IN THE INCOME TAX APPELLATE TRIBUNAL
"C" BENCH : BANGALORE

BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT
AND SHRI B R BASKARAN, ACCOUNTANT MEMBER

ITA No.3418/Bang/2018
Assessment year: 2009-10

The Joint Commissioner of Income Tax, Special Range 4, Bangalore.	Vs.	Mphasis Ltd., Bagmane World Technology Centre, WTC 3, Block B, 1st Floor, Wing A, K R Puram, Marathahalli Outer Ring Road, Mahadevapura, Bangalore – 560 048. **PAN: AAACB 6820C**
APPELLANT		RESPONDENT

ITA No.65/Bang/2019
Assessment year: 2009-10

Mphasis Ltd., Bagmane World Technology Centre, Bangalore – 560 048. **PAN: AAACB 6820C**	Vs.	The Joint Commissioner of Income Tax, Special Range 4, Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	Shri Pradeep Kumar, CIT(DR)(ITAT), Bengaluru.
Respondent by	:	Shri Padam Chand Khincha, CA

Date of hearing	:	03 .06.2020
Date of Pronouncement	:	03 .06.2020

O R D E R

Per N.V. Vasudevan, Vice President

ITA No.3418/Bang/2018 is an appeal by the revenue while ITA No.65/Bang/2019 is an appeal by the assessee. Both these appeals are directed against the order of CIT(Appeals)-IV, Bangalore dated 29.10.2018 and are in relation to assessment year 2009-10.

2. The assessee is a company engaged in the business of providing software development services. For the AY 2009-10, the assessee filed a return of income on 30.9.2009 declaring a total income of Rs.45,78,65,652 after claiming deduction u/s. 10A, 10B and 10AA of the Income-tax Act, 1961 [the Act]. The final order of assessment after directions of the Dispute Resolution Panel (DRP) was passed u/s. 143(3) r.w.s. 144C of the Act on 31.3.2014. Against the aforesaid order, the assessee preferred appeal before the Tribunal and the same is stated to be pending.

3. The AO issued a notice u/s. 148 of the Act dated 30.3.2016. As we have already seen, the assessee is in the business of rendering software development services. The software is developed both on-site and off-site. The assessee designed software in India in its own premises by its own employees. However, certain parts of the software development are required to be executed physically at the customer's premises outside India. The services rendered at the customer's site are referred to as on-site services. The assessee sub-contracts the on-site services to its Associated Enterprise [AE] which is located outside India. Apart from on-site services, Assessee's AE's located outside India also rendered marketing services for which the assessee pays selling commission. The assessee paid the following sums to the AE on account of on-site services and selling commission:-

Particulars	Amount in Rs.
Payments for on-site services	5,760,203,166
Payments for selling commission	21,802,448
Total	5,782,005,614

4. According to the AO, for the aforesaid payments made to the non-residents, the assessee was obliged to deduct tax at source in terms of section 195 of the Act. Since the assessee failed to deduct tax at source, the aforesaid payment was liable to be disallowed under the provisions of section 40(a)(i) of the Act. Since no such disallowance was made in the order passed u/s. 143(3) r.w.s. 144C of the Act, the AO initiated proceedings u/s. 148 of the Act. The reasons recorded for initiating proceedings u/s. 148 of the Act are given in para 2 of the order of reassessment and the gist of the same has already been narrated above.

5. In the reassessment proceedings, the assessee made the following three submissions:-

(1) The proceedings u/s. 148 of the Act have been initiated beyond a period of 4 years from the end of relevant previous year. Since the order of assessment u/s. 143(3) has already been passed in the case of assessee for AY 2009-10, the proviso to section 147 of the Act will apply and therefore the assessment can be reopened only when there has been a failure on the part of assessee to fully and truly disclose all material facts necessary for assessment of total income of relevant previous year. According to the assessee, there was no failure to disclose fully and truly all material facts and therefore the reopening is invalid. The assessee also contended that even in the reasons recorded by the AO, there has been no allegation that there was a failure on the part of assessee to fully

and truly disclose all material facts for assessment of total income of that assessment year. The assessee also submitted that the reassessment proceedings have been initiated purely on the basis of change of opinion and are therefore invalid in the absence of any tangible material coming into possession of the AO, after conclusion of original assessment proceedings and in the light of the Hon'ble Supreme Court decision in the case of *CIT v. Kelvinator of India Ltd., 320 ITR 561 (SC)*.

(2) The assessee also submitted that the payments in question are not chargeable to tax in India and therefore there was no requirement of deduction of tax at source u/s. 195 of the Act and consequently there cannot be any disallowance u/s. 40(a)(i) of the Act.

(3) Without prejudice to the above submissions, the assessee submitted that it is entitled to deduction u/s. 10A/10AA of the Act on its profits derived from rendering software development services and even assuming that the disallowance has to be made u/s. 40(a)(i) of the Act, the same will go to enhance the profits on which deduction u/s. 10A/10AA of the Act has to be allowed and consequently there would be no ultimate tax liability.

6. The AO did not accept any of the aforesaid contentions. He held that reassessment proceedings were validly reopened. He also rejected the contention of assessee that payment in question is not chargeable to tax under the Act. Consequently, the AO added to the total income of the Assessee, the sum disallowed u/s. 40a(i) of the Act viz., payment for on-site services and payment for selling commission by the assessee to its AE.

7. On appeal by the assessee, the CIT(Appeals) upheld the action of the AO insofar as the contention of assessee with regard to validity of initiation of reassessment proceedings and the sum in question is not chargeable to tax in India under the Act. With regard to the alternative contention that disallowance u/s. 40(a)(i) will have no effect because deduction u/s 10A/10AA of the Act has to be allowed on the enhanced income, the CIT(Appeals) agreed with the submission of the assessee.

8. The revenue is aggrieved by the action of the CIT(Appeals) in allowing alternative relief to the assessee and has filed the appeal raising the following grounds:-

> “1. The Order of the Ld.CIT (A) is opposed to the law and facts of the case.
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> 2. The Ld CIT (A) has erred in allowing the appeal of the assessee without appreciating the fact that the deduction u/s 10A/10AA is allowable only on the profits derived from export of article or thing or computer software and the receipts in convertible foreign exchange have to be brought to India within six months from the end of the financial year and not allowable on the enhanced profits due to disallowance U/s 40(a)(i).
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> 3. The Ld CIT (A) has erred in allowing the appeal of the assessee relying on Board's Circular No.37/2016 dated 02.11.2016 which is applicable to Chapter VIA deductions only and not applicable to deductions U/s 10A/10AA/10B.
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> 4. The Ld CIT (A) failed to appreciate that the real intention of the legislature that the assessee is not allowed to take advantage of one provision by violating the another provision of the Act. If the same is allowed every assessee claiming deduction U/s 10A/10AA violate the provisions of TDS to take undue advantage.

5. The Ld CIT(A) failed to take note that on similar issue of allowing deduction u/s 10A on enhanced profits the Hon'ble Supreme Court admitted SLP in the case of M/s Lionbridge Technologies (P) Ltd (96 Taxmann.com 495).

6. For these and other grounds that may be urged at the time of hearing, it is prayed that the order of the CIT (A) in so far as it is relates to the above grounds may be reversed and that of the Assessing Officer may be restored.

7. The appellant craves leave to add, alter, amend and/or delete any of the grounds that may be urged."

9. On the other hand, the assessee is aggrieved by the action of the CIT(Appeals) in upholding the validity of initiation of reassessment proceedings and in holding that the sum in question is chargeable to tax. The following are the concise grounds of appeal raised by the assessee:-

"Grounds relating to reopening of assessment under section 147

1. The learned CIT(A) erred in confirming the reassessment proceedings and the reassessment order passed under section 143(3) read with section 147 (a) without satisfying the pre-requirements of section 147/148; (b) beyond the limitation period of four years as provided under first proviso to section 147; (c) without demonstrating the failure on the part of the appellant to disclose fully and truly all material facts necessary for the original assessment proceedings; (c) on a mere change of opinion without any new tangible information; (d) by relying on the order passed under section 201(1)/(IA) for the purposes of reassessment.

Grounds relating to disallowance under section 40(a)(i)

2. The learned CIT(A) erred in confirming the disallowance under section 40(a)(i) amounting to Rs. 578,20,05,614 in respect of payments made to Associated Enterprises (AEs) without appreciating the fact that the said payments were not chargeable to tax under the Act and under the DTAAs

and consequently not liable for TDS under section 195 and consequently not liable for disallowance under section 40(a)(i).

Levy of Interest under section 234B and 234C

3. The learned CIT(A) erred in confirming the levy of interest under section 234B and 234C of the IT Act, 1961. On facts and circumstances of the case and law applicable, interest under section 234B and 234C is not leviable. The appellant denies its liability to pay interest under section 234B and 234C.

Prayer

4. In view of the above and other grounds to be adduced at the time of hearing, the appellant prays that the reassessment order passed by the learned AO under section 143(3) read with section 147 be quashed or in the alternative, the disallowance confirmed under section 40(a)(i) be deleted, payments made to AEs be held as not liable TDS under section 195 and interest levied under section 234B and 234C be deleted.

The appellant prays accordingly."

10. We have heard the rival submissions. As far as the appeal of the revenue is concerned, we are of the view that the same is without any merit. There is no dispute regarding genuineness of the expenditure that was disallowed and the fact that the said expenditure is otherwise allowable as deduction in computing income from business. In such circumstances, even if the expenditure is disallowed u/s.40(a)(i) of the Act, the result will be that the disallowance will go to increase the profits of the business which is eligible for deduction u/s.10A/10AA of the Act and consequently the deduction u/s. 10A/10AA of the Act should be allowed on such enhanced profit consequent to disallowance u/s. 40(a)(i) of the Act. In this regard, we find that two High Courts viz., Hon'ble Bombay High Court

in the case of *CIT v. Gem Plus Jewellery India Ltd. (2010) 194 Taxman 192 (Born)* and Hon'ble Gujarat High Court in the case of *ITO vs. Kewal Construction, 354 ITR 13 (Gui)* have taken the view that when disallowance u/s. 40(a)(ia) of the Act goes to enhance the profits that are eligible for deduction under Chapter VIA of the Act, the deduction under Chapter VIA should be allowed on such increased profit. This position has also been now confirmed by the CBDT in its Circular No.37/2016 dated 02.11.2016 wherein the Board has observed as follows:-

> "3. In view of the above, the Board has accepted the settled position that the disallowances made under sections 32, 40(a)(ia), 40A(3), 43B, etc. of the Act and other specific disallowances, related to the business activity against which the Chapter VI-A deduction has been claimed, result in enhancement of the profits of the eligible business and that deduction under Chapter VI-A is admissible on the profits so enhanced by the disallowance".

11. Further the Hon'ble Karnataka in the case of *CIT Vs. M/s. M.Pact Technology Services Pvt. Ltd. in ITA No.228/2013 order dated 11.7.2018* had to deal with admissibility of the following substantial question of law in an appeal by the Revenue u/s.260A of the Act :-

> "5. Whether the Tribunal is correct in law in not adjudicating the main issue of applicability of provisions of section 40(a)(ia) in respect of disallowance of sub-contracting chares of RS.16,21,851/- made by assessing authority on the ground that the assessee had failed to deduct tax at source under section 194C of I.T. Act?
>
> 6. Whether the Tribunal is justified in law in directing the assessing authority to allow deduction under section 10A in respect of amount disallowed under section 40(a)(ia) without appreciating the fact that the income enhanced on account of deeming provisions cannot be considered for the purpose of claiming benefit under the provisions of section 10A?"

12. The Hon'ble Karnataka High Court held as follows:

> "5. In so far as the **substantial question of law Nos.5 and 6** are concerned, learned counsel for the Revenue submitted that the ITAT in its Order dated **21.12.2012** has recorded the findings, the relevant portion of which is extracted below for ready reference:-
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> > 14. Having heard both the parties and having considered their rival contentions, we find that the disallowance u/s 40a (ia) is to be made of the expenses incurred and claimed by the assessee but before the payment of which, the assessee has failed to deduct tax at source. The genuineness of the expenditure is not in dispute. The dispute is whether TDS was to be made before making the payment. Without going into the nature of the transaction, we are inclined to accept the alternate plea of the assessee that the disallowance of the expenditure would automatically enhance the taxable income of the assessee and the assessee is eligible for the deduction u/s 10A of the Income-tax Act on the enhanced income. Thus, this ground of appeal is allowed".
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> 6. The relevant portion of the Circular **No.37/2016** dated **02.11.2016** issued by the Central Board of Direct Taxes, Department of Revenue, Ministry of Finance, Government of India, relating to the subject: Chapter VI-A deduction on enhanced profits, is quoted hereunder:
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> > "The issue of the claim of higher education on the enhanced profits has been a contentious one. However, the courts have generally held that if the expenditure disallowed is related to the business activity against which the Chapter VI-A deduction has been claimed, the deduction needs to be allowed on the enhanced profits. Some illustrative cases upholding this view are as follows:
> >
> > [i] If an expenditure incurred by assessee for the purpose of developing a housing project was not allowable on account of non-deduction of TDS under law, such disallowance would ultimately increase assessee's profits from business of developing housing project. The ultimate profits of assessee after adjusting disallowance under section 40[a][ia] of the Act would qualify for deduction

under section 80IB of the Act. This view was taken by the courts in the following cases:

[a] Income-tax Officer-Ward 5[1] vs. Keval Construction, Tax Appeal No.443 of 2012, December 10 2012, Gujarat High Court

[b] Commissioner of Income-tax-IV, Nagpur vs. Sunil Vishwambharnath Tiwari, IT Appeal No.2 of 2011, September 11 2015, Bombay High Court

[ii] If deduction under section 40A[3] of the Act is not allowed, the same would have to be added to the profits of the undertaking on which the assessee would be entitled for deduction under section 80-IB of the Act."

7. Applying the same analogy, it can be held that if deduction u/s. 40[a][ia] of the Act is not allowed, the same would have been to be added to the profits of the undertaking on which the Assessee would be entitled for deduction u/s. 10A of the Act. This view is fortified by the decision of Bombay High Court in the case of '**Commissioner of Income Tax v. Gem Plus Jewellery India Ltd.,' [2011] 330 ITR 175 [Bom]**, wherein it is held thus:

"13. By reason of the judgment of the Supreme Court in Commissioner of Income Tax v. Alom Extrusions Limited [2009] 319 ITR 306 the employer's contribution was liable to be allowed, since it was deposited by the due date for the filing of the return. The peculiar position, however, as it obtains in the present case arises out of the fact that the disallowance which was effected by the Assessing Officer has not, the Court is informed, been challenged by the assessee. As a matter of fact the question of law which is formulated by the Revenue proceeds on the basis that the assessed income was enhanced due to the disallowance of the employer's as well as the employees' contribution towards Provident Fund /ESIC and the only question which is canvassed on behalf of the Revenue is whether on that basis the Tribunal was justified in directing the Assessing Officer to grant the exemption under Section 10A. On this position, in the present case it cannot be disputed that the net consequence of the disallowance of the employer's and the employee's

> contribution is that the business profits have to that extent been enhanced. There was, as we have already noted, an add back by the Assessing Officer to the income. All profits of the unit of the assessee have been derived from manufacturing activity. The salaries paid by the assessee, it has not been disputed, relate to the manufacturing activity. The disallowance of the Provident Fund/ESIC payments has been made because of the statutory provisions - Section 43B in the case of the employer's contribution and Section 36(v) read with Section 2(24)(x) in the case of the employee's contribution which has been deemed to be the income of the assessee. The plain consequence of the disallowance and the add back that has been made by the Assessing Officer is an increase in the business profits of the assessee. The contention of the Revenue that in computing the deduction under Section 10A the addition made on account of the disallowance of the Provident Fund / ESIC payments ought to be ignored cannot be accepted. No statutory provision to that effect having been made, the plain consequence of the disallowance made by the Assessing Officer must follow. The second question shall accordingly stand answered against the Revenue and in favour of the assessee."

13. In view of the aforesaid decisions and the CBDT Circular No.37/2020, there is no merit in the grievance projected by the revenue in its appeal.

14. As far as appeal of the assessee is concerned, we are of the view that in view of the dismissal of the revenue's appeal, the issue with regard to question, whether the assessment was validly reopened or not whether the sum in question is chargeable to tax is purely academic, because there may not be any tax liability ultimately. The ld. counsel for the assessee has, however, drawn our attention to the decision of the Hon'ble High Court of Karnataka in WP No.55355/2019 (T-IT) dated 21.1.2020 in the case of assessee for the AY 2010-11 on identical reasons recorded. The Hon'ble High Court quashed the initiation of reassessment proceedings.

15. As we have already observed, by dismissal of revenue's appeal, there may not be any necessity for adjudicating the validity of initiation of reassessment proceedings in the present AY 2009-10. We, however, make it clear that the assessee will be at liberty to agitate this issue if circumstances so warrant. For the very same reason, we are of the view that it is not required to adjudicate the question as to, whether the sum in question is chargeable to tax under the Act or not. The issue is, however, left open without adjudication.

16. In the result, both the appeals are dismissed.

Pronounced in the open court on this 03rd day of June, 2020.

Sd/-	Sd/-
(B R BASKARAN) ACCOUNTANT MEMBER	(N V VASUDEVAN) VICE PRESIDENT

Bangalore,
Dated, the 3rd June, 2020.

/*Desai S Murthy* /

Copy to:
1. Appellant 2. Respondent 3. CIT 4. CIT(A)
5. DR, ITAT, Bangalore.

By order

Assistant Registrar
ITAT, Bangalore.