowance of marketing service charges is confirmed by the Tribunal, then there should be a direction to the AO to allow the deduction u/s 10A of the Act on the finally assessed income.

5.2 The learned Departmental Representative, on the other hand, supported the orders of the authorities below and submitted that the genuineness and reasonableness of the transaction between the assessee and its AE has to be established by the assessee and since the assessee has failed to establish the same, the AO has rightly made the disallowance.

6. Having regard to the rival contentions and the material on record, we find that the assessee has furnished the copies of the agreement between the assessee and its AE for rendering of marketing services and the invoices raised by the AE before the AO but the AO has not verified the genuineness or reasonableness of the same but has only made the disallowance on a proportionate basis of the increase in revenue to sales. This, in our view, is not sustainable in view of the decision of the Hon'ble Delhi High Court in the case of *EKL Appliances Ltd* (cited supra) wherein it has been held as under:

> *"21. The position emerging from the above decisions is that it is not necessary for the assessee to show that any legitimate expenditure incurred by him was also incurred out of necessity. It is also not necessary for the assessee to show that any expenditure incurred by him for the*

purpose of business carried on by him has actually resulted in profit or income either in the same year or in any of the subsequent years. The only condition is that the expenditure should have been incurred 'wholly and exclusively' for the purpose of business and nothing more. It is this principle that inter alia finds expression in the OECD guidelines, in the paragraphs which we have quoted above.

22. Even Rule 10B(1)(a) does not authorize disallowance of any expenditure on the ground that it was not necessary or prudent for the assessee to have incurred the same or that in the view of the Revenue the expenditure was unremunerative or that in view of the continued losses suffered by the assessee in his business, he could have fared better had he not incurred such expenditure. These are irrelevant considerations for the purpose of Rule 10B. Whether or not to enter into the transaction is for the assessee to decide. The quantum of expenditure can no doubt be examined by the TPO as per law but in judging the allowability thereof as business expenditure, he has no authority to disallow the entire expenditure or a part thereof on the ground that the assessee has suffered continuous losses. The financial health of assessee can never be a criterion to judge allowability of an expense; there is certainly no authority for that. What the TPO has done in the present case is to hold that the assessee ought not to have entered into the agreement to pay royalty/brand fee, because it has been suffering losses continuously. So long as the expenditure or payment has been demonstrated to have been incurred or laid out for the purposes of business, it is not concern of the TPO to disallow the same on any extraneous reasoning. As provided in the OECD guidelines, he is expected to examine the international transaction as he actually finds the same and then make suitable adjustment but a wholesale disallowance of the expenditure, particularly on the grounds which have been given by the TPO is not contemplated or authorised."

We also find that the assessee has made the same plea before the CIT(A) and has also filed the above details and documents but the CIT(A) also has neither called for a remand report nor has verified the genuineness or reasonableness of the payment made by the assessee to its AE but has only confirmed the addition made by the AO by further holding that the said

payment is chargeable to tax in India and since the assessee has failed to deduct tax at source, the disallowance u/s 40(a)(i) is called for. This, in our view, is not justified without verification of facts. In view of the same, we deem it fit and proper to remand the issues to the file of the AO for *de novo* consideration of the issue as regards the genuineness and also the reasonableness of the expenditure claimed by the assessee. It is made clear that the AO cannot make disallowance on the ground that the assessee has not generated revenue in proportion to the expenditure. This ground of appeal is accordingly allowed for statistical purposes.

6.1 As regards exclusion of tele-communication expenses from the export turnover for the purpose of deduction u/s 10A is concerned, we find that the alternate prayer of the assessee is covered in favour of the assessee by the decision of the jurisdictional High Court in the case of *CIT vs. Tata Elxsi Ltd.* (349 ITR 98) which has been followed by the CIT(A) in directing the AO to exclude the same from the total turnover also for the purpose of computation of deduction us 10A. Therefore, we see no reason to interfere with the order of the CIT(A) on this issue. This ground of appeal is rejected.

6.2 As regards the third ground of appeal that the deduction u/s 10A should be granted on 'the profits and gains as

are derived by an undertaking from the export of articles or things or computer software' as assessed by the AO, we find that the AO is bound to first compute the income from export of articles or things or computer software, as the case may be, and thereafter allow the deduction u/s 10A in accordance with law. Therefore, the AO is directed to grant the deduction u/s 10A in accordance with law.

7. The grounds No.4 and 5 relating to interest u/s 234B and 234C are consequential in nature and therefore the AO is directed to give consequential relief to the assessee, if any.

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

Pronounced in the open court on 30th of January, 2015.

sd/-	**sd/-**
(Abraham P George)	**(Smt. P.Madhavi Devi)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

eksrinivasulu
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.