IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI 'K' BENCH, MUMBAI

[BEFORE SHRI SHAMIM YAHYA, HON'BLE ACCOUNTANT MEMBER &
SHRI PAWAN SINGH, HON'BLE JUDICIAL MEMBER]

I.T.A. No. 594/Mum/2017
Assessment Year: 2010-11

DCIT 8(2)(2), Mumbai……Appellant
Room No. 348, M.K. Road,
Mumbai – 400 020.

Vs.

M/s. Sonata Software Ltd……Respondent
208, T.V. Industrial Estate,
S.K. Ahire Marg, Worli,
Mumbai – 400 030.
[PAN: AABCS 8459 D

I.T.A. No. 721/Mum/2017
Assessment Year: 2010-11

M/s. Sonata Software Ltd……Appellant
208, T.V. Industrial Estate,
S.K. Ahire Marg, Worli,
Mumbai – 400 030.
[PAN: AABCS 8459 D

Vs.

DCIT Range 7(2) Mumbai……Respondent
Presently DCIT 8(2)(2)
Aayakar Bhavan,
Mumbai – 400 020.

Appearances by:
Shri Rajesh Kumar Mishra, Addl. CIT appeared on behalf of the Revenue.
Shri Vijay Mehta, AR appeared on behalf of the Assessee.

Date of concluding the hearing : November 14, 2019
Date of pronouncing the order : January 21, 2020

ORDER

PER SHRI SHAMIM YAHYA, AM

These are cross-appeals by the Assessee and the Revenue arising out of order of Ld. CIT(A) dated 31.10.2016 for A.Y. 2010-11.

2. The issue raised in revenue's appeal read as under:

i. On the facts and circumstances of the case and in law, the Ld. CIT(A) was erred in allowing the ground that service charges recovered from its 100% subsidiary company i.e. SITL is eligible for deduction u/s 10A.

ii. On the facts and in the circumstances of the case and in law, the Ld. CIT(A) was erred in deputation charge for 10A deduction as the assessee company had received deputation charge from its 100%

subsidiary company i.e. SITL and not eligible for deduction u/s 10A of the IT Act.

iii. On the facts and circumstances of the case and in law, the Ld. CIT(A) was erred in deleting the addition made on account of unbilled software income which is not eligible for deduction u/s 10A of the I.T. Act.

3. Ground raised in assessee's appeal read as under:

On the facts and circumstances of the case and in law the Ld. CIT(A) erred in upholding the contention of the AO in making an upward adjustment of Rs. 57,82,500/- on account of transfer pricing adjustment in respect of Arm's Length Price of redemption of preference shares of its associated enterprise.

Assessee's Appeal

4. Brief facts of the case are as under:

4. The appellant (Sonata Software Ltd. or SSL in short) is a company incorporated in India, engaged in the business of software development. It offers software development and IT consulting services, specialising in area of eCommerce, business intelligence, enterprise application integration, ECRM for financial services, insurance and healthcare sectors. Assessee has set up several undertakings which are recognised by software technology parks of India as undertakings set up under the software technology park (STP) scheme and accordingly eligible for deduction u/s 10A of the Act.

5. The T.P.O. in this case dealt with the issue of arm's length price of investment in preference share of assessee's wholly owned subsidiary. The appellant had furnished Form 3CEB for the relevant assessment year reporting various international transactions entered by the appellant with Associated Enterprises. Accordingly, the AO made reference u/s 92CA(1) of the Act for the year under consideration to the Additional Commissioner of Income Tax, Transfer Pricing – 11(4), Mumbai ('TPO') to determine the arm's length price in relation to the international transactions entered by the appellant. The TPO vide order u/s 92CA(3) dated 22.01.2014 has made an adjustment to the tune of Rs. 57,82,500/- to the arm's length price of the investment in preference shares of the subsidiary company made by the appellant.

5.1 It is seen that during the relevant year under consideration, the appellant has redeemed its investment of 25,00,000. Redeemable Preference Shares (preference shares) having a face value of one doller each (at par) for an amount of Rs. 11,95,27,269/- in its associated enterprise (AE) i.e. Sonata Software North America Income (SSNA). The Investment had been made in September, 2001. The claim of the appellant before the TPO was that SSNA was set up on account of requirements of customers in USA who preferred to deal with an U.S. Entity. The motive and intention of investment in shares of SSNA was related to enabling SSNA raise its capital base so as to expand its information technology operations in USA by effectively projecting to US Market as an entity of United States and thereby gain confidence of prospective customers of USA. The business of SSNA in US has a direct impact on the revenues of the appellant as the entire software development project is offshored to the appellant. The assessee produced a chart before the AO to contend that because of SSNA, it had earned revenues of over 219 crores in last eight years and a profit of over Rs. 42 crores could be attributed to it. It contended that the significant contribution to its revenues should be treated as sufficient return on its investment and its redeeming the shares at face value was justified.

5.2 The TPO rejected the contention of the appellant. He held that the appellant was required to redeem the shares at an arm's length value and since the arm's length value of these shares was US$ 1.05 as per valuation report submitted by the appellant itself, redeeming the shares at face value of $1 did not represent at arm's length transaction. The TPO proceeded to make an adjustment based on the arm's length value of $1.05. He also held that since there was only one price available, the appellant was not entitled to be benefits allowable in second proviso to section 92C(2) of the Act.

5. Upon assessee's appeal, Ld. CIT(A) considered the submission of the assessee. However, we upheld the action of the Transfer Pricing Officer by holding as under:

"5.4 It is seen that in the present case there is no dispute that the transaction constitutes an international transaction. Further, in the present case, the CUP used by the TPO is not exactly a comparable uncontrolled price but the price (value) of the share itself determined by an Independent Valuer. The independent valuer has determined the

price of transaction itself rather than price of a comparable instance. In light of the fact that the independent valuer has determined the price of the very same transaction, there is no reason to deviate from this price in terms of second proviso to section 92C9(2) of the Act.

5.5 The decision quoted by the appellant has been examined. It is seen that in these cases, the prices to be compared were the prices charged to AEs and prices charged to non-AEs wherein the ITAT held that when the price charged from non-AEs was treated at ALP, then the price charged from AEs was to be tested with the ALP after factoring the second proviso in section 92C(2) of the Act.

5.6 It is also seen that there are contrary decisions on this issue wherein it has been held that in certain cases, the second proviso to section 92C(2) may not be applicable.
The Hon'ble Delhi ITAT, in the case of Vipin Enterprises (2012) 18 taxmann.com 85 (Delhi) has held at para 5.6 that;
It has also been argued that the assessee is entitled to deduction of 5% from the adjusted ALP under the provision contained in section 92C. This provision, in sub-section (1) enumerates six distinct methods for computation of ALP. Sub-section (2) provides that the most appropriate of these six methods shall be applied determination of ALP. Proviso to this sub-section states that where more than the price is determined by the most appropriate method, the ALP shall be taken to be the arithmetical mean prices, or, at the option of the assessee, a price which may vary from arithmetical mean by an amount not exceeding 5 per cent of such arithmetical mean. The case of the assessee is that under this proviso, the assessee is entitled to deduction of 5 per cent of the arithmetical mean as the Commissioner (Appeals) has used data of two comparable cases, 'G' and 'A'. However, this argument is not in line with the content of the proviso, which is applicable where more than one price is determined by the most appropriate method.

5.7 Similar view has been taken by ITATS in UE Trade Corporation (India) (2011-TII-04-ITAT-Del-TP), Haworth (India) Pvt. Ltd A.Y 2006-07 (TA No 5341/Del/2010) Limited (2011-TII-44-ITAT-Hyd-T) etc.

5.8 Hence, in cases where there is a comparison between third party prices and related party prices, the ITAT view has been that second proviso must be applied. However, in instances where there is only one

price, benefit of this proviso cannot be given. In the instant case, there is no comparison between two prices, related and un-related. There is an arm's length determination of the price of the transaction itself through a scientific process by an independent valuer. Once such a price is determined, as held in Vipin Enterprises, there is no question of allowing benefit of safe harbour under second proviso.

5.9 The value of share sought to be used as an arm's length price of the transaction of purchase of share by the appellant is the 'fair price' of share determined by an independent valuer and has been determined at the instance of the appellant itself. Hence, this price determined by the assessee is the price of the transaction itself and not a comparable instance. It is not that this price so determined is being compared to a similar third party transaction. The price represents the fair price of the transaction being undertaken by the appellant. If the appellant is to adopting the fair price determined by itself (through an independent valuer mandated by it) then it has to come up with a reason for doing so. No such reason has been advanced to me. Once he has determined a fair price for the transaction itself without resorting to a non-AE CUP, he is bound to adopt the same without the benefit of the second proviso to section 92C(2) of the Act.

5.10 In the light of the fact that the transaction in this case represents determination of fair value of shares of the AE which have been bought back by the appellant by an independent valuer, the price determined by the independent valuer is liable to be adopted without application of second proviso to section 92C(2) of the Act. It is so held.

6. Against the above order, assessee is in appeal before us.

7. We have heard both the counsels and perused the records. Learned counsel of the assessee contended that only issue for adjudication here is the application of safe harbour rules under the 2nd proviso to section 902C(2) which provides for (+/-) 5% variation from the arm's length price.

He submitted that the rate at which the international transaction has been entered into by the assessee is dollar 1 as against rate of

dollar 1.05 adopted by the TPO. He submitted that the said provision duly permits (+/-) 5% variation in the arm's length price and in such circumstances no adjustment is to be done. Learned counsel contended that this issue is squarely covered in favour of the assessee by the following ITAT decisions.

Per contra learned departmental present relied upon the orders of the authorities below.

Upon careful consideration we find that the international transaction in dispute in the present case is the redemption of the preference shares at the rate of dollar 1. The said international transaction has been benchmarked by the Transfer Pricing Officer on the basis of valuation report submitted by the assessee wherein the same was valued at dollar 1.05. Assessee's plea for granting relief as per the safe harbour rules of (+/-) 5% has been rejected by the authorities below. The learned CIT has dealt with the same on the ground that the said proviso is applicable only when more than one rates have been considered for the benchmarking. However as pointed by the learned counsel of the assessee in this regard we note that following decisions of ITAT are in favour of the assessee.

1. Dy Director of IT vs. Development Bank of Singapore (Mumbai) (2013) 155 TTJ (Mumbai) 265

   > "LIBOR is arithmetic mean of the rates of interest charged or paid on inter-bank deposits by a number of panel banks representing different comparable uncontrolled transactions and, therefore, benefit of plus/minus 5% variation is available to the assessee where the rate of interest is benchmarked on the basis of LIBOR rates."

2. DCIT vs. Begadiya Brothers Pvt. Ltd. (ITA No. 387/BIL/2014 dated 11.10.2018)

> "Thus the CIT(A) after verifying all the aspects and also that of the evidences come to the conclusion that the transaction in two vessels, namely "THEOSKEPASTI" and "GOA'' are within deviation of (+/-) 5%, and therefore, the transaction is within ALP. Accordingly, the upward adjustment of Rs. 81,44,959/- is rightly deleted by the CIT(A). The case of the assessee is also supported by another reason that prices quoted by Steel Index are available in public domain and assessee filed price data of relevant dates during proceedings before TPO. The TPO has accepted the TSI prices in TP Study for determining ALP. Therefore, the comment of TPO in his report that Trade Steel Index is arithmetical which was not explained by the assessee was rightly rejected by the CIT(A) and held that the assessee has sufficiently demonstrated the same. Therefore, there is no need to interfere with the order of the CIT(A)."

From the above case laws from the tribunal in our considered opinion the submission of the assessee is cogent. In these cases variation of (+/-) 5% have been accepted by the ITAT for the single rate used for benchmarking the arm's length price of the international transaction. Hence in accordance with the ratio from the above cases, the relief for variation of 5% sought by the assessee is to be granted from the arm's length price accepted by the Transfer Pricing Officer is justified. The distinction brought about by the learned CIT(A) that when, one rate is considered then safe harbour rules do not apply, is not mentioned the statute books and the same cannot be sustained. Hence when the assessee is granted the benefit of safe harbour rules as mentioned in the 2nd proviso to section 92C(2) the price at which the international transaction has actually been undertaken is to be deemed to be the arm's length price. This is so because if the (+/-) 5% variation is granted from the arm's length price of international transaction determined at dollar 1.05 the price of dollar 1 at which redemption has been done by the assessee is to be accepted.

Accordingly following the precedence from the decisions as referred above we set aside the orders of the ld. CIT and decide the issue in favour of the assessee.

In the result assessee's appeal stands allowed.

8. Revenue's appeal – issue relating to 10A deduction service charges recovered from its 100% subsidy.

9. On this issue at the outset, learned counsel of the assessee contended that this issue has been decided by the ITAT as well as Hon'ble High Court in favour of the assessee, hence facts being identical, he submitted that this issue needs to be decided in favour of the assessee. Per contra ld. LD.DR could not controvert this submission.

10. Upon careful consideration, we find that the issue is squarely covered in favour of the assessee by the decision of ITAT and Hon'ble High Court in assessee's own case. In this regard, we may gainfully referred to the issue as discussed in the order of the Ld. CIT(A) as under:

> 6.1 During the assessment proceedings for A.Y. 1998-99, the Assessing Officer (A.O.') was of the view that the transfer of SSD as a unit to SSL was formed by splitting or reconstruction of business already in existence and the undertaking has been carrying on its activities prior to A.Y. 1995-96. The same view point has also been followed in the assessment order u/s 144C r.w.s 143(3) of the Act dated 06.02.2012 for A.Y. 2008-09. The A.O. has considered the above issue at para 6.1 and 6.2 in page 3 of the assessment order, which is reproduced below:
>
> > "6.1 In this case the deduction u/s. 10A was disallowed in AY 1998-99 and 99-00 on the ground that undertaking was formed by splitting or reconstruction of business already in existence and

the undertaking has been carrying on its activities prior to A.Y. 1995-96. The ITAT decided the issue in favour of assessee against which the department is in appeal before the Hon'ble Supreme Court. In subsequent years the assessment orders of AY 1998-99 and 99-00 were followed by A.O. and ITAT also followed its order of AY 98-99 and 1999-00. Therefore, following the orders of earlier years the deduction u/s 10A is not allowed to the assessee.."

"6.2 As per assessee's submission a company viz. IOCL had set up a division, Sonata Software Division (SSD) in 1980. In A.Y. 95-96 this division was demerged and became the assessee company i.e. Sonata Software Ltd. As per assessment order for A.Y. 2000-01 the assessee claimed deduction u/s. 80-0 for A. Y. 95-96, 96-97 & 97-98 and exercised option not to claim deduction u/s. 10A in view of provisions of Sec. 10A(7). Alternatively, deduction u/s. 80HHE was also claimed. The assessee's claim of deduction u/s. 10A was disallowed in A.Y. 98-99 & 99-2000 on the ground that this undertaking was formed by splitting or reconstruction of business already in existence and the undertaking has been carrying on its activities prior to A.Y. 95-96. Another ground of disallowance was that the undertaking was formed by transfer of more than 20% of used plant and machinery to new business. The ITAT in its order dated 17.03.2003 for these years allowed the appeal in favour of the assessee against which department has filed an appeal before the Hon'ble Bombay High Court. In subsequent years also the department has filed appeal before the Hon'ble High Court. Since the department has not accepted ITAT's decision in the earlier years, for the same reasons as earlier years, this year also the assessee is held not to be eligible to claim deduction u/s 10A of the Act. Accordingly, the claim of Rs.48,09,68,997/- is therefore disallowed".

6.2 The appellant has claimed that the Hon'ble ITAT. "G" Bench, Mumbai vide order No. Income Tax Act, 1961 (in short 'the Act') No. 495/496/MUM/2002 dated 17.03.2003 in appellant's own case, allowed the claim u/s 10A of the Act for the initial year of claim for A.Y. 1998-99 and for subsequent A.Y. 1999- 2000.

6.3 It is seen that that the AO, in his assessment order, has admitted that the issue has been decided in favour of the appellant by ITAT in earlier years. Respectfully following the orders of the ITAT in preceding years,

the claim of deduction u/s 10A of the Act is allowed. The ground raised by the appellant is upheld.

11. We find that identical issue was dealt with by ITAT in assessee's own case for A.Y. 2008-09 vide order dated 22.04.2019 covered in favour of assessee.

12. Respectfully following the precedent in assessee's own case, we do not find any infirmity in the order of the Ld. CIT(A). Accordingly we uphold the same.

13. In the result, appeal filed by the Revenue is dismissed and appeal by the Assessee is allowed.

Order Pronounced in the Open Court on 21st January, 2020.

Sd/-	Sd/-
(PAWAN SINGH)	(SHAMIM YAHYA)
JUDICIAL MEMBER	ACCOUNTANT MEMBER

Dated: 21/01/2020
Biswajit, Sr. PS

Copy of the order forwarded to:
1. ***M/s. Sonata Software Ltd., 208, T.V. Industrial Estate, S.K. Ahire Marg, Worli, Mumbai – 400 025.***
2. ***DCIT Range 7(2), presently DCIT 8(2)(2), Mumbai.***

3. CIT(A)-
4. CIT- ,
5. CIT(DR), Mumbai Benches, Mumbai.

True copy
By order

Assistant Registrar
ITAT, Mumbai Benches