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

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

IT(TP)A No.79/Bang/2019
Assessment year : 2014-15

Brocade Communications Systems Private Limited, Floor-3, B & C Wing & Floor 8, D Wing, S1, Wipro Electronic City Special Economic Zone, Doddathogur Village, Begur Hobli, Electronic City, Bengaluru – 560 100. PAN : **AACCB 4490N**.	Vs.	The Deputy Commmissioner of Income Tax, Circle 1(1)(1), Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	Shri T. Suryanarayana, Advocate
Respondent by	:	Shri Muzaffar Hussain, CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	15.06.2020
Date of Pronouncement	:	19.06.2020

O R D E R

Per N.V. Vasudevan, Vice President

This is an appeal by the assessee against the final assessment order dated 30.10.2018 passed u/s. 143(3) r.w.s. 144C of the Income-tax Act, 1961 [the Act].

2. We shall first take up for consideration the addition on account of Transfer Pricing [TP] adjustment of Rs.17,69,47,938/- made by the Transfer Pricing Officer [TPO] towards the international transaction of provision of software development services [SWD services] to the

assessee's Associated Enterprises [AE], which was subsequently reduced to Rs. 15,48,94,050/- on giving effect to the directions of the Dispute Resolution Panel [DRP].

3. The assessee is a subsidiary of Brocade Communications Switzerland SARL, Switzerland with the latter holding 99.99% of equity shares of the assessee. The assessee provided software research & development services and marketing & technical support services to its AEs.

4. For the year under consideration, the assessee, inter alia, provided contract SWD services to its AEs for a consideration of Rs. 161,91,46,172. It is not in dispute that the transaction of rendering SWD services by the assessee to its AE was an international transaction and therefore the price received by the assessee from its AE and income received from such transaction has to pass the Arm's Length Price [ALP] test as laid down in section 92 of the Act.

5. The assessee in support of its claim, that the price received from the AE was at arm's length, filed a TP analysis in which it adopted Transaction Net Margin Method [TNMM] as the Most Appropriate Method [MAM] for determining the ALP. The Profit Level Indicator [PLI] chosen for comparing the assessee's profit margin with that of the comparables was Operating Profit to Operating Cost [OP/OC]. The OP/OC of the assessee was as follows:-

Operating Income	Rs. 162,92,37,531/-
Operating Cost	Rs.139,58,15,664/-
Operating Profit (Op. Income – Op. Cost)	Rs.23,34,21,867/-
Operating/Net mark-up (OP/TC)	**16.72%**

6. The assessee chose 17 comparable companies and the average arithmetic mean profit of those companies was 11.98% before working

capital adjustment and 6.77% after working capital adjustment. Since assessee's profit margin was more than that of the comparable companies, the assessee claimed that the price received from AE was at arm's length.

7. Out of the 17 companies selected by the assessee, the TPO, to whom the AO referred the question of determination of ALP as required u/s. 92CA of the Act, accepted 4 companies viz., Larsen and Toubro Infotech Ltd., Thirdware Solutions Ltd., R S Software (India) Ltd. and Cigniti Technologies Ltd. and rejected the other companies. The TPO on his own chose 4 other comparable companies and determined the ALP and addition to be made to total income on account of shortfall in ALP as follows:-

Comparables selected by TPO and their arithmetic mean

Sl. No.	Name of the Company	OP/OC (WC–unadj) (in %)
1	Infosys Ltd.	36.13
2	Larsen & Toubro Infotech Ltd.	24.61
3	Mindtree Ltd.	20.43
4	Persistent Systems Ltd.	35.10
5	R S Software (India) Ltd.	24.25
6	Cigniti Technologies Ltd.	27.62
7	SQS India Ltd.	22.37
8	Thirdware Solution Ltd.	44.68
AVERAGE MARK-UP		**29.40**

Computation of arm's length price by the TPO and the adjustment made

Arm's Length Mean Mark-up	29.40%
Operating Cost	Rs.1,39,58,15,664/-
Arm's Length Price @129.40% of cost	Rs.1,80,61,85,469/-
Price Received	Rs.1,62,92,37,531/-
Shortfall being adjustment u/s. 92CA	**Rs.17,69,47,938/-**

8. The addition suggested by the TPO was added to the total income of the assessee by the AO in the draft order of assessment. The assessee

preferred objections to the said draft assessment order before the Dispute Resolution Panel u/s. 144C of the Act.

9. Briefly, the directions issued by the DRP are as follows:

(i) **Functionality Filter:**

The following companies were directed by the DRP to be excluded from the list of comparables by accepting the contentions of the Appellant:

(i) Cigniti Technologies Ltd.; and

(ii) SQS India Ltd.

The DRP also directed the inclusion of CG-Vak Software and Exports Ltd.

However the other contentions of the Appellant seeking the exclusion of incomparable companies and inclusion of comparable companies came to be rejected.

(ii) **Working capital and risk adjustments:**

The DRP upheld the action of the TPO in not granting any adjustment towards the differences in working capital ("WC Adjustment") and risk of the Appellant and the comparable companies.

10. On giving effect to the above directions issued by the DRP, the final list of comparables is as follows:

Sl. No.	Name of the Company
1	Infosys Ltd.
2	Larsen & Toubro Infotech Ltd.
3	Mindtree Ltd.
4	Persistent Systems Ltd.
5	R S Software (India) Ltd.
6	Thirdware Solutions Ltd.
7	CG-Vak Software and Exports Ltd.

11. The AO passed the impugned final assessment order in line with the directions of the DRP in which the TP adjustment was reworked.

Aggrieved by the addition made in the final assessment order, the assessee is in appeal before the Tribunal.

12. Briefly, the grounds in the appeal which are being pressed are as follows:-

(i) That the DRP erred in upholding the inclusion of Infosys Ltd., Persistent Systems Ltd., Larsen and Toubro Infotech Ltd. and Thirdware Solutions Ltd. (Ground No. 9).

(ii) That the DRP erred in upholding the exclusion Akshay Software Technologies Ltd., Sasken Communication Technologies Ltd., Maveric Systems Ltd., Sankhya Infotech Ltd. and 8K Miles Software Ltd. (Ground Nos. 7 and 8).

(iii) That the DRP erred in not granting WC Adjustment (Ground No.4).

(iv) That the DRP erred in not granting adjustment on account of risks ('risk adjustment') assumed by the Appellant and the comparable companies (Ground No. 5)

(v) That the DRP has erred in upholding certain mistakes and/or omissions in calculating the Profit Level Indicators of the Companies adopted by the TPO (Ground No. 10)

13. As far as ground No.9 raised by the assessee is concerned, the assessee is seeking the exclusion of Infosys Ltd., Persistent Systems Ltd., Larsen and Toubro Infotech Ltd. and Thirdware Solutions Ltd. from the list of comparables. The assessee had chosen Larsen and Toubro Infotech Ltd. and Thirdware Solutions Ltd. as comparable companies in its TP study. However, before the DRP, the assessee sought exclusion of these two companies from the list of comparables.

14. It is not in dispute that these four companies were excluded from the final list of comparables in cases of assessees placed similar to the assessee by this Tribunal for the AY 2014-15 in *LG Soft India Pvt. Ltd. v.*

DCIT, Order dated 28.05.2019 in IT(TP)A No. 3122/Bang/2018 and *EMC Software and Services India Pvt. Ltd. v. JCIT*, Order dated 18.12.2019 passed in IT(TP)A No. 3375/Bang/2018), wherein the aforesaid 4 companies were directed to be excluded. In view of the above, it is submitted that this company ought to be excluded from the final list of comparables:-

(a) Infosys Ltd. was directed to be excluded on the ground that it owns IPRs, brand value, focusses on R&D and operates in diversified markets, etc.

(b) Larsen & Toubro was excluded on the ground that it is functionally incomparable to the assessee on various counts. The company deals with software products and renders aftermarket service management services, integrated IT service management SaaS solution, business process management implementation services, cloud computing, consulting, enterprise integration, geographical information system and infrastructure management services. Despite rendering these diverse services, the segmental details of the various services and products are not available. The company's business segments are divided into service cluster, industrial cluster and telecom business. In the absence of segmental data being made available as regards the diverse services, it is not possible to determine whether the company passes the filters applied by the TPO. Therefore, the company ought to be excluded. Further, the company is a market leader and thus enjoys significant benefits on account of ownership of marketing intangibles, intellectual property rights and business rights. Also, in addition to the above, the company owns proprietary software products which are developed in-house. Accordingly, the Appellant submits that L&T is a product company having significant intangibles and is thus not comparable

to captive software development service providers such as the Appellant who does not own any significant or non-routine intangibles. Further, L&T enjoys significant brand value. As a result of this high brand value, the company enjoys a high bargaining power in the market.

(c) Persistent Systems Ltd. ("Persistent") was excluded on the ground that it is functionally dissimilar as it is engaged in rendering IT services and in the development of software products without there being separate segmental information disclosed in its Annual Report for such activities. In the absence of segmental data being made available as regards the IT services and products offered by it, it is not possible to determine whether the company passes the filters applied by the TPO. The operations of the company predominantly relate to providing software products, services and technology innovation covering full life cycle of product to its customers, which is completely different from the services rendered by the Appellant. The company also made significant investment in intellectual property led solutions and also had a dedicated team for research and IP developments. The company also owns several IP solutions, and during the year under consideration it acquired four products. Further, it is submitted that Persistent undertakes significant R&D activities and has an in-house R&D centre approved by the Department of Scientific and Industrial Research. The company also made significant investments towards research and development activities in the relevant previous year.

(d) Thirdware Solutions Ltd. was excluded for the reason that the company is not functionally comparable to the Appellant. The company is an IT consulting firm engaged in consulting, design, implementing and support of enterprise applications. The company

has significant capabilities in the transaction, analytics and cloud layers of enterprise application. The company also renders industry-specific solutions spanning business applications consulting, design, implementation and support. The said services are in the nature of knowledge process outsourcing services and are entirely different from the routine SWD services rendered by the assessee.

The company is also engaged in development of software products and earns revenues from sale of user licenses for software applications. These diverse services are reported under one segment without any details being available as regards these services.

15. For the reasons given above and following the decisions of the Tribunal, we direct exclusion of the 4 companies mentioned in ground No.9 and thus ground No.9 is accordingly allowed.

16. As far as ground Nos. 7 & 8 are concerned, the assessee seeks inclusion of Akshay Software Technologies Ltd., Sasken Communication Technologies Ltd. Maveric Systems Ltd., Sakhya Infotech Ltd. and 8K Miles Software Ltd.

Akshay Software Technologies Ltd. ("Akshay")

17. This company was selected by the assessee in its TP analysis but was rejected by the TPO for the reason that the company is engaged in providing professional services, procurement, installation, implementation, support and maintenance of ERP products and services, and that the company incurred expenditure to the tune of 85% on foreign branches, which suggested that the business model adopted by the company was different from that of the assessee. The exclusion of this company came to be upheld by the DRP on the latter basis.

18. Before the Tribunal, the ld. AR submitted that firstly, perusal of the functions of the company listed in its annual report shows that the company is functionally similar to the assessee. The website of the company states that the company is engaged in rendering IT services, which are in the nature of SWD and caters to the needs of corporate bodies, banks and financial institutions. Further, it was submitted that the income from commission and sale of software licenses constitutes a meagre 0.5% of the total revenue and therefore the same would not have any impact on the profitability of the company. It was submitted that the action of the DRP in upholding the exclusion of this company on the basis that it incurs foreign branch expenses indicating that the business model adopted by it is different is erroneous as firstly, the TPO did not apply the on-site development filter. Therefore the action of the DRP is arbitrarily rejecting Akshay on this count, without first applying the filter at a uniform threshold across all companies is erroneous and unsustainable. In any event, it is submitted that foreign branch expenses per se do not indicate onsite development. There is no difference in the business model adopted by the company and the assessee, and without prejudice, it is submitted that the difference if any, would not have any impact on the profitability of the company. Reliance in this regard is placed on the decision of this Tribunal in the case of *DCIT v. ABB Global Industries & Services (P.) Ltd. (reported in [2018] 97 taxmann.com 465 (Bangalore - Trib.)* wherein in the case of an assessee placed similar to that of the assessee, the inclusion of this company was upheld.

19. Reliance was also placed on the decision of this Tribunal in the case of *EMC Software and Services India Pvt. Ltd. v. JCIT (Order dated 18.12.2019 passed in IT(TP)A No. 3375/Bang/2018)*, wherein in the case of an assessee placed similar to the assessee, the comparability of the company was remanded to the TPO.

20. The ld. DR relied on the order of the DRP.

21. We are of the view that in the light of the submissions made as above and as directed by the Tribunal in the case of *EMC Software and Services India Pvt. Ltd. (supra)*, the comparability of the this company should be considered afresh by the TPO after affording assessee opportunity of being heard. We therefore order accordingly.

Sasken Communication Technologies Ltd. ("Sasken")

22. This company was selected by the assessee and came to be rejected by the TPO for the reason that the company was functionally dissimilar. The exclusion of the company came to be upheld by the DRP on the grounds that (i) the company fails export turnover filter; (ii) the company earns revenue from licensing, SWD and royalty; and (iii) the company offers R&D consultancy, wireless and software products.

23. In this regard, it was submitted by the ld. AR that the company is functionally similar to the Appellant as the services rendered by the company predominantly are in the nature of SWD services, with 99.12% of its revenue for the year being generated from rendering the said services. The income from software products constitutes a meagre 0.88% of total revenue, which would not have any impact on the profitability of the company's SWD services segment. Detailed submissions in this regard are placed at pages 169 and 429 of the paperbook. Further, the services rendered by the company predominantly fall within the ambit of SWD services as per the Safe Harbour rules prescribed by the CBDT and therefore the company is comparable to the assessee. Further, it was submitted that the DRP erred in taking into account only the revenues earned from services rendered to customers in North America, Europe and Asia Pacific region while determining whether the company passes the

export revenue filter applied by the TPO. It was submitted that if the entire foreign exchange earned by the company during the year is taken into consideration, it would pass the export revenue filter applied by the TPO. Therefore, it was submitted that the company ought to be included in the final list of comparables.

24. In any event, it was submitted that the DRP upheld the rejection of this company as its income from export of services as a percentage of total revenue was 74.35%, i.e. for the reason that it fails the export revenue filter by a meagre .65%. In this regard it was submitted that the DRP has proceeded on a hyper-technical basis to exclude the company, without appreciating the object behind application of the said filter. The export revenue filter was applied by the TPO to exclude predominantly domestic companies which cannot be compared with the assessee having major earnings from export. Therefore, while the objective stands complied substantially, the company cannot be excluded for failing the threshold marginally.

25. It was submitted that this company was selected by the TPO and its inclusion was upheld by the DRP for the assessment year 2011-12 in the assessee's own case. Therefore this company ought to be included in the final list of comparables.

26. Reliance was also placed on the decision of this Hon'ble Tribunal in the case of *EMC Software and Services India Pvt. Ltd. v. JCIT* (supra) wherein in the case of an assessee placed similar to the assessee, the comparability of the company was remanded to the TPO.

27. The ld. DR relied on the order of DRP.

28. In the light of the submissions made as above and as directed by the Tribunal in the case of *EMC Software and Services India Pvt. Ltd. (supra)*,

we are of the view that the comparability of the this company should be considered afresh by the TPO after affording assessee opportunity of being heard. We hold accordingly.

Maveric Systems Ltd. ("Maveric")

29. It was submitted that this company appeared in the accept/reject matrix of the search conducted by the TPO and was rejected by the TPO on the basis that the company was engaged in software testing. The company's inclusion was sought by the assessee. In the order passed under Section 92CA of the Act, the TPO excluded the company on the ground that the company is engaged in significant R&D activity and incurred expenditure of 6% of turnover. The DRP upheld the exclusion of the company on the basis that generally, companies with R&D expenditure of less than 3% alone were considered.

30. In this regard it was submitted that the actions of the lower authorities are erroneous and wholly inconsistent. It was submitted that while the TPO rejected the application of R&D expenses > 3% of total turnover filter, the DRP upheld the exclusion of the company on the basis that it incurred R&D expenses in excess of 3% of revenue. This action of the DRP is wholly baseless and arbitrary and on that ground, the company ought to be included in the final list of comparables. It was submitted that the company is functionally comparable and passes all filters applied by the TPO, which is not disputed by the lower authorities. Therefore this company ought to be included in the final list of comparables. Relevant submissions in this regard are placed at pages 171 and 474 of the paperbook.

31. Reliance was placed on the decision of this Tribunal in the case of *EMC Software and Services India Pvt. Ltd. v. JCIT (supra)* wherein in the

case of an assessee placed similar to the assessee, the company's comparability was remanded to the TPO.

32. The ld. DR relied on the order of the DRP.

33. In the light of the submissions made as above and as directed by the Tribunal in the case of *EMC Software and Services India Pvt. Ltd. (supra)*, we are of the view that the comparability of this company should be considered afresh by the TPO after affording assessee opportunity of being heard. It is ordered accordingly.

Sankhya Infotech Ltd. ("Sankhya")

34. This company was selected by the assessee in its TP study and came to be rejected by the TPO for the reason that it fails the export revenue filter. While the assessee demonstrated before the DRP that the company passes the filter and earned revenue from export of services comprising 96.53% of the total revenue, the DRP upheld the rejection of the company on an altogether new basis that the company is engaged in development of software and products, and that it had incurred substantial R&D expenses to the tune of 5.9% of total operating revenue.

35. At the outset it was submitted that the company is functionally comparable and passes all the filters applied by the TPO. It was submitted that action of the DRP in upholding the exclusion of the company on an altogether new basis without first putting the assessee on notice of the same is wholly erroneous and unsustainable.

36. We are of the view that the comparability of the company should be considered afresh by the TPO both on the export revenue filter and the filters applied by the DRP, because admittedly the assessee was not

confronted by the DRP on the new filter it applied nor did it give a finding one way or the other on the export turnover filter.

8K Miles Software Ltd.

37. This company was selected by the assessee in its TP study and came to be rejected by the TPO for the reason that it fails the export revenue filter. While the assessee demonstrated before the DRP that the company passes the filter and earned revenue from export of services comprising 95.41% of the total revenue, the DRP upheld the rejection of the company on an altogether new basis that the company had employed more assets in the nature of intangibles.

38. At the outset, it was submitted that the company is functionally comparable and passes all the filters applied by the TPO. It is submitted that action of the DRP in upholding the exclusion of the company on an altogether new basis without first putting the assessee on notice of the same is wholly erroneous and unsustainable.

39. We are of the view that the comparability of the company should be considered afresh by the TPO both on the export revenue filter and the filters applied by the DRP, because admittedly the assessee was not confronted by the DRP on the new filter it applied nor did it give a finding one way or the other on the export turnover filter.

40. In ground no.4, the assessee has projected its grievance regarding non-grant of working capital adjustment (WCA) and risk adjustment. The assessee submits that that Rule 10B(3) of the Income-tax Rules, 1962 (“the Rules”), itself categorically provides that an adjustment ought to be provided for any differences in the economic factors between the tested party and the comparables. A working capital adjustment is one such adjustment which is to be applied in order to adjust for the differences

between the working capital positions of the tested party and of the comparable.

41. Reliance was placed by the assessee on the decision of this Tribunal in the cases of *Bearing Point Business Consulting (P.) Ltd. vs. DCIT [(2013) 33 taxmann.com 92]*. Further in the assessee's own case for the AY 2010-11, this Tribunal held that working capital adjustment ought to be granted while computing the ALP. Further, in the assessee's own case for the AY 2009-10, this Tribunal upheld the action of the DRP in directing allowing working capital adjustment on actual basis without applying any restriction.

42. The ld. DR relied on the order of DRP.

43. We are of the view that it is now a settled proposition of law that necessary adjustments are to be made to the margins of comparables to give effect to the differences in the working capital positions of the tested party and of the comparables. The TPO ought to have given the assessee the benefit of the same. We hold and direct the TPO to allow working capital adjustment after verification of the assessee's computation and after affording opportunity of being heard to the assessee.

44. As regards risk adjustment, it was submitted that Rule 10B(2) of the Rules specifically state that comparability of an international transaction with an uncontrolled transaction shall be judged with reference to *inter* alia the risks assumed by the parties to the transaction. Coupled with Rule 10B(3) of the Rules, it becomes clear that adjustment towards differences in risk assumed by the parties in contemplated in the statute itself. In this regard it was submitted that the TPO and the DRP erred in holding that no such adjustment was warranted as it was not demonstrated that there was a difference in the risks assumed by the tested party and the comparable

companies. In this regard it was submitted that since the Appellant is a captive service provider, the risks assumed by the Appellant are significantly low. The following chart sets out the levels of risk assumed by the assessee and its AE:

Risk	Appellant	AE
Market risk	0	4
Project liability risk	1	3
R&D risk	0	4
Credit risk	0	4
Foreign exchange risk	2	2
Manpower risk	0	4
General business risk	2	2

Note:
0 indicates no responsibility,
1 indicates low risk,
2 indicates moderate risk,
3 indicates high risk,
4 indicates significant risk.

Detailed submissions in this regard are placed at pages 249-266 of the paperbook.

45. Reliance in this regard was placed on the decision of the Hon'ble Delhi Bench of the Tribunal in the case of *Honeywell Turbo Technologies (India) (P.) Ltd. v. DCIT (reported in [2017] 78 taxmann.com 342 (Pune - Trib.)*, wherein the Tribunal granted an adjustment to be granted for differences in risk assumed by the tested party and the comparable entities.

46. We are of the view that the question of allowing risk adjustment should be considered by the TPO afresh in the light of the submissions and after examining the computation of risk adjustment and affording opportunity of being heard to the assessee.

47. In Ground No. 10 the assessee pointed out to the mistakes in computation of PLI. It was submitted that the TPO has considered

provision for doubtful debts and provision for doubtful advances are non-operating in nature and the action was upheld by the DRP. In this regard it was submitted that provision for doubtful debts is a provision which is to be made as a part of the operating activities of business governed by the principles of prudence, and therefore it is not correct to contend that the same is non-operating in nature. Reliance in this regard is placed on the decision of the Delhi Bench of the Tribunal in the case of *Rolls- Royce India (P.) Ltd. v. DCIT (reported in [2016] 69 taxmann.com 209 (Delhi - Trib.)*. Therefore it was submitted that the aforesaid items are to be treated as being operating in nature.

48. The ld. DR relied on the order of the DRP.

49. We are of the view that in the light of the decision of the Tribunal in the case of *Rolls- Royce India (P.) Ltd. (supra)*, the PLI should directed to be reworked by considering the provision for doubtful debts as operating expenditure. We hold and direct accordingly.

50. The other grounds raised in the appeal in relation to its international transaction of provision of SWD services were not pressed at this stage. However, the assessee has sought liberty to urge the said grounds in any future proceeding, appellate or otherwise, and in these proceedings at a future point in time, which liberty is allowed.

51. The TPO is directed to compute the ALP in accordance with the directions contained in this order, after affording assessee opportunity of being heard.

52. Vide Ground No.11 & 13, the assessee has challenged the action of the AO in bringing to tax value of certain assets received by it free of cost under Section 28(iv) of the Act. During the year under consideration, the assessee received certain assets free of cost from its AEs. The said assets

were accounted for in the books of the AEs since the ownership of the assets remains with the AEs, depreciation on the same were claimed by the AEs. Since the assets were received free of cost, the same were not reflected in the books of the assessee.

53. The DRP upheld the action of the AO in bringing the value of assets to tax under Section 28(iv) of the Act *inter alia* on the basis that the assessee was the beneficial owner of the asset. In this regard it was submitted that the action of the lower authorities is erroneous. It was submitted that in order to bring a benefit or perquisite to tax under Section 28(iv) of the Act, the necessary preconditions are that such benefit or perquisite should arise from the business and there must be a nexus between the benefit/perquisite and the business. It was submitted that the assets received by the assessee free of cost did not arise from the business inasmuch as the same was not as a consequence of the services rendered by the assessee to the AEs/third parties who supplied the assets. Therefore, at the threshold, this section cannot be invoked.

54. It was submitted that the assets received by the assessee free of cost cannot be brought to tax under Section 28(iv) of the Act. Reliance in this regard is placed on the following decisions:

i. Mahindra and Mahindra Ltd. v. CIT (reported in 261 ITR 501)
ii. Logitronics Pvt. Ltd. v. CIT (Order passed by the Hon'ble Delhi High Court on ITA No. 1623/2010) and
iii. CIT v. Jubilant Securities Ltd. (Order passed by the Hon'ble Delhi High Court on ITA No. 503/2010)

55. Further, it was submitted that a benefit/perquisite can be brought to tax under Section 28(iv) of the Act only if the same is in the nature of income. In the present case, the assets received by the assessee cannot be treated as income inasmuch as the goods are capital in nature and therefore cannot be treated as a trading receipt.

56. It was submitted that out of the total amount of Rs. 15,07,90,003/- brought to tax under Section 28(iv) by the AO, the DRP directed that an amount of Rs. 1,65,86,025/- be brought to tax under Section 69 of the Act. It was submitted that the AO grossly erred in bring the value of certain assets received free of cost by the assessee to tax under Section 69 of the Act. It was submitted that the said section does not apply at the very threshold as the requirements for invoking the said provision is not satisfied in the present case. It was submitted that Section 69 of the Act applies only in a case where the assessee has made certain investments which are not recorded in the books of accounts, and the assessee offers no explanation about the nature and source of the investment. It was submitted that the assets were not recorded in the books of the assessee as the same were received by it free of cost, and recording of assets received free of cost would run counter to the applicable accounting standards. The assessee had demonstrated before the lower authorities the nature and source of the assets, which the authorities failed to appreciate. Further, the DRP erred in directing the AO to bring the value of the assets to tax as income from other sources. It was submitted that the assets received by the assessee free of cost cannot be treated as 'income' under Section 2(24) of the Act, which is a prerequisite for invoking the provisions of Section 56 of the Act. Further, the assets received by the assessee are not covered under Section 56(2) of the Act and therefore the value of such assets cannot be brought to tax as income from other sources.

57. Without prejudice to the contentions on ground nos. 11 & 13, in ground No. 12 , the assessee has submitted that during the year under consideration the assessee is eligible to claim deduction of its profits and gains derived from export of articles, under Section 10A of the Act. The addition made under Section 28(iv) of the Act would go to enhance the profits of the assessee and the assessee would be eligible to claim

deduction of the enhanced profits. However, the DRP rejected the claim on the basis that the issue had not reached finality. In this regard it was submitted that the assessee is entitled to claim deduction on the enhanced profits and reliance in this regard is placed on the decision of the Hon'ble High Court of Karnataka in *CIT v. Mpact Technology Services Pvt. Ltd. (Order dated 11.07.2018 passed in ITA No. 228/2013)*.

58. The ld. DR relied on the order of DRP.

59. We have given a careful consideration to the rival submissions. The facts as recorded in the order of DRP shows that the assessee received capital assets worth Rs.15,07,90,003 from the holding company, Brocade Communication Systems LLC. Out of the aforesaid assets received by the assessee, the DRP found that the invoices submitted in respect of the assets of the value of Rs.1,65,86,025 did not show that the assets came to be received free of cost or loan basis by the assessee from its AE. In the above circumstances, the DRP treated the assets worth Rs.13,42,03,978 [15,07,90,003 (–) 1,65,86,025] as value of benefit/perquisite received by the assessee in the course of business and taxed it u/s. 28(iv) of the Act. A sum of Rs.1,68,86,025 was taxed as income from other sources.

60. As rightly contended by the assessee, the provisions of section 69 are not attracted because there is nothing brought on record to show that the assessee was the owner of these assets. From the fact that invoices were in the name of assessee, it cannot be said that assessee was the owner of the assets, especially in the light of the affirmation by Brocade Communication LLC that they are given all the assets free of cost to the assessee. Therefore, the addition of Rs.1,65,86,025 u/s. 69 of the Act cannot be sustained.

61. The entire value of assets totalling Rs.15,07,90,003 has to be regarded as an addition made u/s. 28(1)(iv) of the Act, as was done by the

AO in the order of assessment. The issue that arises for consideration in ground Nos.11 & 13 is as to, whether the revenue authorities were justified in treating the value of assets as a benefit/perquisite received by the assessee and taxing the same u/s. 28(1)(iv) of the Act. We are of the view that this issue need not be adjudicated in view of ground No.12 raised by the assessee before us. In ground No.12, the assessee has prayed that the addition made will go to enhance its profits and that profit is eligible for claim of deduction u/s. 10A of the Act and therefore, the addition, even if sustained, will not have any impact on the tax liability. The plea of the assessee in this regard is supported by the decision of the Hon'ble High Court of Karnataka in the case of *Mpact Technology Services Pvt. Ltd. (supra)*. The CBDT in Circular No.37/2016 dated 02.11.2016 has also taken the view that any disallowance of expenses which go to enhance the profits of eligible business, would be eligible for deduction on enhanced profits.

62. In view of the above, we direct the AO to allow deduction u/s. 10A of the Act on the enhanced profits. Accordingly, ground No.12 is allowed. Ground No.11 is treated as academic and left open without any adjudication.

63. In the result, the appeal by the assessee is partly allowed.

Pronounced in the open court on this 19th day of June, 2020.

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

Bangalore,
Dated, the 19th 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.