

**IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCHES "B", HYDERABAD**

**BEFORE SMT. P. MADHAVI DEVI, JUDICIAL MEMBER
AND
SHRI B. RAMAKOTAIAH, ACCOUNTANT MEMBER**

I.T.A. No. 392/HYD/2016

Assessment Year: 2009-10

M/s. ValueLabs LLP, HYDERABAD [PAN: AAEFV9532G]	Vs	Deputy Commissioner of Income Tax, Circle-8(1), HYDERABAD
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(Appellant)

(Respondent)

For Assessee	:	Shri P. Murali Mohan Rao, AR
For Revenue	:	Smt. N. Swapna, DR

Date of Hearing : 04-01-2018

Date of Pronouncement : 24-01-2018

ORDER

PER B. RAMAKOTAIAH, A.M. :

This is an appeal by assessee against the order of the Commissioner of Income Tax (Appeals)-9, Hyderabad, dated 12-01-2016. The issue in this appeal is whether the interest income and other income earned by assessee is eligible for deduction u/s. 10A of the Income Tax Act [Act].

2. Briefly stated, assessee is a firm engaged in the business of development and export of software and has earned income of Rs. 62,62,81,648/-. After claiming deduction of Rs. 62,55,84,569/- u/s. 10A of the Act. Assessee filed its return of income declaring total income at Rs. 6,62,225/-. The Assessing Officer (AO) has noticed that assessee has earned interest income

of Rs. 4,62,35,101/- and other income of Rs. 41,39,680/-. Considering that these amounts are not derived from the export of software and following the principles laid down by the Hon'ble Supreme Court in the case of CIT Vs. Sterling Foods [237 ITR 579] (SC) and CIT Vs. Pandian Chemicals Ltd., [262 ITR 278], AO excluded the above amounts from the computation u/s. 10A and restricted the deduction accordingly.

3. Before the Ld.CIT(A), assessee contended that interest income and other income have direct nexus with the activity of business and that these receipts form part of business of assessee. It relied on the following case law:

- i. Order of ITAT, Mumbai in the case of M/s. JP Morgan Services India Pvt. Ltd., Vs. DCIT [33 SOT 327] (Mumbai);
- ii. Judgment in the case of CIT Vs. Punit Commercial Ltd., [116 Taxmann 191] (Bombay);
- iii. Judgment in the case of CIT Vs. Lok Holding [308 ITR 356] (Bombay);
- iv. Judgment in the case of CIT Vs. Eltek SGS (P) Ltd., [300 ITR 6] (Delhi);

4. Ld.CIT(A), however, did not accept the contentions and following the principles laid down by the Hon'ble Supreme Court in the case of Liberty India Vs. CIT [183 Taxman 349] [317 ITR 218] (SC) and also other decisions as stated in para 6.4 of the order upheld the order of AO. Hence the present appeal.

5. Assessee in the course of present appeal, raised additional grounds that AO has erred in not excluding the above incomes from total turnover while excluding from export turnover. It is noticed that AO has not excluded the above incomes from the export turnover and export turnover was taken as admitted by assessee itself. Therefore, the additional grounds raised does not arise on the facts of the case and after being pointed out Ld. Counsel did not press the same.

6. Coming to the issue of treating the interest income and other income, it was contended that these incomes are incidental to the business and are to be treated as 'business profits'. Referring to the provisions before the amendment to Section 10B from 01-04-2001 and subsequent to amendment brought on 01-04-2001, it was submitted that the profits of the undertaking are to be considered while allowing the deduction u/s. 10B. It was submitted that the Hon'ble High Court of Karnataka (Full Bench) in the case of CIT Vs. Hewlett Packard Global Soft Ltd., [87 taxmann.com 182] (Karnataka) (FB) has examined the legal position including the decision of Hon'ble Supreme Court and came to the following conclusion:

"37. On the above legal position discussed by us, we are of the opinion that the Respondent assessee was entitled to 100% exemption or deduction under Section 10-A of the Act in respect of the interest income earned by it on the deposits made by it with the Banks in the ordinary course of its business and also interest earned by it from the staff loans and such interest income would not be taxable as 'Income from other Sources' under Section 56 of the Act. The incidental activity of parking of Surplus Funds with the Banks or advancing of staff loans by such special category of assessee covered under Section 10-A or 10-B of the Act is integral part of their export business activity and a business decision taken in view of the commercial expediency and the interest income earned incidentally cannot be de-linked from its profits and gains derived

by the Undertaking engaged in the export of Articles as envisaged under Section 10-A or Section 10-B of the Act and cannot be taxed separately under Section 56 of the Act."

6.1. In view of the above, it was submitted that interest income and other income will form part of business income and accordingly is eligible for deduction u/s. 10A. Ld. Counsel placed reliance on the following decisions:

- i. Order of ITAT, Mumbai in the case of State Street Syntel Services Pvt. Ltd., (Formerly known as Syntel Sourcing P. Ltd) Vs. Dy.CIT in ITA No. 6026/Mum/2013 dt. 09-03-2016;
- ii. Order of ITAT, Mumbai in the case of State Street Syntel Services Pvt. Ltd., (Formerly known as Syntel Sourcing P. Ltd) Vs. ACIT in ITA No. 3743/Mum/2013 dt. 29-02-2016;
- iii. Order of ITAT, Mumbai in the case of M/s. J.P. Morgan Services India Pvt. Ltd., Vs. The DCIT in ITA No. 5547/Mum/2009 dt. 23-04-2013;
- iv. Judgment of Hon'ble High Court of Delhi in the case of Pr.CIT Vs. Universal Precision Screws in ITA No. 392/2015, dt. 06-10-2015;
- v. Judgment of Hon'ble High Court of Delhi in the case of Riviera Home Furnishing Vs. Addl. CIT in ITA No. 459/2015, dt. 19-11-2015;
- vi. Order of ITAT, Hyderabad in the case of Shiva Shankar Granites (P.) Ltd., Vs. ITO [81 ITD 106] (Hyderabad);
- vii. Order of ITAT, Bangalore in the case of ABB Global Industries and Services Limited (Formerly known as ABB Global Services Ltd) Vs. Dy.CIT, in ITA No. 1353/Bang/2011, dt. 31-10-2013;

- viii. Order of ITAT, Bangalore in the case of Dy.CIT Vs. M/s. Subex Ltd., in ITA Nos. 673 & 674 (Bang)/2010, dt. 31-01-2011;
- ix. Judgment of Hon'ble High Court of Calcutta in the case of CIT Vs. Hindustan Gum & Chemicals Ltd., [241 Taxman 401] (Calcutta);
- x. Judgment of Hon'ble High Court of Karnataka in the case of CIT Vs. Motorola India Electronics (P) Ltd., [46 taxmann.com 167] (Karnataka);

7. In reply, Ld.DR relied on the principles laid down by the Hon'ble Supreme Court in the case of Liberty India Vs. CIT (supra) and further in the case of Pandian Chemicals Ltd., Vs. CIT [262 ITR 278] (SC). Ld.DR also placed on record the decision of Hon'ble High Court of Madras in the case of CIT Vs. Menon Impex (P.) Ltd., [259 ITR 403] (Madras) which was followed in India Comnet International Vs. ITO [304 ITR 322] (Madras). It was the submission that there was no nexus between interest earned and industrial undertaking. Therefore, assessee is not entitled for deduction u/s. 10A.

8. We have considered the rival contentions and perused the various case law placed on record. As seen from the order of the AO, AO has not treated the interest income and other incomes as 'income from other sources'. So, some of the principles laid down by various courts that these interest incomes and other incomes should be considered as business income and not as income from other sources does not apply, as the AO has treated the above incomes as part of business income itself. However, the

issue is whether there is nexus between the earning of interest income and other incomes with the undertaking which is in the business of export of software. There is no finding by the AO that there is a nexus or not to the extent of interest income is concerned. In fact the AO has not discussed even the nature of interest income earned. As far as the other incomes are concerned, we have perused the details placed on record and it is noticed that the other incomes are of following nature:

	Rs.
1. Excess provisions reversed	27,57,647
2. Bad debts recovered	6,85,965
3. Miscellaneous Receipts	6,96,068
Total:	41,39,680

8.1. Out of these, the excess provisions reversed pertain to provisions created in immediately previous financial year 2007-08 which are considered excess, including audit fee excess. These amounts are incomes u/s. 41(1), if they are allowed as deduction in earlier year. Since the amounts are directly connected to the business, the excess provision reversed is certainly having a nexus with the business.

8.2. As far as the bad debts recovered are concerned, as seen from the ledger copy placed on record, these bad debts are previously written-off so to that extent profit in those years has come down. Therefore, the recovery of the bad debts certainly has a business connection. The last item is the miscellaneous receipts. As seen from the ledger copy, these are incentives received from airlines, recovery of subscription from the employees, notice period payments recovered from the employees who retired or resigned,

recovery of salary advances etc., and also includes sale of scrap. These amounts are part of business income and has a direct nexus with the activity of assessee. Therefore, without considering the various case law itself, since these amounts have a direct nexus (under the Company Law, these are to be reported as other incomes), We are of the opinion that these amounts are to be considered as part of business income and cannot be excluded for the purpose of deduction u/s. 10A of the Act.

8.3. That leaves us with the issue of interest income. As already stated, there is no examination of nature of interest income earned by assessee. Assessee also had not placed on record the details of interest income earned, so as to examine whether it has any nexus with the business. In all the case law relied upon by assessee, there is a finding that amount of interest received is having a direct nexus with that of business in the sense that – (i) the deposits are short term which are not immediately required for the business; (ii) the interest earned is from the Exchange Earners Foreign Currency Account (EEFC A/c). The decision relied on by the Ld. Counsel in the case of CIT Vs. Hewlett Packard Global Soft Ltd., (supra), wherein the issue involved is with reference to interest income on the short term deposits made by it, out of its surplus funds temporarily parked in the current a/c and also interest earned from the advance of loans to the staff members. On those facts, the Hon'ble High Court of Karnataka in the Full Bench decision, held that all profits and gains of 100% EOU including incidental income by way of interest on bank deposits or staff loans would be entitled to 100% exemption.

8.4. However, it is not known in the present facts of the case whether the interest income is earned on short term deposits out of surplus funds or long term deposits which has no connection with the business activity of assessee. Ld. Counsel's reliance on the above decisions may apply to the facts of the case in case interest earned are on short term deposits in the current a/c or in the EEFC A/c. The Hon'ble Delhi High Court in the case of Pr.CIT Vs. Universal Precision Screws (supra) has also examined the principles and allowed the claim on the finding that interest on FDR was received on margin money kept in the bank for utilization of letter of credit and bank guarantee limits. In those circumstances, the decision of the ITAT was upheld where in it was held that such interest bears the requisite characteristic of business income and has nexus to the business activity of assessee. Similar principle was followed in other decision relied upon by the Ld. Counsel.

8.5. Even though the AO has treated the income as 'business income', there is no finding whether the interest income has a nexus with the business of the 'undertaking'. Just because the assessee has earned interest income out of the business it may not be eligible for deduction unless it has nexus with the business of undertaking. Consider a situation in which an assessee who has surplus amounts and earns substantial income by way of interest along with the business of undertaking, for example, export of software nominally. In these circumstances, it cannot be stated that Legislature intended to exclude the entire income of interest even though the business of undertaking is very much less, compared to the investments made for earning the interest income.

The intention of Legislature cannot be misused or misutilised by simply undertaking an export and contending that ET/TT ratio gives 100% exemption to all other incomes, not connected with the business of the undertaking. It is to be examined whether assessee's earning of interest is in connection with the business of assessee or not? AO is directed to examine this aspect and give a finding about the nature of deposits made by assessee, the source of funds and whether it has any nexus with the export business of the undertaking. Unless such finding is given, the principles established in various case law cannot be applied.

8.6. Therefore, in the interest of justice, we restore the issue to the file of AO to give proper findings on the nature of interest income earned and accordingly, consider the claims of assessee, keeping in mind the principles laid down in various case law. Assessee should be given due opportunity. In the result, grounds pertaining to 'other income' are considered allowed and grounds pertaining to interest income are considered allowed for statistical purposes.

9. In the result, appeal of assessee is considered allowed for statistical purposes.

Order pronounced in the open court on 24th January, 2018

Sd/-
(P. MADHAVI DEVI)
JUDICIAL MEMBER

Hyderabad, Dated 24th January, 2018

TNMM

Sd/-
(B. RAMAKOTIAH)
ACCOUNTANT MEMBER

Copy to :

1. M/s. ValueLabs LLP, C/o. P. Murali & Co., Chartered Accountants, 6-3-655/2/3, 1st Floor, Somajiguda, Hyderabad.

2. The Deputy Commissioner of Income Tax, Circle-8(1), Hyderabad.

3. CIT(Appeals)-9, Hyderabad

4. Pr.CIT-2, Hyderabad.

5. D.R. ITAT, Hyderabad.

6. Guard File.