

IN THE INCOME TAX APPELLATE TRIBUNAL
‘A’ BENCH : BANGALORE
BEFORE SHRI. CHANDRA POOJARI, ACCOUNTANT MEMBER
AND
SMT. BEENA PILLAI, JUDICIAL MEMBER

IT(TP)A No.429/Bang/2015
Assessment Year : 2010-11

The Asst. Commissioner of Income-Tax, Circle-4(1)(2), Bengaluru.	Vs.	M/s Mphasis Limited Bagmane World Technology Center Marathahalli Ring Road, Doddanakundi Village, Mahadevapuru Bengaluru-560 048. PAN - AAACB 6820 C
APPELLANT		RESPONDENT

IT(TP)A No.578/Bang/2015
Assessment Year : 2010-11

M/s Mphasis Limited Bagmane World Technology Center Marathahalli Ring Road, Doddanakundi Village, Mahadevapuru Bengaluru-560 048. PAN - AAACB 6820 C	Vs.	The Addl. Commissioner of Income-Tax, Circle-4(1)(2), Bengaluru.
APPELLANT		RESPONDENT

Assessee by	:	Shri Padamchand Khincha, C.A
Revenue by	:	Ms. Neera Malhotra, CIT(DR)

Date of Hearing	:	09-03-2021
Date of Pronouncement	:	14-06-2021

ORDER**PER BEENA PILLAI, JUDICIAL MEMBER**

Present cross appeals has been filed by revenue as well as assessee against final assessment order dated 29/01/2015 passed under section 143(3) read with section 144C (5) of the Act by the Ld.ACIT Range-4 (1), Bangalore on following grounds of appeal:

ITA No. 429/B/2015

On the facts and in the circumstances of the case the Dispute Resolution Panel erred in directing the AO to recomputed the deduction allowable u/s 10A of the Income Tax Act, when there is no provision stipulated in the section that the expenses required to be reduced from the export turnover as per clause (iv) of the explanation to section 10A to be reduced from the total turnover also.

The appellant craves leave to add, alter, amend and / or delete any of the grounds mentioned above.

ITA No. 578/B/2015**GROUND'S RELATING TO LEGAL ISSUES**

1. The Orders passed by learned Additional Commissioner of Income Tax Circle- 4(1), Bangalore (hereinafter referred to as "AO" for brevity), learned Joint Commissioner of Income Tax TP-II, Bangalore (hereinafter referred to as "TPO" for brevity) and Honorable Dispute Resolution Panel (hereinafter referred to as Honorable DRP) ("AO "TPO" and "DRP" collectively referred as "lower income tax authorities" for brevity) are bad in law and liable to be quashed.
2. The learned Assessing Officer has erred in making a reference to Transfer Pricing Officer for determining arm's length price without demonstrating as to why it was necessary and exdient to do so. The Honorable DRP has erred in confirming the action of the Assessing officer.
3. The lower income tax authorities have erred in
 - a. Making transfer pricing adjustment of Rs. 117,20,60,655/-.
 - b. Passing the order without demonstrating that appellant had motive of tax evasion.
 - c. Not appreciating that there is no amendment to the definition of "income" and charging or computation provision relating to income under the head "Profits & Gains of Business or Profession" do not refer to or include the amounts computed under Chapter X and therefore addition made under Chapter X is bad in law.
 - d. Passing the orders without considering all the submissions and/or without appreciating properly the facts and circumstances of the case and the law applicable.

GROUND RELATING DETERMINATION OF ARM'S LENGTH PRICE BY THE TPO

4. The lower income tax authorities have erred in:

- a. Not appreciating that the Appellant had adopted TNMM at each segment level, in which process, the selling commission, network charges and other intra-group service payments were considered as closely linked transaction and hence were subsumed into the expenditure and accordingly already considered;
- b. Not appreciating that once the net profit margin is tested on the touchstone of arm's length price, it pre-supposes that the various components of income and expenditure considered in the process of arriving at the net profit are also at arm's length; and
- c. Comparing prices after completing the analysis of comparing margins, which process unacceptable in law.

ADJUSTMENT MADE BY THE TPO FOR SELLING COMMISSION AND NETWORK CHARGES

ALP OF SELLING COMMISSION

5. With respect to selling commission, the lower income tax authorities have erred in:

- a. Concluding that arm's length price of selling commission is NIL without basing the same on any comparable;
- b. Not appreciating that the law of transfer pricing is based on the test of comparability and if no comparables are identified, it cannot be concluded that the transaction is not at arm's length;
- c. Concluding that arm's length price of selling commission is NIL without appreciating that the commission was paid based on the Agreement entered into with AE and was for providing marketing services for off-shore services;
- d. Concluding that the cost base adopted for the mark up is not clear when all the details of cost incurred and allocation thereof were available on the record;
- e. Adopting CUP method as the most appropriate method without justifying how the same was the most appropriate method in the facts and circumstance of the case; and
- f. Not appreciating that the Appellant had received tangible and direct benefit from services rendered by the AE.

ALP OF NETWORK CHARGES

6. With respect to network charges, the lower income tax authorities have erred in:

- a. Concluding that the network charges were only reimbursement of expenses without appreciating that the AE rendered various value added services on which mark up was levied in addition to certain cost to cost reimbursement;
- b. Concluding that no mark up should have been paid by the Appellant ignoring the business and commercial realities;
- c. Concluding that the arm's length mark up on network charges is NIL adopting internal CUP without appreciating that the transactions being compared were themselves international transactions and therefore cannot be considered for comparison;
- d. Considering and erroneously clubbing incorrect expense heads of "Communication costs and Other expenses paid to HP Singapore" together with Network Charges and deeming the differential amount of Rs. 12,80,73,476 as adjustment without appreciating the nature of transaction and on ground that details of such payments are not made available;
- e. Adopting CUP method as the most appropriate method without justifying how the same was the most appropriate method in the facts and circumstance of the case;
- f. Concluding that arm's length mark up for network charges is NIL without considering any comparable; and
- g. Assuming without admitting that the adjustment is to be made, the lower income tax authorities have erred in not allowing the benefit of the +/-5% range prescribed in the proviso to section 92C(2).

GROUND RELATING TO CHARGING INTEREST ON EXTENDED PAYMENT TERMS GIVEN TO AE

7. The lower income tax authorities have erred in:

- a. Ignoring the business, commercial and industry realities and economic circumstances applicable to the Appellant;
- b. Making adjustment for notional interest on extended payment terms given to AE without appreciating that there is no real income arising to the Appellant;
- c. Not appreciating that the receivable from the AE is not an international transaction within the meaning of section 92B of the Act;
- d. Without prejudice, assuming that receivable is an international transaction, the lower income tax authorities have erred in not appreciating that receivable is not separate transaction from the sale from which it is arising;
- e. Not appreciating that the Appellant's margin at each segment level are concluded to be at arm's length and therefore separate addition of notional interest on receivable is not warranted;
- f. Not appreciating that the Appellant does not charge interest on receivable from both the AE as well as non-AE and on this ground itself the addition made by the TPO is liable to be quashed;
- g. Without prejudice, adopting flawed methodology for determining arm's length interest rate at 14.74%. The rate determined is excessive;
- h. Without prejudice, not adopting LIBOR as the basis for benchmarking.
- i. Computing interest from the date of invoice and not for the excess credit period only; and
- J. Assuming without admitting that the adjustment is to be made, the lower income tax authorities have erred in not allowing the benefit of the +/-5% range prescribed in the proviso to section 92C(2).

GROUND RELATING TO VARIATION OF DEDUCTION UNDER SECTION 10A/ 10AA/ 10B

8. The lower income tax authorities have erred in:

- a. Not granting deduction u/s 10A/10AA/10B with respect to profits attributable towards onsite software development work being sub-contracted to and performed by the AE's overseas without appreciating the fact that i) the entire risk & rewards and functions & responsibilities of executing the work lies with the Appellant; and ii) the entire on-site software development work was performed under the control and supervision of the Appellant.
- b. Excluding communication charges from export turnover in process of computing deduction u/s 10A/ 10AA/10B without reducing the same from total turnover
- c. Not appreciating that, under similar facts and circumstances of the case, the Honorable High Court of Karnataka and the Bangalore bench of the ITAT as well as other Tribunals have held that if some expenses, for any reason are excluded in arriving at the 'export turnover' the same should also be reduced from 'total turnover'.
- d. Not appreciating that, under similar facts and circumstances of the case, the Honorable Bangalore bench of the ITAT in case of Mphasis Software Services India Pvt Ltd (MSSIP[L] in AY 08 (A group company of Mphasis Group), have held that where entire on-site software development work was performed under the control and supervision of the Appellant, profits attributable to onsite development of software is eligible for deduction u/s 10A/ 10B/ 10AA as the case may be, and the ratio this decision applies to the impugned assessment of the Appellant.

GROUND RELATING DEPRECIATION

9. The lower income tax authorities have erred in:

- a. Holding that the servers, switches, routers partake the character of 'plant machinery' as against 'computers & software'.

- b. Holding that the servers, switches, routers should form part of block of 'plant & machinery' and depreciation @ 15% be allowed on them.
- c. Granting depreciation on servers, switches, routers @ 15% and accordingly, disallowing the excess depreciation of 45% amounting to Rs. 63,38,865.
- d. Without prejudice, not re-computing opening WDV to take into consideration disallowance of excess depreciation made in the preceding assessment year.
- e. Without prejudice, not granting deduction under section 10A/10B/10AA on the excess depreciation disallowed.

GROUND RELATING ADDITIONAL CLAIM

10. The lower income tax authorities have erred in:
- a. Dis-regarding the additional claim made by the Appellant during the assessment proceedings with respect to depreciation of goodwill, additional TDS claim and deduction u/s 40(a)(ia) on the ground that valid claim can only be made by filing revised return.
 - b. Not granting depreciation on goodwill arising on account merger of Mphasis Finsolutions with itself.
 - c. Granting credit for taxes deducted at source of Rs. 119,172,068/- as against the correct amount of Rs. 123,256,842/- resulting into lower credit of Rs 4,084,774/-.
 - d. Not considering additional TDS claim arising on account of merger of Mphasis Finsolutions, Electronic Data Systems India Pvt Ltd. and Kshema Technologies India Ltd with the Appellant, resulting into lower credit of Rs. 6,905,109/-.
 - e. Not granting credit for additional TDS claimed of Rs.68,77,303/- during assessment proceeding based on TDS certificates.
 - f. Not allowing deduction u/s 40(a)(ia) to the tune of Rs. 10,40,253 for expenses disallowed during AY 2009-10 and for which TDS was duly deducted and deposited to the credit of Government during the year under consideration. The learned AO has further erred in reducing Rs. 10,40,253 from the profits of the business and thereby reducing deduction u/s 10A/10B/10AA.

GENERAL GROUNDS

11. The lower income tax authorities have erred in levying a sum of Rs.77,43,733 towards interest under section 234A even though the return of income was filed within the due date prescribed under the Act. The Appellant denies its liability to pay interest.
12. The lower income tax authorities have erred in levying a sum of Rs. 42,36,34,219 /- towards interest under section 234B. On the facts and in the circumstances of the case, interest under section 234B is not leviable. The Appellant denies its liability to pay interest.

The Appellant submits that each of the above grounds/ sub-grounds are independent and without prejudice to one another.

The Appellant craves leave to add, alter, vary, omit, substitute or amend the above grounds of appeal, at any time before or at, the time of hearing, of the appeal, so as to enable the Income-tax Appellate Tribunal to decide the appeal according to law.

The Appellant prays accordingly.

Brief facts of the case are as under:

2. The assessee is a company and engaged in the business of software development, providing information technology enabled services, BPO including call centre services. It filed its return of

income on 06/10/2010 declaring total income of Rs.288,31,65,798/-. The return was processed under section 143 (1) of the Act.

3. The Assessee had claimed deduction under section 10A, 10B, 10AA of the Act as under:

Particulars	Deduction	Amount
Mphasis	10A	320,99,79,247
Mphasis Finsolutions (Merged into Assessee)	10A	12,13,52,081
Mphasis	10AA(4 units)	2,10,16,39,388
Mphasis	10B (8 units)	3,37,43,69,464
Total		880,73,40,180

4. Subsequently assessee revised its return of income on 29/11/2011 on account of merger of M/s.Mphasis Finesolutions Ltd., with assessee w.e.f. 01.11.2009.

5. Subsequently, notice under section 143 (2) and 142 (1) were issued in response to which, representative of assessee appeared before the Ld.AO and filed requisite details as called for. The Ld. AO observed that, assessee had international transaction with its associated enterprises that exceeded Rs.15 crores and accordingly a reference was made to the Transfer Pricing Officer for determining arms length price in respect of those international transactions.

6. On receipt of reference under section 92CA of the Act, Ld.TPO called upon assessee to file economic details of international transactions. Ld.TPO observed that assessee had following international transactions as mentioned in Form 3CEB:

SL.No	Description	Amount Paid(Rs.)	Amount Received(Rs.)
1.	Purchase of Computers equipment, servers and related accessories	2,41,92,493	
2	Purchase of software Licences	2,45,19,997	
3.	Provision services		3170,18,14,860
4.	Software Development & IT Consultancy	242,79,84,925	
5.	Software development, ITES & IT Consultancy	475,78,65,788	
6.	Selling Commission	93,53,07,973	
7.	Software support annual maintenance charges, communication charges and other expenses such as technical and professional services. Use of server and software	196,48,07,913	
8.	Operating expenses allocation		14,00,25,260
9.	General administration expense allocation		17,18,67,704
10.	Reimbursement of various expenses	19,02,96,505	
11.	Recovery of various expenses		2,37,26,352

7. The segmental results of the revenue generated under SWD and ITES segment and IT Outsourcing Support Services are as under:

Segmental Results

Description	Application Services (SWD) (Rs.)	ITES (Rs.)	IT Outsourcing (Support Services) (Rs.)
Operating Revenue	2662,46,27,000	291,99,93,000	836,73,53,000
Operating Expenses	1981,56,45,000	234,36,57,000	551,70,41,000
Operating Profit	680,89,82,000	57,63,36,000	285,03,12,000
OP/ Expenses	34.36%	24.59%	51.66%

8. The Ld.TPO observed that, assessee used TNMM as most appropriate method for determining the arm's length price of the services rendered. Assessee used OP/OC as the PLI and computed the net profit margin of assessee at 34.36% for SWD services segment, 24.59% under ITES segment and IT outsourcing (support services) at 51.66%.

9. The comparables selected by assessee SWD and ITES segment and IT outsourcing service segment had average margin of 11.26% on sales 18.52% and 14.08% on cost for ITES and IT outsourcing services rendered.

10. The Ld.TPO dissatisfied with the study, conducted independent search for all the 3 segments, and found that, the margin computed by the Ld.TPO was less than the margin computed by assessee. Ld.TPO thus concluded SWD, ITES segment and IT outsourcing segment to be at arms length.

11. The Ld.TPO further observed that, during the year under consideration assessee paid certain amounts as selling commission and networking charges to its AE. A notice was issued to assessee asking for the details in respect of these payments. Assessee filed various submissions in respect of its contentions which were rejected by the Ld. TPO. The Ld. TPO computed arm's length price of selling commission at 'nil' on the ground that, there is no direct and tangible benefit to the assessee from payment of selling commission. In respect of payment for network charges, technical and professional services use of server of software, the Ld. TPO observed that charging of

markup of 8% - 10% by AE is without any basis and that these transactions are in the nature of reimbursement. The Ld. TPO thus determined the markup on cost at 'nil' for the networking charges paid.

12. The Ld.TPO also computed notional interest on outstanding receivables for more than 180 days at the rate of 14.74%.

13. Thus the adjustments proposed by the Ld. TPO are as under:

Particulars	TP Adjusment
Selling Commission	93,53,07,973
Network Charges	22,75,19,231
National Interest on receivable	92,33,451
Total	117,20,60,655

14. On receipt of the transfer pricing order the Ld.AO in the draft assessment order made following additions:

- recomputed deduction under section 10 A/10 B/10 AA of the Act;
- while computing export turnover/total turnover, the Ld.AO reduced forex gain on hedging and telecommunication expenditure incurred in foreign currency;
- disallowed depreciation on computer peripherals by restricting it to 15% as against 60% claimed by assessee;
- assessee had made an additional claim vide letter dated 05/04/2013, wherein certain inadvertent computational errors were pointed out under the deduction computed for section 10A/10B/10AA. Assessee had claimed depreciation on goodwill arising due to merger of Mphasis Finesolutions

into assessee and assessee claimed deduction disallowed for assessment year 2009-10 under section 40(a)(ia) of the Act, as the TDS was remitted during the year under consideration. All these claims were incorporated in the revised return which work rejected by the Ld.AO.

15. The Ld.AO thus computed proposed adjustment at Rs.6,46,47,17,384/- as income in the hands of assessee, after giving credit to taxes paid and raised a demand of Rs.106,26,14,503/-.

16. On receipt of the draft assessment order, assessee raised objections before the DRP.

17. DRP directed the Ld. AO to recompute export turnover for purposes of computing deduction under section 10A in accordance with the decision of *Hon'ble Karnataka High Court* in case of *CIT vs Tata Elxi Ltd.*, reported in 349 ITR 98. However, exclusion of the on-site development charges and communication charges from export turnover for computing deductions under section 10 A/10 AA/10 B was not decided by the DRP.

18. In terms of the depreciation claimed and the additional claim raised by assessee, the DRP did not consider the objections as these did not form part of the original return of income.

19. In respect of the other issues the DRP upheld the observations of the Ld. AO/TPO.

20. Upon receipt of the DRP directions, the Ld. AO passed the final impugned assessment order, against which both assessee as well as revenue are in appeal.

21. At the outset, both sides submit that the issue raised by revenue is no more *resintegra* by virtue of the decision of *Hon'ble Supreme Court* in case of *CIT vs HCL Technologies Ltd.*, reported in (2018) 404 ITR 719. *Hon'ble Supreme Court* upheld the observations of *Hon'ble Karnataka High Court* in case of *CIT vs Tata Elxi Ltd. (supra)*.

Accordingly the appeal filed by revenue stands dismissed.

Assessee's appeal:

22. Ground No. 4-6 relates to the addition made on account of selling commission and networking charges:

23. It has been submitted that during the year under consideration assessee paid following amounts as selling commission and networking charges to its AE:

Selling commission - Rs.93,53,07,973/-

Networking charges - Rs.183,67,34,437/-

24. The Ld.AR submitted that assessee is engaged in the business of providing software development services to domestic and international customers and its AE's. These transactions entered by assessee are structured under 2 categories being:-

- type I: composite contracts of performing both offshore and on-site services entered by assessee with the end customer and offshore work sub contractor to assessee

- type 2 composite contracts for performing both offshore and on-site services entered by the assessee with the end customer and on-site work subcontracted to AE
- type III-composite contracts for performing both offshore and on-site services entered by assessee with the end customer and offshore work assigned to the assessee.

25. It was been submitted that the payments made towards selling commission by assessee to its AE are at a percentage of total revenues as per the transfer pricing policy of Mphasis Ltd. The Ld.AR also submitted that the international transaction pertaining to providing offshore software development services to AE and availing of marketing and on-site services are considered closely linked to the activity of providing software development services and hence the same has to be analysed by using combined transaction approach. It was also submitted that, the margin earned by assessee are comparable to margins earned by other service providers operating in India and therefore these services are to be treated to be at arms length.

In regards to networking charges Ld.AR submitted that assessee paid such charges for using some tools/software developed by EDS International Singapore PTE. Assessee paid markup on such cost, as these are developed by EDS Singapore, while for other cost, such as BT circuit and GSM, no markup is added since these costs are resulted due to the contracts EDS Singapore has with 3rd parties customer. It was submitted that, all these details

and breakups of the markup were provided to the authorities below, however the same were not appreciated.

25.1 On the contrary the Ld.CIT.DR submitted that as per agreement for selling and marketing services dated 01/04/2008 between assessee and its US AE it is mutually agreed that fee for services rendered by the US AE will be at cost, allocated to the company to which profit markup will be added which is mutually agreed. The Ld.CIT.DR further submitted that, the service fee charged to the taxpayer on the gross bill is without netting of the receivables that are payable by the AE to assessee. She also submitted that the agreement does not discuss on what shall be the cost base and how that will be allocated and what shall be the mark up.

She thus supported the addition made in this by authority below.

26. We have perused submissions advanced by both sides in light of records placed before us.

27. We note that, the reason for making adjustment in the hands of assessee towards selling commission and networking charges is that, there is no basis for such cost allocation. Further the disallowance of networking charges is on the basis that the agreement does not mention about the markup on cost.

28. We note that this issue has not been decided by the DRP though objection was raised. Under such circumstance we direct DRP to consider this issue based on various evidences/details filed by assessee having regards to various judicial

pronouncements passed by *Hon'ble High Courts*, in accordance with law.

29. Needless to say that proper opportunity of being heard must be granted to assessee in accordance with law.

Accordingly, Grounds 4-6 stands allowed for statistical purposes.

30. Ground No.7 has been raised by assessee in respect of addition made on account of outstanding receivables.

31. At the outset the Ld.AR submitted that margin has been found to be at arms length by using TNMM as most appropriate method. However adjustment was made in respect of outstanding receivables that exceeded 180 days at 14.74% without adopting LIBOR as a basis for benchmarking.

32. Ld.AR submitted that, as TNMM is used as most appropriate method, the outstanding receivables get subsumed in the working capital adjustment and therefore separate addition is not warranted.

33. The Ld.CIT.DR placed reliance on various decisions of coordinate benches of this *Tribunal* wherein, this issue is remanded to Ld.AO for verification in accordance with law based on the evidences filed by assessee.

34. We have perused submissions advanced by both sides in light of records placed before us.

35. We note that, the Ld.AO has not looked into various aspects in the light of the evidences filed by assessee. The submission by Ld.AR that under TNMM the working capital adjustment

subsumes the outstanding receivables, needs to be verified by the Ld.AO/TPO. Several factors need to be considered before coming to the conclusion that the receivables from AE needs to be separately benchmarked. Most importantly the impact this would have on working capital of assessee would have to be studied.

In the event any receivables needs to be separately benchmarked, we direct Ld.AO/TPO to compute the interest in accordance with the ratio of *Hon'ble Delhi High Court* in case of *CIT vs Cotton Naturals India Pvt. Ltd.* reported in (2015) 276 CTR 445.

36. With the above directions we remand this issue back to the Ld.AO/TPO to reconsider the issue in accordance with law.

Accordingly this ground raised by assessee stands allowed for statistical purposes.

37. Ground No.8 is raised by assessee against not granting deduction under section 10A/10AA/10B with respect to profits attributable towards on-site software development work being sub contractor to an performed by the AEs overseas.

38. Ld.AR submitted that, assessee subcontracted part of on-site software development activity to its associated enterprise and that the risk, rewards and responsibilities of the outcome of the sub contractor work continue to rest with assessee. It was submitted that, assessee has entered into the main contract with the foreign client in respect of the work that was sub contracted to the AE. Ld.AR submitted that, Ld. AO/TPO wrongly held that assessee is not eligible for deduction under section

10A/10AA/10B in respect of profits attributable to sub contracting of software development work.

39. The Ld.AR submitted that, coordinate bench of this *Tribunal* in assessee's own case for assessment year 2007-08 in *ITA No.1209/B/2012* and *ITA No.1168/B/2012* by order dated 20/12/2013 has held that assessee is not involved in rendering of technical services and therefore no expenditure incurred in foreign currency is to be excluded from export turnover in computing deduction under section 10A of the Act. This view has been upheld by *Hon'ble High Court* in 263-264/2014 by order dated 29/07/2015 reported in (2015) 62 *Taxmann.com* 165.

On the contrary, Ld.CIT.DR relied on orders passed by authorities.

40. We have perused submissions advanced by both sides in light of records placed before us.

41. We note that, the Ld.AO opined that, the expenditure incurred by assessee in foreign currency has already been factored in for the purpose of arriving at profits attributable to on-site development of computer software outside India and therefore was excluded from export turnover for purpose of determining the deduction under section 10A/10AA/10B of the Act. *Hon'ble High Court* in assessee's own case (supra) observed as under:

“17. A plain reading of the said notice would make it clear that the Assessing Officer has himself accepted that it was only some part of the software development which was carried out 'on-site' by the assessee, meaning thereby that the other part of the contract was carried out by the assessee 'off-shore' i.e., at its site or workplace in

India. Such being the position, we are of the clear opinion that it was not the entire contract which was passed on to the AE by the assessee but some part of it was done by the assessee itself in India as 'off-shore' work and the remaining part was sub-contracted to the AE for 'on-site' work. It may be relevant to notice here that the sub-contracted part carried out 'on-site' outside India by the sub-contractor, did not have the personnel of the assessee but admittedly the supervision and control (with regard to the quality and specifications of the work to be done) was with the assessee through its Project Manager, as would be clear from the terms of the MSA. In fact, assessee had also right to reject such activities of AE, if it did not conform to specification agreed to it under the contract.

18. *We have also gone through the provisions of Master Service Agreement which was entered into between the assessee and the AE, which admittedly was a group company of the assessee. The terms of the MSA relate to the 'on-site' work which was to be carried out by the AE, on behalf of the assessee. In such agreement, the task order was to be given by the assessee to the AE, for which the responsibility was of the AE, subject to the supervision and all pervasive control of the assessee. The product which was to be delivered would be that of the assessee, after payment was made to the AE. As such, it is clear that the AE was carrying on the work under the supervision and control of the assessee, as well as on behalf of the assessee. The proprietorship of the product was also to remain with the assessee.*

19. *We may explain the transaction with an example. If a total contract (Type II Model) was procured by the assessee, say for an amount of Rs.10 crores, for carrying on the work of the end customer, out of which 'off shore' work was to be carried out by the assessee to the extent of, say Rs.8 crores and the remaining 'on-site' work of Rs. 2 crores was sub-contracted to the AE, then, the question for consideration would be with regard to the profits earned from 'on-site' development work of Rs. 2 crores which had been sub-contracted to the AE. There is, admittedly, no dispute with regard to profits earned from 'off-shore' work carried out by the assessee, amounting to Rs. 8 crores. For such 'on-site' development work, the assessee has an option of sending its own personnel for which it will have to have an establishment at the place of the end customer situate outside India, for which it may have to incur travelling and other expenses for its personnel to go 'on-site' outside India for performing such work; or on the other hand, another option for the assessee is of sub-contracting the 'on-site' work to an AE which has to work under the supervision and all pervasive control of the assessee and carry out the 'on-site' work on behalf of the assessee at the place of the end customer. The payment for 'on-site' work done would, in such a case, be made by the assessee to the AE and not by the end customer, who would make the*

entire payment of Rs.10 crores to the assessee. There could be a marginal difference in the expenses which the assessee would have incurred if it would have carried out the 'on-site' work through its own personnel as against the payment which is made to the AE for doing such work, but such decision of passing on part of the work to be done by a sub-contractor (AE) or not, has to be taken by the assessee as a prudent businessman keeping in view the business necessities and the comparative cost effectiveness and it is not for the Courts or the Income Tax authorities to decide the same. Even by executing the contract as per the given example, the benefit of foreign exchange being brought into the country would still be there and thus the object of insertion of Section 10A would be achieved.

20. The question which now remains to be answered by this Court is that would it be permissible for the benefit under Section 10A to be given to the assessee if the 'on-site' work carried outside the country is not done through its own personnel. For this, we may refer to Explanation-3 to Section 10A, which is clarificatory in nature and does not limit the benefit provided by Section 10A but only enlarges its scope. In the said explanation, it is provided that the profits and gains derived from 'on-site' development of computer software outside India would be deemed to be profits and gains from the export of computer software outside India. By this explanation, it is clear that the profits and gains which are derived from 'on-site' development of computer software would also be covered under Section 10A of the Act. What we notice is that the main Section 10A nowhere provides that the 'on-site' work of software development should be carried out by the own personnel of the assessee. As such, it would be wrong to deny the benefit under the said section merely because the 'on-site' work was not done by the personnel of the assessee as we are of the firm view that authorities or Courts are not to read something into the provision of law which is not there in the Section or its Explanation; more so, in the case of a beneficial piece of legislation, as is the present one.

21. With regard to denial of benefit of Section 10A because of the personnel of the assessee having not performed the 'on-site' work, emphasis has been laid by the learned counsel for Revenue on the Circular No.694 dated 23.11.1994 issued by the Central Board of Direct Taxes (CBDT). The relevant paragraph 7 of the said Circular is reproduced below:

"Similarly, for the purpose of s.10A or 10B, as long as a unit in the EPZ/EOU/STP itself produces computer programmes and exports them, it should not matter whether the programme is actually written within the premises of the unit. It is, accordingly, clarified that, where a unit in the EPZ/EOU/STP develops software sur place, that is, at the client's site abroad, such unit should not be denied the tax holiday under s.10A or 10B on the

ground that it was prepared on site, as long as the software is a product of the unit, i.e., it is produced by the unit."

22. *In our view, the said Circular is in favour of the assessee and not against it. Learned counsel for Revenue has laid much stress on the wordings that the assessee unit should have produced the computer programme by itself or that it should be produced by the unit of the assessee itself. There is no denial of the fact that even the 'on-site' work of computer software development has been done under the direct supervision and control of the assessee through the AE, which would be nothing but on behalf of the assessee 'itself'. As indicated in the said Circular, 'itself' would not mean that personnel of the assessee will have to carry out the work. However, it should be the product of the assessee and since in the present case, the ownership of the product (software), after payment by the assessee for the work done by the AE, would be of the assessee, the same would be nothing but the product of the assessee and not a product of AE. The other Circular dated 17.1.2013 on which the learned counsel for Revenue has relied upon, also does not anywhere specify that the personnel of the assessee should only be deputed for carrying on the work. Even otherwise, the Circulars issued by the CBDT cannot over ride the provisions of the Act. If the main Section of the Act does not provide for the benefit to be given only to such units or exporters who carry out 'on-site' work through its own personnel, the same cannot be read into the provisions of Section 10A of the Act.*

23. *The sole ground for denying the benefit of section 10A by the Assessing Officer or the appellate Commissioner is that 'on-site' development of computer software has not been executed by the assessee itself through its own personnel. Such interpretation of the Section cannot be accepted because what is not there in the Section or the Explanation, cannot be read into by the authorities or by this Court.*

24. *Learned counsel for the Revenue has also submitted that the conditions laid down in sub-section (2) of Section 10A of the Act have not been fulfilled by the assessee, which have to be strictly construed and as such, the assessee would not be entitled to the benefit of Section 10A. According to the learned counsel for the Revenue, the production or manufacture should be in any free trade zone and if the same is not done in the free trade zone, the assessee would not get benefit of such manufacture or produce. The benefit is site specific and not project specific. According to him, only such production or manufacture which is carried at the site of the assessee's unit in the free trade zone would alone be eligible for the benefit under section 10A and not such production or manufacture which has been carried outside or by a third party. A mere reading of sub-section (2) would not be sufficient. The entire section has to be read in conjunction with*

Explanation 3, which clarifies that profits and gains derived from 'on-site' development of software outside India shall also be deemed to be profits and gains derived from the export of software outside India, and same would also be entitled to such benefit. If the interpretation, as contended by the Revenue is accepted, the very purpose of inserting Explanation 3 to Section 10A of the Act would be lost or frustrated.

25. *Lastly, learned counsel for the Revenue has contended that there is no nexus between 'off-shore' production by the assessee in India and 'on-site' production by the AE outside India. He relies on the finding of the Assessing Officer given in this regard, which is as under:*

"Hence the profits and gains derived from Model No.2 cannot be deemed to be the profits and gains of the assessee company w.r. to export of computer software outside India. To be precise, the deduction is available only if the on-site development of computer software is executed by the assessee itself through its own personnel. The sub-contracting of "On site" part of the software development to other entity and the resultant profit is not covered in Explanation 3 to Section 10A of IT Act and such profits and gains would not qualify for deduction under section 10A of IT Act.

.....

From the discussion on relevant paras of the MSA, it is further brought on record that the execution of off-shore part of the contract had got nothing to do with the on site work executed from abroad by the AEs. The execution of off shore part of the contract was on a separate channel and the AEs were never involved in any implementation of the product developed by the assessee in India. The AEs worked independently with its own personnel and created its own intellectual properties i.e., software product (Deliverables).

Hence it is abundantly clear that the assessee never involved either directly or indirectly in the on-site software development activity executed by the AEs. Even if it is involved administratively for co-ordination between the AEs and its clients in getting the contract executed, the assessee shall not be eligible for deduction since the core function of software development function was executed by the AEs. Neither the plant and machinery nor the employees of the STP Unit were utilized in developing the software in On-site Locations abroad. The Sub-contract work executed by AEs did not have any Indian connection on these works executed by it. The assessee has attempted to claim exemption on the work executed by a foreign entity over which the provisions of Indian Income Tax Act, 1961 are not applicable."

26. *The Tribunal has considered this aspect and has come to the conclusion that the assessee company was solely responsible for the*

risks and rewards arising out of the sub-contract to the AE. It has given a clear finding that "the assessee is solely responsible for the discharge of its obligations under the contract to the customer and the sub-contractor has no say in the matter. It is seen from the Master Services Agreement that it is the assessee which is under an obligation to discharge its obligation of specific requirement of the customer and in pursuance thereof, to pass on the specification of the products to the AE and also to reserve right to reject the product if the AE does not produce the product in conformity with the product as given in the task order. Therefore, it can be safely concluded that the development of the software by the AE is under the supervision and control of the assessee".

27. *From the record it is not borne out that the entire 'on-site' work has been sub-contracted to the AE. The MSA provides for the AE to work under total supervision and control of the assessee. The software to be produced by the assessee during its 'on-site' development has to be as per the specifications given by the assessee. The AE has no concern or direct dealing with the end customer. The assessee provides all relevant information and inputs to the AE on behalf of the end customer. The AE is admittedly answerable to the assessee and not the end customer. In such nature of the work which is carried on by the AE on behalf of the assessee, it cannot be said that there is no nexus between 'off-shore' development and 'on-site' development.*

28. *In view of the above discussion, we are of the opinion that in the facts of the present case, the income earned by the assessee through 'on-site' development of software by the AE on behalf of the assessee, would be eligible for deduction under Section 10A of the Act."*

42. Based on the above observations by *Hon'ble High Court*, we direct the Ld.AO to verify the MSA having regard to the contract entered into by assessee with the foreign clients. In the event the services rendered by AE's under the total supervision of assessee and that the entire risk in respect of these contracts are owned by assessee then the expenditure deserves to be included for the purposes of computing deduction under section 10A/10AA/10B of the Act as they are attributable to rendering of services to foreign clients.

Accordingly this ground raised by assessee stands allowed for statistical purposes.

43. Ground No.9 is in respect of disallowance of depreciation on computer peripherals at 60% and restricting it to 15%.

Admittedly, this issue stands settled by decision of *Hon'ble Special Bench* in case of *DCIT vs Datacraft India Ltd.* reported in *(2010) 40 SOT 295*.

44. We therefore direct the Ld.AO to grant depreciation on the computer peripherals at 60%.

Accordingly this ground raised by assessee stands allowed.

Ground No. 10 are in respect of the additional claims raised by assessee before the Ld. AO.

45. It has been submitted that DRP wrongly observed that assessee has not raised these claim by way of revised return and therefore these issues have not been adjudicated.

46. However on perusal of records we note that these issues have been raised by assessee by way of revised return filed subsequently. As these issues have not been considered by DRP, we remand this issue to DRP to consider it in light of evidences/documents filed by assessee in accordance with law.

Accordingly ground No. 10 raised by assessee stands allowed for statistical purposes.

47. Ground No. 11-12 are consequential in nature and therefore do not require any adjudication.

Accordingly appeal filed by assessee stands allowed as indicated herein above.

In the result appeal filed by revenue stands dismissed and appeal filed by assessee stands allowed as indicated hereinabove.

Order pronounced in the open court on 14th June, 2021

Sd/-
(CHANDRA POOJARI)
Accountant Member
Bangalore,
Dated, the 14th June, 2021.
/Vms/

Sd/-
(BEENA PILLAI)
Judicial Member

Copy to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore
6. Guard file

By order

Assistant Registrar, ITAT, Bangalore

		Date	Initial	
1.	Draft dictated on	On Dragon		Sr.PS
2.	Draft placed before author	-6-2021		Sr.PS
3.	Draft proposed & placed before the second member	-6-2021		JM/AM
4.	Draft discussed/approved by Second Member.	-6-2021		JM/AM
5.	Approved Draft comes to the Sr.PS/PS	-6-2021		Sr.PS/PS
6.	Kept for pronouncement on	-6-2021		Sr.PS
7.	Date of uploading the order on Website	-6-2021		Sr.PS
8.	If not uploaded, furnish the reason	--		Sr.PS
9.	File sent to the Bench Clerk	-6-2021		Sr.PS
10.	Date on which file goes to the AR			
11.	Date on which file goes to the Head Clerk.			
12.	Date of dispatch of Order.			
13.	Draft dictation sheets are attached	No		Sr.PS