

आयकर अपीलीय अधिकरण पुणे न्यायपीठ "ए" पुणे में  
**IN THE INCOME TAX APPELLATE TRIBUNAL  
PUNE BENCH "A", PUNE**

सुश्री सुषमा चावला, न्यायिक सदस्य एवं, श्री डी. करुणाकरा राव, लेखा सदस्य के समक्ष  
**BEFORE MS. SUSHMA CHOWLA, JM AND SHRI D. KARUNAKARA RAO, AM**

**आयकर अपील सं. / ITA No.894/PUN/2016**  
**निर्धारण वर्ष / Assessment Year : 2012-13**

M/s. AB Knowledge Systems,  
406, Lunkad Sky Station,  
Viman Nagar,  
Pune – 411014

.... अपीलार्थी/Appellant

PAN: AARFA5025E

Vs.

The Income Tax Officer,  
Ward 7(3), Pune

.... प्रत्यर्थी / Respondent

अपीलार्थी की ओर से / Appellant by : Shri Sunil Pathak  
प्रत्यर्थी की ओर से / Respondent by : Shri Sanjeev Ghei

सुनवाई की तारीख / <b>Date of Hearing : 24.01.2019</b>	घोषणा की तारीख / <b>Date of Pronouncement: 11.02.2019</b>
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**आदेश / ORDER**

**PER SUSHMA CHOWLA, JM:**

The appeal filed by assessee is against order of CIT(A), Pune-5, Pune, dated 12.02.2016 relating to assessment year 2012-13 against order passed under section 143(3) of the Income-tax Act, 1961 (in short 'the Act').

2. The assessee has raised the following grounds of appeal:-

- 1 *On the facts and in the circumstances of the case and in law, the Ld. Commissioner of Income Tax (Appeals) erred in holding that the*

*Assessing Officer had correctly assumed jurisdiction u/s 80-IA(10) and/or 80-IA(8) r.w.s. 10AA(9).*

- 2 *Without prejudice to 1 above, assuming that provisions of section 80-IA(8) r.w.s. 10AA(9) do apply, on the facts and in the circumstances of the case, the Ld. CIT(A) ought to have held that deduction allowable u/s 10AA was to be computed as contemplated in the manner specified in section 80-IA(8) and not as done by AO.*
- 3 *On the facts and in the circumstances of the case, the Ld. CIT(A) erred in upholding that provisions of section 145(3) were correctly invoked by the AO.*
- 4 *Without prejudice to 3 above, assuming that provisions of section 145(3) do apply, on the facts and in the circumstances of the case, Ld. CIT(A) erred in holding that AO had computed appellant's income in a best judgement manner as envisaged in section 144.*
- 5 *On the facts and in the circumstances of the case, the CIT(A) erred in upholding that appellant earned income of Rs.5,53,02,457 as income from undisclosed source as assessed by AO.*
- 6 *On the facts and in the circumstances of the case, the CIT(A) failed to appreciate the nature of business carried out by the appellant at its SEZ Unit and the reasons for earning high margins of profits and erred in denying the exemption claimed for the entire profits earned from SEZ unit as permitted u/s 10AA.*
7. *The addition made by the AO be deleted or in the alternative restricted to the amount calculated on pro-rata basis by re-computing Profits earned by SEZ multiplied by the Revenue earned by SEZ and divided by total Revenues earned by SEZ + STPI units.*

3. Briefly, in the facts of the case, the assessee for the year under consideration had furnished return of income declaring nil income. The assessee was engaged in the business of providing consultancy services in the field of engineering and information technology and other incidental activity connected therewith, outside India. The assessee had two units; one was eligible for deduction under section 10AA of the Act and other one was taxable under the normal provisions of the Act. The Assessing Officer noted that in the taxable unit, the assessee was showing losses, whereas in the exempt unit, it was showing profit @ 84%. The assessee was show caused as to why section 80IA (8) and (10) of the Act should not be applied. In response to the same, the assessee replied that STPI Unit was functioning for part of the year, so it had incurred loss. The Assessing Officer noted that in both the units the

assessee was making sales to the same person, so he was of the view that the assessee was trying to inflate expenses in the taxable unit; whereas in the exempt unit, expenses were not claimed. The Assessing Officer thus, applying provisions of section 80IA(8) and (10) r.w.s. 10AA(9) of the Act held that books of account of assessee are un-reliable and the same were thus, rejected under section 145(3) of the Act. The Assessing Officer was of the view that in this line of business profit @ 15% to 25% was very normal which was accepted norm in the field and he adopted 25% of turnover as net profit of assessee from SEZ unit. Thus, excess profit of ₹ 5,53,02,457/- was treated as income from undisclosed sources and added back to the total income of assessee.

4. Before the CIT(A), the assessee explained that undertaking under STPI dealt in consultancy and designing; whereas SEZ unit dealt in knowledge based software, income from which was claimed as exempt under section 10AA of the Act. The total earnings from STPI unit were about ₹ 1.08 crores and the assessee further explained that it offered to develop knowledge based software for the Engineering Divisions of Siemens Product Lifecycle Management Software Inc., USA (in short 'Siemens') and Sandvik Mining & Construction, Sweden (in short 'Sandvik') and obtained purchase order, for which the assessee was to start work by end of 2011 and to be delivered by 30.09.2012. Similarly, it also received four purchase orders from Sandvik aggregating to Euro 511,375 for execution from January 2012 to July 2012. Registration with SEEPZ i.e. Special Economic Zone was given by letter dated 10.10.2011 for new unit at Hinjewadi, Phase-1, which was authorized for "Engineering Design Automation Software Development". The operations of that unit commenced from 03.01.2012 and the assessee exported knowledge based software from SEZ unit and invoices for the work done on mile stone basis. The total revenue earned by SEZ unit were ₹ 7.84 crores, against which

it had booked expenditure. The assessee then stressed before the CIT(A) that in order to invoke provisions of section 80IA(8) and (10) r.w.s. 10AA(9) of the Act, since there was no close connection between assessee and the said two customers, hence the said provisions could not be applied. Similarly, provisions of section 80IA(8) could not be applied as there was no transfer of goods or services from eligible business to or from any other business carried on by the assessee. Since both the units were working in two different lines and there were no goods or services which were supplied by STPI unit to SEZ or vice-versa. In such scenario, rejection of books of account was incorrect and also mere high profitability in SEZ unit and merely loss in STPI unit do not warrant rejection of books of account. The assessee also explained the reason for loss, wherein the work of design, consultancy without programming was not taken from October, 2011 onwards as SEZ unit with knowledge based software development with programming was registered on 10.10.2011 and the assessee concentrated its energies on the said SEZ. Since the assessee had developed unique software which was being supplied to leading edge technologies enabling tremendous savings in Customers cost in engineering designs and hence, margins for SEZ were high. The assessee explained the nature of said business and supplies made by it to its associated enterprises which in turn, were supplied to high end customers of Siemens and Sandvik. The assessee before the CIT(A) also stressed that the Assessing Officer had wrongly assumed jurisdiction and invoked provisions of section 80IA(8) r.w.s. 10AA(9) of the Act when there was no transfer of any goods or services from STPI to SEZ unit or vice-versa. At best, the Assessing Officer ought to have identified the goods or services supplied by STPI to SEZ unit and assessed the market value of said goods or services and reduce the same from the profits of SEZ. However, no such exercise was carried out by the Assessing Officer and claim of assessee was arbitrarily re-worked. The assessee also challenged

rejection of books of account under section 145(3) of the Act without giving any specific finding or fact in this regard and without confronting the assessee with show cause notice in this regard. Further, the assessee challenged the order of Assessing Officer in adopting profit percentage of 25% while computing profits of SEZ unit for allowing deduction allowable under section 10AA of the Act. On the other hand, the Assessing Officer had not disturbed book results. Reference was made to the order of Assessing Officer, who for the purpose of arriving at the profits from business of SEZ had taken the full reported profits of ₹ 7.49 crores. However, for allowing deduction of profits from SEZ, the Assessing Officer estimates the said profits at ₹ 1.96 crores i.e. 25% of total revenue. The assessee also explained the reason for high profits earned by it in the knowledge based software provided by it. All these are reproduced by the CIT(A) in the appellate order. The assessee then further explained that for invoking provisions of section 80IA of the Act, it was incumbent upon the Assessing Officer to establish close connection between assessee and Sandvik or between assessee and Siemens. Unless and until close connection between assessee and customers was established, provisions of section 80IA(10) of the Act could not be invoked. In respect of section 80IA(8) of the Act, there has to be transfer of goods or services from eligible business to or from any other business carried on by assessee. Here, again the Assessing Officer had failed to establish any transfer of goods or any services from STPI to SEZ unit or vice-versa and hence, this section was also not applicable. The assessee had filed revised grounds of appeal, additional evidence in the form of documents relating to provisions of knowledge based design services before the CIT(A), hence remand report was called for. The Assessing Officer submitted remand report reiterating findings in the assessment order, against which the assessee filed written submissions. The CIT(A) from para 4.7 at page 39 of appellate order comments that there was very thin margin about the

nature and activities of assessee as far as its STPI unit. The STPI unit was providing knowledge based software development with programming. In both the units, the engineers and experts who were qualified on the information technology including architecture and designing were required to carry out the activities. Since the assessee had earned its income from the same customers base, the CIT(A) was of the view that the assessee could not allege that there was no close relationship with the said foreign parties. The CIT(A) thus, rejected the contention of assessee that provisions of section 80IA(10) r.w.s 10AA(9) of the Act were not attracted. The CIT(A) was of the view that the assessee had carried out almost identical nature of business both for STPI and SEZ. So, the first contention of assessee of no close connection with the parties to whom the goods were sold was not accepted and the CIT(A) held that the provisions of section 80IA(10) r.w.s. 10AA(9) of the Act were squarely applicable. The second contention of assessee that there was no transfer of any goods or services from STPI to SEZ or vice-versa and the application of provisions of section 80IA(8) r.w.s. 10AA(9) of the Act was also held to be clearly applicable as the assessee was providing designing, consultancy to both the units. The CIT(A) also rejected the plea of assessee that no discrepancy was found enabling the Assessing Officer to apply provisions of section 145(3) of the Act. The CIT(A) also upheld the order of Assessing Officer in this regard. The CIT(A) also referred to submissions of assessee that appropriate disallowance may be made. However, since the assessee failed to quantify the same, the plea of assessee was rejected and the addition made of ₹ 5.53 crores was upheld.

5. The assessee is in appeal against the order of CIT(A).

6. The learned Authorized Representative for the assessee pointed out that the assessee in STPI unit was designing but in the SEZ unit had started making software for those drawings which were completely different products. He explained that Sandvik was making industrial tools and used to give the assessee drawings and the assessee then would make design for it; but later on the assessee developed the software, where item is put in and automatically design/s comes out. The learned Authorized Representative for the assessee pointed out that case of both the authorities below was that the assessee had booked expenses in STPI unit and on the other hand, profits shown in SEZ unit were without expenses and the same were also very high. He made reference to all the provisions which have been applied by the Assessing Officer and CIT(A). Before us, he filed chart explaining difference between business carried out in STPI unit and SEZ unit and pointed out that there was overlapping of customers and also the software cost was much higher than the design cost. He then referred to segmental details of two units filed at page 34 of Paper Book. The second unit i.e. SEZ was started in October, 2011. Our attention was drawn to another chart filed by assessee during the course of hearing, in which it was pointed out that STPI unit was functional from April to October, 2011, whereas SEZ unit was in operation from November to March, 2012. Then, some re-allocation of expenses was made and it was pointed out by the learned Authorized Representative for the assessee that at best addition on account of allocation of expenses would work out to ₹ 17,53,709/-. The learned Authorized Representative for the assessee stressed that profits of SEZ unit were higher because software price of products was higher and even if these expenses were extra, then only proportionate expenses were to be disallowed. He on the other hand, stressed that expenses booked by assessee under both the units were not high. The learned Authorized Representative for the assessee further stated that profits of STPI unit were not tinkered and the

profits of SEZ unit were itself higher. He then referred to the order of Assessing Officer relating to assessment year 2013-14 and pointed out that when there was no STPI unit, then no adjustment was made in the hands of assessee. He then, placed reliance on the following decisions:-

- i) *CIT Vs. Schmetz India (P.) Ltd. (2012) 26 taxmann.com 336 (Bom)*
- ii) *Spicer India Ltd. Vs. CIT in ITA No.1112/PN/2012, relating to assessment year 2006-07 and cross appeals in ITA No.1113/PN/2012 & 1280/PN/2012, relating to assessment year 2007-08, consolidated order dated 08.07.2015.*
- iii) *Honeywell Automation India Ltd. Vs. DCIT (2015) 55 taxmann.com 539 (Pune-Trib.)*
- iv) *Malay N. Sanghvi Vs. ITO (2017) 88 taxmann.com 556 (Bom).*
- v) *Khinvasara Investment (P.) Ltd. Vs. JCIT (2008) 110 ITD 198 (Pune)*

7. The learned Departmental Representative for the Revenue placing reliance on the orders of authorities below pointed out that the Assessing Officer has estimated income observing that in the list of business of assessee, profit from 15% to 25% was normal.

8. We have heard the rival contentions and perused the record. The issue arising in the present appeal is against claim of deduction under section 80IA(10) of the Act against profits of SEZ unit. The assessee was initially running STPI unit in which it was providing consultancy by way of developing specifications for manufacture and was also designing the products and was also designing products manufactured by Sandvik and Siemens. This unit was being run by assessee for the past several years and was closed in October, 2011 during the year under consideration. The assessee meanwhile established SEZ unit at Hinjewadi for development of software for giving output designs for manufacture of parts, from given inputs and rules. The high end software was developed by assessee to automatically produce requisite 3D

designs, wherein customer could use own inputs and rules to generate output design for manufacture. This was at variance to the work carried out in STPI unit, wherein the designs were produced manually with the aid of Computer Aided Design (CAD) and the output of unit was the designs and drawings option in CAD software being chosen manually. However, in SEZ unit, the assessee on customers specific engineering requirements incorporate the same in software code to run customers data and give automated designs. The assessee has also filed elaborate submissions in this regard before the CIT(A) which have been reproduced by CIT(A) in the appellate order, wherein the assessee has pointed out that it was providing knowledge based engineering services to its clients i.e. Sandvik and Siemens, who in turn were supplying the same to their customers. One such instance was knowledge based software development with programming. The assessee has placed on record an agreement enabling the software development by it, to be used to create engineering drawings of US Navy's latest nuclear aircraft carrier costing USD 8 billion. In other words, the assessee claims that services provided by it were highly technical and software developed by it could be used by customer for generating automated engineering drawings which were incidental to output based on customers input parameters and hence, the margins earned by assessee were on higher unit.

9. The question which arises in such circumstances is whether the Assessing Officer had jurisdiction to question the margins of assessee and come to a finding that the margins were high and compute the profits eligible for deduction under section 10A of the Act by applying net profit rate to the total receipts. The Assessing Officer in this regard has applied provisions of section 80IA(10) r.w.s 10AA(9) of the Act and 80IA(8) again r.w.s. 10AA(9) of the Act and held the assessee to have claimed deduction under section 10A of the Act

excessively. The Assessing Officer has then rejected books of account maintained by the assessee under section 145(3) of the Act on this ground and estimated the profits by applying net profit margin rate of 25% and on such profits, allowed deduction under section 10A of the Act. [During the year under consideration, total receipts of SEZ unit were ₹ 7.84 crores on which after expenses the assessee had shown profit @ net profit ratio of 84% declaring income of ₹ 7.49 crores, which was claimed as exempt under section 10A of the Act. As pointed out earlier, the assessee had established STPI unit on 10.08.2010 which was operational upto October 2011. STPI unit was established at Vimannagar to provide designing, consultancy without programming to Sandvik and Siemens. The total earnings of STPI unit were ₹ 1.08 crores and after claiming total expenses of ₹ 1.10 crores, the said unit had shown marginal loss. As against this, SEZ unit was given recognition on 10.10.2011 and the unit was established at Hinjewadi, Phase-1. The operations commenced on 03.01.2012 and the customers were again Sandvik and Siemens from which it earned total revenue of ₹ 7.84 crores. The Assessing Officer because of high profits of SEZ unit, was of the view that deduction claimed under section 10A of the Act needs to be re-computed as per section 80IA(10) and 80IA(8) r.w.s. 10AA(9) of the Act.] In such scenario, the Assessing Officer has re-computed the deduction claimed by assessee under section 10A of the Act and as against ₹ 7.49 crores, has also allowed sum of ₹ 1.96 crores as the said deduction under section 10A of the Act. In this regard, it would be relevant to refer to the provisions of the Act.

10. As per provisions of sub-section (10) of section 80IA of the Act, for invoking the said sub-section, there has to be close connection between the assessee and any other person, during the course of business which is so arranged that the business transacted between them, produces to the

assessee more than the ordinary profits, which might be expected to arise in such eligible business. In other words, for invoking of provisions of section 80IA(10) of the Act, the first step which has to be crossed is whether there is any close connection between assessee and Sandvik or Siemens to which it is providing knowledge based engineering design services. The factum of close connection is to be established for invoking and applying the provisions of sub-section (10) of section 80IA of the Act.

11. The Pune Bench of Tribunal adjudicated the issue of application of provisions of section 10A(7) r.w.s. 80IA(10) of the Act in M/s. Honeywell Automation India Ltd. Vs. DCIT (supra), wherein the Tribunal had held that in the absence of any arrangement arrived at between the parties, which resulted in higher profits, there was no merit in re-working the profits by invoking the provisions of section 10A r.w.s. 80IA(10) of the Act.

*“7. Before proceeding further, we may briefly touch-upon the relevant provisions of the Act, which have a bearing on the controversy before us. Sub-section (7) of section 10A of the Act reads as under :-*

*“(7) The provisions of sub-section (8) and sub-section (10) of section 80-IA shall, so far as may be, apply in relation to the undertaking referred to in this section as they apply for the purposes of the undertaking referred to in section 80-IA.”*

*8. Further, sub-sections (8) and (10) of section 80-IA of the Act referred to in section 10A(7) read as under :-*

*“(8) Where any goods [or services] held for the purposes of the eligible business are transferred to any other business carried on by the assessee, or where any goods [or services] held for the purposes of any other business carried on by the assessee are transferred to the eligible business and, in either case, the consideration, if any, for such transfer as recorded in the accounts of the eligible business does not correspond to the market value of such goods [or services] as on the date of the transfer, then, for the purposes of the deduction under this section, the profits and gains of such eligible business shall be computed as if the transfer, in either case, had been made at the market value of such goods [or services] as on that date :*

**Provided** that where, in the opinion of the Assessing Officer, the computation of the profits and gains of the eligible business in the manner hereinbefore specified presents exceptional difficulties, the Assessing Officer may compute such profits and gains on such reasonable basis as he may deem fit.

*[Explanation.—For the purposes of this sub-section, “market value”, in relation to any goods or services, means the price that such goods or services would ordinarily fetch in the open market.]*

(9) xxxxxxxxxx

(10) *Where it appears to the Assessing Officer that, owing to the close connection between the assessee carrying on the eligible business to which this section applies and any other person, or for any other reason, the course of business between them is so arranged that the business transacted between them produces to the assessee more than the ordinary profits which might be expected to arise in such eligible business, the Assessing Officer shall, in computing the profits and gains of such eligible business for the purposes of the deduction under this section, take the amount of profits as may be reasonably deemed to have been derived therefrom.”*

9. Section 10A of the Act is a special provision in respect of newly established undertakings in free trade zone, etc.. Section 10A postulates a deduction of such profits and gains as are derived by an undertaking from the export of articles or things or computer software for a period of ten assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce such articles or things or computer software, as the case may be, while computing the total income of an assessee. Shorn of other details, for the present it would suffice to note that the three units of the assessee, namely, Unit No.I & II at Pune and Unit at Chennai are recognized as STPI Units in accordance with the Software Technology Park Scheme of the Government of India and they are eligible for the benefits of section 10A of the Act.

10. The bone of contention in the present case between the assessee and the Revenue is invoking of section 10A(7) r.w.s. 80-IA(10) of the Act. Section 80-IA(10) of the Act, reproduced above, empowers the Assessing Officer to re-compute the profits and gains of the eligible business for the purposes of deduction u/s 10A of the Act if it appears to him that the profits declared by the assessee are more than the ordinary profits which might be expected to arise in such an eligible business. So however, the aforesaid power of the Assessing Officer is subject to the pre-requisites contained in sub-section (10) of section 80-IA of the Act itself. The circumstances in which such a course is available to the Assessing Officer is contained in section 80-IA(10) itself. A perusal of section 10A(7) r.w.s. 80-IA(10) of the Act would show that the two essential conditions are to be established before the Assessing Officer can proceed to disregard the profits declared by the assessee and determine the amount of profits which may reasonably deemed to have been derived from such business. Notably, such conditions are (i) existence of a close connection between the assessee carrying on eligible business and any other person; and, (ii) that the course of business is so arranged that the business transacted produces to the assessee more than the ordinary profits.

11. At the outset, it is to be noted that the opening sentence in section 80-IA(10) of the Act contains the expression – “where it appears to the Assessing Officer that .....”. This would show that the onus is on the Assessing Officer to justify invoking of section 10A(7) r.w.s. 80-IA(10) of the Act, having regard to the facts circumstances of a given case. Evidently, the primary rule of evidence is that “what is apparent is real” unless proved otherwise by the person alleging it so. Ostensibly, if the Assessing Officer is to invoke the provisions of section 10A(7) r.w.s. 80-IA(10) of the Act then the onus is on him to justify such invocation having regard to the cogent material and evidence on record. On this aspect of the matter, there was no dispute between the rival counsels inasmuch as the Ld. CIT-DR quite fairly agreed that the onus was on the Assessing Officer to justify invoking of section 10A(7) r.w.s. 80-IA(10) of the Act in the facts of a given case. Nevertheless, on this aspect, we may also make a reference to the judgement of the Hon’ble Karnataka High Court in the

case of *CIT vs. H.P. Global Soft Ltd.*, 342 ITR 263, which was referred to in the course of hearing before us. In the case before the Karnataka High Court, the issue was similar inasmuch as therein, the Assessing Officer had invoked the provisions of section 80-I(9) r.w.s. 10A(6) of the Act while re-determining the claim of exemption in terms of the then prevailing section 10A(4) of the Act, and the assessment years were 1995-96 to 1998-99. The provisions of section 10A(6) r.w.s. 80-I(9) of the Act, which were before the Hon'ble Karnataka High Court are quite similar to the provisions of section 10A(7) r.w.s. 80-IA(10) of the Act before us. The Hon'ble Karnataka High Court, upheld the stand that the requirements of the provisions of section 80-I(9) of the Act are two-fold, namely that there should be a close connection between the assessee and the other person, which may be a reason for the assessee to earn higher profits but, more importantly there should be material to indicate that assessee had indulged in an arrangement with the other person so as to produce to the assessee more profits than ordinarily what profits the assessee might have expected to arise from such business. As per the Hon'ble Karnataka High Court, it was for the Assessing Officer to indicate any material or evidence to disclose any such arrangement between the assessee and the other person. The aforesaid judgement of the Hon'ble Karnataka High Court justifies the assertion of the assessee before us that the onus for justifying the invoking of section 80-IA(10) r.w.s. 10A(7) of the Act is on the Revenue based on cogent material. At this point, we may also make a reference to the judgement of the Hon'ble Bombay High Court in the case of *CIT vs. M/s Schmetz India Pvt. Ltd.* vide Income Tax Appeal No.4508 of 2010 dated 04.09.2012, which is also to the similar effect. In the case before the Hon'ble Bombay High Court assessee was a wholly owned subsidiary of a German Company. It had two divisions – one at Kandla in the Kandla Free Trade Zone, engaged in the manufacture and export of industrial sewing machine needles; and other at Mumbai, engaged in trading in industrial sewing machine needles. The manufacturing division at Kandla exported its entire production of industrial machine needles to its holding company in Germany. For the assessment year 2004-05 assessee declared an income of Rs.20.54 crores from its manufacturing division at Kandla and claimed 100% deduction u/s 10A of the Act. During the course of the assessment proceedings, Assessing Officer was of the view that abnormal profits had been declared in respect of the Kandla division, only in view of the income therefrom being exempt u/s 10A of the Act, and that the trading division at Mumbai showed a loss of Rs.70.29 lacs. The Assessing Officer invoked the provisions of section 10A(7) r.w.s. 80-IA(10) of the Act to hold that profits of Kandla Division were abnormal profits. The Tribunal disagreed with the Assessing Officer. The Tribunal, inter-alia, held that the Assessing Officer has not been able to prove that any arrangement had been arrived between the parties which resulted in extraordinary profits to the respondent-assessee's manufacturing division at Kandla. Consequently, the working of the profits by the Assessing Officer was not approved. The aforesaid action of the Tribunal was upheld by the Hon'ble Bombay High Court. On this aspect, the Bangalore Bench of the Tribunal in the case of *Digital Equipment India Ltd. vs. DCIT*, 103 TTJ 329 (Bang.) has also held that the conditions of the section have to be objectively satisfied by the Assessing Officer, based on cogent reasoning and evidence.

12. At the time of hearing, the Ld. Representative for the assessee vehemently argued that the provisions of section 10A(7) r.w.s. 80-IA(10) of the Act are inapplicable in the present case because there is no material lead by the Revenue to say that there was any arrangement between the assessee and the associated enterprises which produced to the assessee more than the 'ordinary profits' within the meaning of section 10A(7) r.w.s. 80-IA(10) of the Act. According to the Ld. Representative, the transactions of the assessee by way of rendering software engineering services to its associated enterprises abroad are not arranged so to yield any extraordinary profits to the assessee. The Ld. Representative pointed out that assessee was charging the same rate for services rendered to associated enterprises as well as to the non-related

parties. The details of rates charged by the assessee to the third parties vis-à-vis the related parties have also been placed in the Paper Book along with sample copies of invoices raised on the and non-related parties. It was also pointed out with reference to the submissions made to the Assessing Officer, which have been reproduced in para 2.6 of the assessment order, that the assessee has continued to charge similar rates even after the tax holiday period of STPI Unit had ended.

13. At the time of hearing, it was explained that the tax holiday u/s 10A of the Act was available for Unit No.I at Pune upto assessment year 2007-08; that for Unit No.II at Pune upto assessment year 2011-12; and, that for Chennai Unit upto assessment year 2009-10. A statement showing operating margins to total cost earned by the assessee from the STPI Units relatable to the software engineering services segment was furnished to show that even after the expiry of the tax holiday period the profits of the Units is higher than the other Units of the assessee.

14. In this context, a reference has also been made to the commercial reasons explained before the Assessing Officer for the high profits earned by the assessee's STPI Unit. From the submissions furnished to the Assessing Officer, which have been reproduced in para 2.6 of the assessment order, it is revealed that reasons were advanced to justify the higher margins of the STPI Units. Firstly, it was contended that there was substantial cost savings in terms of costs on sales, marketing, sale promotion and advertisement because majority of the business in the engineering services segment was with affiliates only. Secondly, it was pointed out that assessee is in the business of IT enabled services rendering engineering consultancy services in execution of industrial automation and building automation and control projects and it does not incur much product development costs or investments which are usually incurred by other software companies. Thirdly, it was pointed out that the salary levels in the case of the assessee are much lower than other software companies because assessee was hiring electronics and process engineering Graduates/Diploma holders and not software professionals. It is also pointed out that assessee has a lower rate of idle staff as it works mostly on in-house Honeywell Technology and therefore the productivity of the employees is much higher than other software companies. Further, it was also pointed out that assessee was reimbursed all the costs, like foreign travel and living expenses incurred abroad by its employees in the course of rendering engineering/software services. Assessee was also reimbursed incidental expenses incurred by it viz. visa costs, work permit costs, etc. and therefore the cost of sales was on lower side, as a result of which the percentage of Operating profit to total cost shows a higher percentage, although the impact on profit remains unaltered. All these points, which were raised before the Assessing Officer, have been reiterated before us to show that the higher profits are not attributable to any arrangement with associated enterprises but due to business reasons.

15. Apart therefrom, it has also been pointed out that assessee is a public limited company listed on the stock-exchange wherein the overseas Honeywell entities owned 81.24% of shareholding and the public shareholding is to the extent of 18.76%. It was pointed out that initially TATA group was also owning shares in the assessee company to the extent of 40% and Honeywell entities held 41% and the balance 19% was held by the public. This pattern had changed from November, 2004 onwards when the TATA group gave up its shareholding in the assessee company. On the basis of the aforesaid shareholding pattern, a plea setup by the assessee is that if there was any manipulation of profits by assessee charging higher rates to its overseas Honeywell group entities resulting in shifting of profits from overseas entities to the assessee-company, it would not be a prudent exercise by the Honeywell group because it does benefit the Honeywell group as a whole. Since there is a significant public shareholding in the assessee company, it would mean that the any extraordinary benefit passed on by overseas Honeywell group entities

to assessee would result in a loss for Honeywell group on an overall basis to the extent of public shareholding in the assessee company. It was, therefore, contended that in such a scenario, it could not be said that there was any arrangement between the assessee and the overseas Honeywell entities to produce higher profits to the assessee. In support of such proposition, reliance has been placed on the decisions of the Mumbai Bench of the Tribunal in the case of ITO vs. Zydus Nycomed Healthcare (ITA Nos.4013/Mum/208, 4206/Mum/2009 and 4343/Mum/2009 dated 31.10.2013).

16. Apart from the aforesaid, it has been vehemently argued that ordinary profits for the purposes of section 10A(7) r.w.s. 80-IA(10) of the Act cannot be computed relying upon the Transfer Pricing documents prepared by the assessee. The Ld. Representative pointed out that having regard to the intention of the Transfer Pricing Provisions, the margins determined under the TNM Method are to be taken as indicative of the least profits that must be retained in India and it cannot be used to benchmark the 'ordinary profits' as referred to in section 10A(7) r.w.s. 80-IA(10) of the Act. The sum and substance of the plea setup by the assessee is that the legislative intent behind the Transfer Pricing Provisions is different from the intent behind section 10A(7) r.w.s. 80-IA(10) of the Act.

17. The Ld. CIT-DR has made detailed submissions in support of the invoking of section 10A(7) r.w.s. 80-IA(10) of the Act in the present case. The Ld. CIT-DR submitted that section 80-IA(10) of the Act placed much lighter burden of proof on the Assessing Officer because of the presence of the expression "it appears" in section 80-IA(10) of the Act. According to the Ld. CIT-DR, section 80-IA(10) can be invoked by the Assessing Officer when 'it appears' to him, and it is not subject to the Assessing Officer's belief or satisfaction as is the case with invoking of section 147/148, etc.. The following portion of section 80-IA(10) of the Act was emphasized ".....the Assessing Officer shall, in computing the profits and gains of such eligible business for the purposes of the deduction under this section, take the amount of profits as may be reasonably deemed to have been derived....." to say that it does not require the Assessing Officer to precisely determine the eligible profits, but only a prima-facie satisfaction about presence of more than the ordinary profits would suffice. It is sought to be emphasized that because of the presence of the words ".....as may be reasonably deemed to have been derived....." in section 80-IA(10) of the Act, a much lighter burden of proof is put on the Assessing Officer for computing tax avoidance. As per the Ld. CIT-DR, similar to the Transfer Pricing Provisions, the said Provision does not require a precise accuracy on the part of the Assessing Officer. At this point, the Ld. CIT-DR relied upon the decision of the Hon'ble Kerala High Court in the case of Abdul Vahab P. vs. ACIT, (2012) 249 CTR 102 (Kerala) wherein the word "appears" has been understood to imply a 'prima-facie' satisfaction of the Assessing Officer. Therefore, it is sought to be made out that a prima-facie satisfaction of the Assessing Officer is enough to apply the provisions of section 10A(7) r.w.s. 80-IA(10) of the Act.

18. It is further submitted that the word "arrangement" used in section 80-IA(10) of the Act is to be understood as any agreement with the associated enterprise and in support of the same reliance has been placed on the decision of the Hon'ble Bombay High Court in the case of Bank of India Ltd. vs. Ahmedabad Manufacturing & Calico, (1972) 42 CompCas 211 (BomXDPB-p-42), wherein it has been held as under :-

"The word "arrange" has, as one of its meaning, in the Shorter Oxford Dictionary, edition, "to come to an agreement or understanding", and the word "arrangement" has, as its primary meaning, "the action of arranging". As a matter of plain language it would, therefore, follow that the term "arrangement" means any agreement or understanding between the parties concerned."

19. As per the Ld. CIT-DR, since there is an agreement between the assessee and the associated enterprises for Provision of IT enabled engineering/software services, it is to be understood as an "arrangement" within the meaning of section 80-IA(10) of the Act. According to him, the requirements of section 80-IA(10) of the Act are satisfied if there exists an arrangement which leads to production of more than ordinary profits. Therefore, according to him, in the present case, the Assessing Officer is justified to invoke section 10A(7) r.w.s. 80-IA(10) of the Act inasmuch as the profit margin of the assessee's STPI Units is 80.06% as against 17.06% of the comparable selected by the assessee itself in its Transfer Pricing Study. As per the Ld. CIT-DR, when the arrangement has led to resulting into more than ordinary profits, necessary condition for invoking section 80-IA(10) of the Act is satisfied.

20. Apart from the aforesaid submissions, the Ld. CIT-DR has made other pleas also to justify the restriction of deduction u/s 10A of the Act. In this context, he has pointed out that even the Safe Harbor Rules issued by the CBDT with respect to the Transfer Pricing assessment provide for 20% operating profit as an acceptable profit in IT enabled services segment and therefore that was a good benchmark as to what constitutes 'ordinary profits' in the assessee's impugned line of business. The Ld. CIT-DR also made a submission that even if the computation of excess profits done by the Assessing Officer based on the margin of the comparable is not found to be a good methodology, yet the failure of computation process by the Assessing Officer would not vitiate the invoking section 10A(7) r.w.s. 80-IA(10) of the Act in the present case. The excess profits according to him can be computed by an appropriate method by remanding the matter back to the file of the Assessing Officer. In any case, it has been contended section 80-IA(10) of the Act requires computing of 'more than ordinary profits' in the eligible business. Comparable companies are in the same line of the business and having similar functions performed, assets employed and risks assumed as the assessee, therefore, comparable companies are carrying on eligible business, and thus the profits margin of comparable reflect ordinary profits.

21. With regard to the assessee's plea that even after the expiry of section 10A benefits, assessee was declaring healthy profits, the Ld. CIT-DR pointed out that what matters in future years is the actual amount of the taxes paid and not merely the profits generated in the Unit. It was also contended that the fact that assessee has rendered services to the non-related parties at the same rates is also not relevant for the purposes of application of section 10A(7) r.w.s. 80-IA(10) of the Act. It was also submitted by him that fact of the assessee being reimbursed the travelling costs, etc. cannot be responsible for assessee's high profit which are not of an ordinary level. The Ld. CIT-DR pointed out that if certain part of the expenditure is being incurred by the other parties then the cost of such expenditure would certainly be reduced from the price charged by the assessee for the services rendered. In any case, it is pointed out that reimbursement of expenses is a profit neutral transaction and does not impact the profitability of the assessee.

22. Before we proceed further, it would be appropriate to examine the scope and intent of the provisions of section 10A(7) r.w.s. 80-IA(10) of the Act. In this context, a reference has been made to the CBDT Circular No.308 dated 29.06.2008 wherein the reasons for introduction of sub-section (7) to section 10A of the Act has been explained. In-particular, reference has been made to the following contents of the Circular :-

*"The provisions of sub-section (8) and sub-section (9) of section 80-I will also apply in relation to the industrial undertaking referred to in the new section 10A as they apply in relation to an industrial undertaking referred to under section 80-I. Under the applied sub-section (8) of section 80-I, it is provided that where an Assessee has several units, some in the free trade zone and some outside, the profits of the unit in*

*the free trade zone will be computed after taking the cost of the goods transferred to or from the unit on the basis of the market value of such goods. The applied sub-section (9) of section 80-I empowers the Income-tax Officer to determine the reasonable profits that could be attributed to the qualifying undertaking in the free trade zone in cases where, owing to the close connection between the Assessee and any other persons or for any other reason, the course of the business is so arranged that the industrial undertaking set up in the free trade zone derives more than ordinary profits which may be expected to arise in that business. This provision has been made with a view to avoiding abuse of the new tax concessions by manipulation of profits between associate concerns or different units of the same concern.*

***[underlined for emphasis by us]***

23. Quite clearly, the provisions of section 10A(7) of the Act intend to plug abuse of tax concession by manipulation of profits between associated concerns or between different units of the same concern. The objective of the aforesaid Provision is that the tax concessions are not abused by manipulation of profits. In our considered opinion, the aforesaid explanation in the CBDT Circular (*supra*) signifies the legislative intent and it is also manifested in the language of section 10A(7) r.w.s. 80-IA(10) of the Act. We say so for the reason that the phraseology of section 80-IA(10) of the Act itself suggests that the profits and gains of an eligible business cannot be tinkered with by the Assessing Officer merely because they are more than the ordinary profits or that they are quite high. The existence of substantial or more than ordinary profits by itself does not sufficiently empower the Assessing Officer to disregard them and determine the profits which he may consider to be reasonably deemed to have been derived therefrom. The presence of the expression “the course of business ..... is so arranged ..... that the business transacted ..... produces to the assessee more than ordinary profits” is significant and its understanding has to be prefaced by the legislative objective of plugging abuse of the tax concessions granted u/s 10A of the Act by manipulation of profits between associated parties. In other words, the import of the expression “so arranged” has to be read in conjunction with the legislative intent that there should not be any abuse of tax concession by manipulation of profits. Therefore, section 10A(7) r.w.s. 80-IA(10) of the Act can be invoked only where it is shown that the course of business is so arranged which reflects an abuse of tax concession whereby the business transacted between two entities is so arranged, which produces to the assessee more than the ordinary profits which might be expected to arise in such eligible business. The emphasis is to eschew those ‘more than the ordinary profits’ which are as a result of a business between two closely connected concerns having been arranged with the intent of abuse of the tax concession. Ostensibly, in the present case, the Revenue would have to justify that the course of business between assessee and the associated enterprises has been ‘so arranged’ which produces to the assessee more than the ordinary profits which might be expected to arise in such eligible business with the intention of abusing the tax concession granted in section 10A of the Act. The mere existence of (i) a close connection between the assessee and the other person; and, (ii) more than ordinary profits is not sufficient to justify invoking of section 80-IA(10) of the Act in the absence of there being any material to say that the course of business between them is “so arranged” to abuse the tax concessions granted u/s 10A of the Act by manipulating profits between associated persons. Ostensibly, the same is required to be demonstrated on the basis of a cogent material and evidence. In other words, the presence of the expression “so arranged” has to be understood in the context of the abuse of tax concession which is sought to be plugged by the provisions of section 10A(7) r.w.s. 80-IA(10) of the Act.

24. On this aspect, the Ld. CIT-DR had vehemently argued, based on the judgement of the Hon’ble Bombay High Court in the case of Bank of India Ltd.

(supra) that the meaning of the word "arranged" in section 80-IA(10) of the Act has to be understood to mean an agreement or an understanding between the parties concerned. The relevant portion of the decision of the Hon'ble Bombay High Court has been reproduced in the earlier part of this order, according to which, it is said that the term arrangement in plain language means any agreement or understanding between the parties concerned. On this basis, the Ld. CIT-DR submitted that undeniably there is an agreement between the assessee and the associated enterprises whereby the services have been provided by the assessee to them and therefore the same is to be understood as an "arrangement" within the meaning of section 10A(7) r.w.s. 80-IA(10) of the Act. Along with the aforesaid, it has also been emphasized, on the basis of the language of section 80-IA(10) of the Act that, the Assessing Officer is not required to prove that there is an arrangement for producing more than ordinary profits. Whereas, as per the Ld. CIT-DR, section provides that arrangement leading to production of more than ordinary profit will satisfy the necessary condition of section 80-IA(10) of the Act. Thus, according to the Ld. CIT-DR, in the instant case there is an arrangement and it has led to production of more than the ordinary profits. According to the Ld. CIT-DR, the meaning of the words "so arranged" in section 80-IA(10) of the Act only seeks to ensure that there was an agreement between the assessee and associated enterprise.

25. We have carefully examined the aforesaid contentions of the Ld. CIT-DR. In our considered opinion, the import of the expression "arranged" in section 80-IA(10) of the Act is not to be understood in its plain language but the same has to be understood in the context in which it is placed in the section. Notably, section 80-IA(10) of the Act restricts the plain meaning of the term "arranged" because it is placed between the words ".....the course of business between them is so arranged that the business transacted between them produces to the assessee more than the ordinary profits which might be expected to arise in such eligible business.....". Therefore, it would necessarily mean that the 'arrangement' referred to is an arrangement of the course of business which produces to the assessee more than the ordinary profits with the intent of abusing the tax concession. Thus, the word "arranged" in the section does not envisage a simple arrangement, but a arrangement of "the course of business transacted" which produces to the assessee more than ordinary profits which might be expected to arise in such a business with the intent of abusing the tax concessions. Therefore, the meaning of the words "so arranged" have to be understood in the context in which they are placed in section 80-IA(10) of the Act. A mere agreement between the assessee and the associated enterprises for transacting business is not enough to invoke section 80-IA(10) of the Act.

26. In-fact, even the Hon'ble Bombay High Court in the case of Bank of India Ltd. (supra) has also appreciated the contextual meaning of the expression "arrangement". The issue before the Hon'ble Bombay High Court was with regard to the scheme of re-construction or arrangement contained in section 391(1) of the Companies Act, 1956. In the context of section 391(1) of the Companies Act, 1956, the Hon'ble High Court was dealing with the meaning of the word "arrangement". After having explained the meaning of the term arrangement in plain language, which we have referred earlier, the Hon'ble High Court went on to say as under in the context of the word "arrangement" qua section 391(1) of the Companies Act, 1956 :-

"Section 391(1), however, in any opinion somewhat restricts this otherwise unlimited import of the term "arrangement" in so far as the said section applies only to an agreement or understanding between the company and its creditors or any class of them, or between the company and its members or any class of them, or between the company and its members or any class of them, which would necessarily mean that it must be an agreement or understanding which affects their rights"

**[underlined for emphasis by us]**

27. The aforesaid clearly points out that the Hon'ble High Court imparted meaning to the word "arrangement" in the context of section 391(1) of the Companies Act, 1956 to mean that it must be an agreement or understanding which affects the rights between the company and its creditors or any class of them and between the company and its members or any class of them. By the same analogy in the present context, we have to understand the meaning of the expression "as arranged" in section 10A(7) r.w.s. 80-IA(10) of the Act to mean a situation whereby the course of business has been so arranged that the business transacted produces to the assessee more than the ordinary profits with an intent to abuse the tax concessions granted in section 10A of the Act. Moreover, if one is to understand the import of the expression "so arranged" in section 80-IA(10) of the Act as canvassed by the Ld. CIT-DR, it would mean that for the purposes of fulfillment of the conditions prescribed in section 10A(7) r.w.s. 80-IA(10) of the Act, existence of mere close connection and more than the ordinary profits would suffice. In other words, as per the Revenue, the existence of close connection and high profits would lead to a presumption that there is an "arrangement" within the meaning of section 80-IA(10) of the Act. The aforesaid plea, in our view, not only belies the language of section 80-IA(10) but also the legislative intent which seeks to curtail the abuse of tax concession by manipulation of profits between associated concerns. Therefore, an arrangement which is referred to in section 10A(7) r.w.s. 80-IA(10) of the Act has to be one which is prefaced by an intention to abuse the tax concessions, as per the intendment of the legislature. Therefore, existence of a mere agreement to do business is not enough to fulfill the requirement of section 10A(7) r.w.s. 80-IA(10) of the Act in the context of the words "the course of business between them is so arranged".

28. At this stage, we may also address the argument of the Ld. CIT-DR that the burden cast on the Assessing Officer in section 10A(7) r.w.s. 80-IA(10) of the Act is much lighter and even a prima-facie satisfaction of an existence of tax avoidance is sufficient. In this context, we may refer to the decision of the Bangalore Bench of the Tribunal in the case of Digital Equipment India Ltd. (supra), wherein similar argument from the side of the Revenue has been addressed. The Bangalore Bench of the Tribunal was dealing with invoking of section 10A(6) r.w.s. 80-1(9) of the Act for assessment year 1995-96, which are pari-materia to section 10A(7) r.w.s. 80-IA(10) of the Act invoked by the Revenue before us. The following discussion is relevant :-

"The requirements under the section are :

- (a) There must be a close connection between the appellant and other person.
- (b) The course of business between them should be so arranged that it produces to the appellant more than the ordinary profits from such business.

To satisfy the above test the AO has to adduce evidence and reasons cogently and the same is open to verification by the appellate authorities. The primary rule of evidence is that "what is apparent is real" unless proved otherwise by the person alleging it otherwise. The manner of satisfaction outlined in the section should be based on evidence and not on surmise or suspicion. The question is not whether the onus is light or heavy but whether the AO has discussed objectively the conditions mentioned in the section to disturb the results declared by the appellant. In this case, the AO has failed to adduce any evidence or reason to satisfy the invoking of s. 80-1(9). First of all, a mere substantial profit does not give rise to any valid view that there could be any arrangement. It is a case of joint venture listed Indian company, where all arrangements are open for scrutiny and acceptance not only by digital group worldwide but also from joint venture partners and

shareholders. Digital group overseas will not pay undue sum, which it cannot recoup entirely to exclusion of others. Hence nothing can be arranged to the exclusive benefit of overseas partner. One cannot presume the existence of close connection or possibility of an arrangement for earning more than ordinary profits. In this case the profits earned is comparable with the profits earned by other companies in the same industry. Hence there is no case for further verification. The AO has compared the profit of software unit with that of hardware unit. Thus the foundation itself is on wrong premise. There cannot be comparison between an orange and an apple. It is known fact that profitability of software units is always higher than hardware unit. The test whether the appellant has earned more than ordinary profits, in this case, the answer is obvious NO, even as found by the AO. When the profits earned are reasonable and not excessive, there is no reason to sustain the addition. Further there is no evidence of existence of any arrangement as contemplated under s. 80-1(9)."

29. Quite clearly, as per the Tribunal the question is not whether the onus is light or heavy but whether the Assessing Officer has discussed objectively the conditions mentioned in the section to disturb the results declared by the appellant.

30. Now, the case of the Assessing Officer is that the profits derived by the assessee from the eligible business are more than the ordinary profits and therefore he is empowered to arrive at what could be a reasonable profit from such eligible business and such profit be taken as reasonably deemed to have been derived from the eligible business for the purposes of computing the deduction u/s 10A of the Act. We find that in the entire assessment order, there is no material or any evidence which has been brought out to say that the course of business between assessee and the associated enterprises has been so arranged that the business transacted has produced to the assessee more than the ordinary profits.

31. No doubt, there is a close connection between assessee and the associated enterprises and to that extent section 10A(7) r.w.s. 80-IA(10) of the Act has been rightly examined by the income-tax authorities. The second aspect that the course of business was so arranged so as to result in more than ordinary profits is not at all forthcoming from the order of the Assessing Officer. There is no material or evidence referred to in the assessment order to indicate that the course of business has been so arranged so as to inflate profits with the intent to abuse tax concession u/s 10A of the Act. At this point, we may make a reference to the stand of the Assessing Officer that the operating profit margins of the assessee are substantially higher than the average operating margin of the comparables selected by the assessee in its Transfer Pricing Study. This has formed the basis for the Assessing Officer to say that assessee has earned more than ordinary profits which might be expected to arise in such a business. Be that as it may, the aforesaid is not enough to say that the course of business has been so arranged to result in more than ordinary profits. However, from the side of the Revenue, it was pointed out that the Transfer Pricing comparability analysis itself suggests that the profit margins of the assessee are more than the ordinarily accepted margin in this line of business. The moot question is as to whether the same can be considered as a material to indicate that the course of business between the assessee and the associated enterprises has been so arranged, so as to result in 'more than the ordinary profits' within the meaning of section 10A(7) r.w.s. 80-IA(10) of the Act. In this context, we may refer to the decision of the Chennai Bench of the Tribunal in the case of Visual Graphics Computing Services India (P) Ltd. vs. ACIT, 148 TTJ 621 (Chennai), wherein following discussion is relevant :-

*"We heard both sides in detail and considered the issue. As far as the present case is concerned, the Transfer Pricing Officer has made a categorical finding that the operating profit reported by the assessee is higher than the profit worked out on the basis of arm's length price. The Transfer Pricing Officer, therefore, concluded that no transfer pricing adjustment is called for in the present case. The Assessing Officer has made the reference to the Transfer Pricing Officer under section 92CA. The reference is made for the purpose of computing income arising from an international transaction with regard to the arm's length price as provided in section 92. Therefore, it is to be seen that the scope and extent of reference made by the Assessing Officer to the Transfer Pricing Officer is confined to the singular purpose stated in section 92. Sections 92A, 92B, 92C, 92CB, 92D, 92E and section 92F are all precisely defining and facilitating provisions ultimately for the purpose of computing the income as stated in section 92. All the above stated sections provided in Chapter X of the Income-tax Act, 1961 belong to a separate code as such, enacted for the purpose of computing income from international transactions having regard to the arm's length price so as to confirm that there is no avoidance of tax by an assessee. Therefore, where in a case, the Transfer Pricing Officer suggests that the operating profit declared by an assessee is compatible to the arm's length price norms and no adjustment is necessary, the operation of all those provisions come to an end. If the, Assessing Officer has to make any other adjustment towards computing deduction available under section 10A, the computation has to be made in the context of section 10A(7) read with section 80-IA(10).*

*It is clear that in a case of transfer pricing assessment, it has got two segments. The first segment consists of rules and procedures for computing the income other than the income arising out of international transactions with associate enterprise. The second segment consists of rules and procedures in connection with computation of income from international transactions with associate enterprises on the basis of the arm's length price. The second segment relating to computation of the arm's length price, is a set of rules for the purposes of transfer pricing matters and those procedures and rules can be used only for the purpose serving the object of section 92. When the Transfer Pricing Officer states that there is no need of transfer pricing adjustment, the matter should end there and any other adjustment that the Assessing Officer would like to make with reference to the first segment must be made independent of the order of the Transfer Pricing Office under section 92CA.*

*To state in simple terms, the transfer pricing regime is different from regular computation of income. Section 10A belongs to that part of regular computation of income and it should be computed independent of transfer pricing regulations and transfer pricing orders. It is not therefore, permissible for the Assessing Officer to work out section 10A deduction on the basis of arm's length price profit generated out of the order of the Transfer Pricing Officer.*

*In fact these issues have already been considered in various orders of the Tribunal. The Income-tax Appellate Tribunal, Chennai "A" Bench in the case of Tweezerman (India) P. Ltd. v. Addl. CIT [2010] 4 ITR (Trib) 130 (Chennai) (133 TTJ 308) has considered the matter in detail and held that the reduction of eligible profits of an assessee as done by the Assessing Officer by invoking the provisions of section 80-IA(10) read with section 10B(7), in the context of the Transfer Pricing Officer's order is unsustainable. The Tribunal has held that the Assessing Officer was not justified to invoke the provisions of section 80-IA(10) read with section 10B(7) so as to reduce the eligible profits on the basis of the arm's length price computed by the Transfer Pricing Officer without*

showing how he determined that the assessee had shown more than "ordinary profits".

As rightly argued by learned senior counsel the arm's length price is determined on the basis of the most appropriate method. The most appropriate method is chosen either on profit basis method or price basis method. In the latter case, profits are not at all considered. In that method, profit is only a derivative of prices. When profits itself is not worked out, how is it justified to adopt the arm's length price profits to determine what is "ordinary profits" for the purpose of section 10A(7)?

In the facts and circumstances of the case, we hold that the Assessing Officer has erred in reducing Rs.4,48,50,795 from the eligible profits of the assessee under section 10A. The said adjustment made by the assessing authority in computing the deduction under section 10A is accordingly, deleted."

32. In our considered opinion, the result of the Transfer Pricing assessment can at best be taken as an indicator for the Assessing Officer to investigate as to whether or not there exists any arrangement which has resulted in more than ordinary profits qua the requirements of section 10A(7) r.w.s. 80-IA(10) of the Act. Even if it is accepted that the difference between the operating margins of the assessee and the comparables show existence of more than the ordinary profits in the hands of the assessee, so however, it was still imperative for the Assessing Officer to establish on the basis of substantive evidence and corroborative material that qua section 10A r.w.s. 80-IA(10) of the Act, the course of business between the assessee and the associated enterprises is so arranged that the business transacted between them produces to the assessee more than the ordinary profits with the intent of abusing tax concession. Quite clearly, in the entire assessment order, there is no whisper of any material or evidence in this regard. In-fact, the approach of the Assessing Officer is quite misdirected as the following discussion in his order shows :-

"Accordingly, the section only encumbers the A.O. to examine if the profits derived from the eligible business by the assessee is more than the ordinary profits, then the A.O. has to arrive as to what could be the reasonable profit from the such eligible business and such profit has to be then taken as reasonably deemed to have been derived from the eligible business for the purposes of computing deduction under the section."

33. The aforesaid discussion in the assessment order reveals that as per the Assessing Officer, the existence of close connection and more than ordinary profits is enough to assume an arrangement as contemplated u/s 80-IA(10) of the Act. The aforesaid understanding, in our view, is directly contrary to the judgement of the Hon'ble Karnataka High Court in the case of H.P. Global Soft Ltd. (supra) and our discussion in the earlier part of this order.

34. In view of the aforesaid, we conclude by holding that in the present case, the Assessing Officer has not proved that any arrangement had been arrived between the parties which resulted in higher profits. Consequently, the re-working of the profits by Assessing Officer by invoking section 10A r.w.s. 80-IA(10) of the Act is not justified. The action of the Assessing Officer to restrict the deduction u/s 10A of the Act to Rs.7,74,60,281/- as against the claim of Rs.36,35,09,382/- is hereby set-aside. Thus, assessee succeeds on this aspect."

12. Now, coming to the facts of present case, we find that the Assessing Officer has invoked the provisions of section 80IA(10) r.w.s. 10AA(9) of the Act

and has observed that profits earned by assessee in SEZ unit are more than ordinary profits. It may be reiterated that the said profits are earned by assessee on providing knowledge based software development with programming to two concerns i.e. Sandvik and Siemens. It is not the case of Revenue that the said two concerns are closely connected to the assessee. Admittedly, the assessee was providing designing, consultancy without programming to the said concerns from its STPI unit but that unit was closed after the assessee got recognition for SEZ unit, which was separately established at different place. The services which are provided from SEZ unit are high end services which were specifically for knowledge based software development. In the absence of Revenue discharging its onus of establishing an arrangement between the parties for earning more than ordinary profits and where no such arrangement existed between the parties, merely because the assessee has earned higher margins does not justify invoking of provisions of section 80IA(10) of the Act. The provisions of section 10AA of the Act are in respect of newly established units in Special Economic Zones. As per sub-section (9), it is provided that provisions of sub-section (8) and sub-section (10) of section 80IA of the Act, which so far as may be, applied in relation to the undertaking referred to in section as they apply for the purpose of undertaking referred to in section 80IA of the Act.

13. In the case before the Pune Bench of Tribunal in M/s. Honeywell Automation India Ltd. Vs. DCIT (supra), deduction which was claimed was in respect of newly established undertaking in the Free Trade Zone and the provisions of section 10A(7) of the Act are *pari materia* to the provisions of section 10AA(9) of the Act. Accordingly, the ratio laid down by the Pune Bench of Tribunal in M/s. Honeywell Automation India Ltd. Vs. DCIT (supra) is squarely applicable to the facts of present case; as far as the issue of grant of

deduction under section 10AA of the Act arises especially where the Revenue has failed to establish close connection between the assessee and the parties to whom services have been rendered by the assessee.

14. We find that the Tribunal has applied the said principle while deciding the issue in relation to grant of deduction under section 10B of the Act, wherein deduction is available in respect of newly established 100% EOU undertakings. In the said case also, the provisions of section 10B(8) r.w.s. 80IA(10) of the Act were invoked and the Tribunal held that the provisions of section 10B of the Act are *pari materia* to the provisions of section 10A of the Act and applied the ratio laid down by the Tribunal in *M/s. Honeywell Automation India Ltd. Vs. DCIT (supra)* and decided that exercise of jurisdiction under section 263 of the Act by the Commissioner in this regard that the assessee had shown higher profits to claim the deduction under section 10B units was misplaced. This proposition was laid down by the Tribunal in *Spicer India Ltd. Vs. CIT (supra)*.

15. The Hon'ble Bombay High Court in *Malay N. Sanghvi (supra)* have laid down the proposition that where the Revenue has not brought on record anything to show that there was any business transacted between the assessee unit and wife's unit which resulted in inflating the profits being earned by assessee or that there was any transaction between them, then merely because there were common customers, in the absence of some arrangement between the parties, would not indicate transfer of profit to assessee's unit. Since this factual finding of CIT(A) has not been considered by the Tribunal in the impugned order, the issue was sent back to the Tribunal for re-consideration.

16. Further, the Hon'ble Bombay High Court in CIT Vs. Schmetz India (P.) Ltd. (supra) while deciding the issue of 10A deduction which was restricted by invoking provisions of section 10A(7) r.w.s. 80IA(10) of the Act, held that in the absence of any arrangement between the assessee and its holding company, high profits earned by EOU unit, on which deduction under section 10A of the Act was to be allowed, could not be curtailed.

17. The gist of all these above decisions is that in order to curtail the deduction claimed under section 10A/10B/10AA of the Act, onus is on the Revenue Department to prove that extraordinary profits are earned by the person are because of an arrangement between the parties. In the case of CIT Vs. Schmetz India (P.) Ltd. (supra), the assessee had two units; wherein manufacturing industrial sewing machine needles and needles imported and traded by Mumbai Division were different from those manufacture and exported by Kandla division. The profits of Kandla division which was an EOU unit were higher, on which the assessee had claimed deduction under section 10A of the Act. The said deduction was curtailed by the Assessing Officer on the ground that profits of Mumbai division were lower and profits of Kandla division were very high. Applying the said ratio to the facts of present case, we have already referred to the activities carried on by the assessee in STPI unit which were for providing designing, consultancy without programming to its customers, on the other hand, SEZ unit provides knowledge based software development with programming to its customers. The customers of two units were same but once SEZ unit was established, STPI unit of assessee was closed. SEZ unit has shown high profits but in the absence of authorities establishing any arrangement between assessee and its customers of arranging its affairs in such manner that it has resulted in earning of extraordinary profits, provisions of section 80IA(8) and 80IA(10) r.w.s. 10AA(9) of the Act cannot be invoked.

Section 80IA(8) of the Act in any case refers to the transfer of any goods or services of eligible business being transferred to any other business carried on by the assessee or vice-versa. It is not the case of Revenue that any goods or services have been so transferred between STPI and SEZ unit. Hence, invoking of provisions of section 80IA(8) of the Act is misplaced. Accordingly, we find no merit in the orders of authorities below in curtailing the deduction claimed under section 10AA of the Act by assessee against profits of its SEZ unit.

18. During the course of hearing, the assessee has filed re-casted Profit and Loss Account for two units and has worked out that expenses to the tune of ₹ 17,53,709/- be allocated to SEZ unit. Bifurcation of expenses in different heads have been furnished by assessee in tabulated chart and in view thereof, we hold that expenses to the tune of ₹ 17,53,709/- debited to STPI unit are to be re-allocated to SEZ unit and consequently, the assessee is entitled to claim the deduction under section 10AA of the Act on the reduced profits of ₹ 7.31 crores. The said reduction in deduction claimed under section 10AA of the Act is on the principle that expenses which are common to both units i.e. STPI and SEZ, then expenses which relate to the functioning of both the units have to be appropriately allocated to exempt unit also. Accordingly, exercise of re-allocating expenses of SEZ unit.

19. Before parting, we may also point out that in assessment year 2013-14, the Assessing Officer has not re-computed the deduction claimed under section 10AA of the Act against profits from SEZ unit.

20. The assessee has also raised the issue of non application of provisions of section 145(3) of the Act. In view of our decision in allowing ground of

appeal No.1 raised by assessee, grounds of appeal No.3 to 6 become academic and ground of appeal No.2 on without prejudice basis also, is dismissed. In view thereof, ground of appeal No.2 without prejudice basis which becomes academic.

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

Order pronounced on this 11<sup>th</sup> day of February, 2019.

**Sd/-**  
**(D.KARUNAKARA RAO)**  
लेखा सदस्य / ACCOUNTANT MEMBER

**Sd/-**  
**(SUSHMA CHOWLA)**  
न्यायिक सदस्य / JUDICIAL MEMBER

पुणे / Pune; दिनांक Dated : 11<sup>th</sup> February, 2019.

GCVSR

**आदेश की प्रतिलिपि अग्रहित/Copy of the Order is forwarded to :**

1. अपीलार्थी / The Appellant;
2. प्रत्यर्थी / The Respondent;
3. आयकर आयुक्त(अपील) / The CIT(A), Pune-5, Pune;
4. The Pr.CIT, Pune-4, Pune;
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, पुणे "ए" / DR 'A', ITAT, Pune;
6. गार्ड फाईल / Guard file.

**आदेशानुसार/ BY ORDER,**

सत्यापित प्रति //True Copy//

वरिष्ठ निजी सचिव / Sr. Private Secretary  
आयकर अपीलीय अधिकरण ,पुणे / ITAT, Pune