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

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

IT(TP)A No. and Assessment Year	Appellant	Respondent
623/Bang/2016 2011-12	The Assistant Commissioner of Income Tax, Circle - 6(1)(1), Bengaluru.	M/s. SAP Lab Pvt. Ltd., 138, Export Promotion Industrial Park, Whitefield, Bengaluru – 560 066. **PAN : AAFCS 3649 P**
566/Bang/2016 2011-12	M/s. SAP Lab Pvt. Ltd., Bengaluru – 560 066. **PAN : AAFCS 3649 P**	The Assistant Commissioner of Income Tax, Circle - 6(1)(1), Bengaluru.

Appellant by	:	Shri. Aliasger Rampurawala, CA
Respondent by	:	Shri. Sumer Singh Meena, CIT(DR)(OSD)(ITAT), Bengaluru

Date of hearing	:	25.11.2021
Date of Pronouncement	:	29.11.2021

O R D E R

Per N. V. VASUDEVAN, Vice President:

These cross appeals by the Revenue and assessee are directed against the final order of assessment dated 28.1.2016 of the ACIT, Circle 6(1)((1), Bangalore (hereinafter referred to as the Assessing Officer, "AO" in short) passed u/s.143(3) read with Section 144C(13) of the Income Tax Act, 1961 (Act) in relation to AY 2011-12.

2. First we shall take up for consideration, assessee's appeal. We shall take up the rephrased grounds of appeal for consideration. The grounds

relating to Transfer Pricing adjustment are contained in Grd. No.1 to 4. The assessee in engaged in the business of provision of Software Development Services (SWD services), to its wholly owned holding company. In terms of the provisions of Sec.92-A of the Act, the assessee and its wholly owned holding company were Associated Enterprises ("AEs"). In terms of Sec.92B(1) of the Act, the transaction of providing SWD Services was an “international transaction” i.e., a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises. In terms of Sec.92(1) of the Act, the any income arising from an international transaction shall be computed having regard to the arm’s length price. In this appeal by the assessee, the dispute is with regard to determination of Arms’ Length Price (ALP) in respect of the international transaction of rendering SWD services to the AE.

3. As far as the provision of Software Development services are concerned, the assessee filed a Transfer Pricing Study (TP Study) to justify the price paid in the international Transaction as at ALP by adopting the Transaction Net Margin Method (TNMM) as the Most Appropriate Method (MAM) of determining ALP. The assessee selected Operating

Profit/Operating Cost (OP/OC) as the Profit Level Indicator (PLI) for the purpose of comparison. The OP/OC of the assessee was arrived at 5.08% by the assessee in its TP study. The assessee chose 16 companies who are engaged in providing similar services such as the assessee. The average arithmetic mean of profit margin of the aforesaid companies was 9.90% and after adjustment of (-) (+) range as per proviso to Sec.92C(2) of the Act, the assessee claimed that its profit margin was comparable with the Operating margin of the comparable companies and therefore the price was at Arm's length. The assessee therefore claimed that the price it charged in the international transaction should be considered as at Arm's Length.

4. The Transfer Pricing Officer (TPO) to whom the determination of ALP was referred to by the AO, accepted TNMM as the MAM and also used the same PLI for comparison i.e., OP/TC. He also selected comparable companies from database. The TPO chosen a set of 13 comparable companies and worked out the average arithmetic mean of their profit margins as follows:

Comparables selected by TPO and their arithmetic mean:

Sl. No.	Name of the Company	Mark-up on Total Costs (WC–unadj) (in %)
1	Acropetal Technologies Ltd. (seg)	31.98
2	e-Zest Solutions Ltd.	21.03
3	E-Infochips Ltd.	56.44
4	Evoke Technologies Pvt. Ltd.	8.11
5	ICRA Techno Analytics Ltd.	24.83
6	Infosys Ltd.	43.39
7	Larsen & Toubro Infotech Ltd.	19.83
8	Mindtree Ltd. (seg)	10.66

9	Persistent Systems & Solutions Ltd.	22.12
10	Persistent Systems Ltd.	22.84
11	R S Software (India) Ltd.	16.37
12	Sasken Communication Technologies Ltd.	24.13
13	Tata Elxsi Ltd. (seg)	20.91
AVERAGE MARK-UP		**24.82**

5. The TPO computed the Addition to total income on account of adjustment to ALP as follows:

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

Arm's Length Mean Margin on cost		24.82%
Less: Working Capital Adjustment		0.89%
Adjusted mean margin of the comparables	A	23.93%
Operating Cost	B	Rs. 859,26,86,766/-
Arm's length Price (123.93% of Operating Cost)	C=B*123.93%	Rs. 1064,89,16,709/-
Price Received	D	Rs. 866,19,53,361/-
Short fall being adjustment u/s. 92CA	**E=C - D**	Rs. **198,69,63,348/-**

Thus a sum of Rs. 198,69,63,348/- was added to the total income of the assessee on account of determination of ALP for provision of SWD services by the assessee to its AE.

6. The assessee filed objections before the Disputes Resolution Panel (DRP) against the draft assessment order passed by the AO wherein the addition suggested by the TPO as adjustment to ALP was added to the total income of the assessee by the AO. The assessee filed objections before the DRP and the DRP gave certain directions. Based on the directions of the

DRP, the AO passed the final order of assessment. To the extent the assessee did not get relief from the DRP, the assessee has preferred appeal before the Tribunal.

7. The relevant provisions of the Act in so far as comparability of international transaction with a transaction of similar nature entered into between unrelated parties, provides as follows:

> **Determination of arm's length price under section 92C .**
>
> **10B .** (1) For the purposes of sub-section (2) of section 92C, the arm's length price in relation to an international transaction **[***or a specified domestic transaction***]** shall be determined by any of the following methods, being the most appropriate method, in the following manner, namely :—
>
> **(a) to (d).**.....
>
> (e)transactional net margin method, by which,—
>
> (*i*) the net profit margin realised by the enterprise from an international transaction **[***or a specified domestic transaction***]** entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;
>
> (*ii*) the net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;
>
> (*iii*) the net profit margin referred to in sub-clause (*ii*) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction **[***or the specified domestic transaction***]** and the comparable uncontrolled transactions, or between the enterprises entering into such transactions,

which could materially affect the amount of net profit margin in the open market;

(*iv*) the net profit margin realised by the enterprise and referred to in sub-clause (*i*) is established to be the same as the net profit margin referred to in sub-clause (*iii*);

(*v*) the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction **[***or the specified domestic transaction***]**;

(f).....

(2) For the purposes of sub-rule (1), the comparability of an international transaction **[***or a specified domestic transaction***]** with an uncontrolled transaction shall be judged with reference to the following, namely:—

(*a*) the specific characteristics of the property transferred or services provided in either transaction;

(*b*) the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;

(*c*) the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;

(*d*) conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

(3) An uncontrolled transaction shall be comparable to an international transaction **[***or a specified domestic transaction***]** if—

(*i*) none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely

to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market; or

(*ii*) reasonably accurate adjustments can be made to eliminate the material effects of such differences.

8. A reading of Rule 10B(1)(e)(iii) of the Rules read with Sec.92CA of the Act, would clearly shows that the net profit margin arising in comparable uncontrolled transactions has to be adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, which could materially affect the amount of net profit margin in the open market.

9. Chapters I and III of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (hereafter the "TPG") contain extensive guidance on comparability analyses for transfer pricing purposes. Guidance on comparability adjustments is found in paragraphs 3.47-3.54 and in the Annex to Chapter III of the TPG. A revised version of this guidance was approved by the Council of the OECD on 22 July 2010. In paragraph 2 of these guidelines it has been explained as to what is comparability adjustment. The guideline explains that when applying the arm's length principle, the conditions of a controlled transaction (i.e. a transaction between a taxpayer and an associated enterprise) are generally compared to the conditions of comparable uncontrolled transactions. In this context, to be comparable means that:

- None of the differences (if any) between the situations being compared could materially affect the condition being examined in the methodology (e.g. price or margin), or

- Reasonably accurate adjustments can be made to eliminate the effect of any such differences. These are called "comparability adjustments.

10. In the light of the aforesaid legal provisions and commentary, we shall proceed to examine the arguments advanced before us on the choice of comparable companies, which the assessee disputes in its appeal. The learned counsel for the assessee submitted that he seeks for adjudication only ground No.2.6 and 2.7 with regard to transfer pricing adjustment viz., exclusion of two companies Persistent Systems Lt., and Sasken Communication Technologies Ltd., and inclusion of FCS Software Solutions Ltd. He relied on the decision of the ITAT Bangalore Bench in the case of DCIT Vs. M/s.Brocade Communications Systems Pvt.Ltd. IT(TP) A.No.481/Bang/2016 for AY 2016-17 rendered in the case of a company engaged in SWD services such as the assessee and in whose case also the very same 13 comparable companies chosen in the present case was chosen as comparable company. The functional profile of the said company and the assessee are identical. In the aforesaid decision, the Tribunal upheld exclusion of Sasken Communication Technologies Ltd., and Persistent Systems Ltd., with the following observations:

> *"24. As far as exclusion of Persistent Systems Ltd., is concerned, the learne counsel for the Assessee brought to our notice a decision of the ITAT Bangalore Bench in the case of Electronics for Imaging India (P) Ltd. Vs. DCIT (2017) 85 taxmann.com 124 (Bangalore-Tribunal) rendered in the case of an Assessee rendering SWD services such as the Assessee. wherein comparability of this company with a SWD service provider was considered and this tribunal held paragraph 9.2.4 of its order held that this company is a SWD service as well as Software Product company and the segmental details*

of the various segments are not available. As far as exclusion of Sasken Communication Technologies Ltd.. is concerned. in the very same decision in the case of Electronics for Imaging India (P) Ltd., (supra), this company was held to be not comparable as it had revenues both from software products and SWD services and segmental details were not available. In view of the aforesaid decisions, we direct that the aforesaid two companies be excluded from the list of comparable companies. No other grounds in the CO were pressed for adjudication."

11. As far as inclusion of FCS Software Solutions is concerned, the learned counsel for the assessee relied on the decision of the ITAT Bangalore Bench in the case of Rambus Chip Technologies (India) Pvt.Ltd. Vs. ACIT ITA No.978/Bang/2017 for AY 2011-12 order dated 10.1.2020 rendered in the case of a company engaged in SWD services such as the assessee and in whose case also the very same 13 comparable companies chosen in the present case was chosen as comparable company. The functional profile of the said company and the assessee are identical. In the aforesaid decision, the Tribunal upheld inclusion of FCS Software Solutions Ltd., with the following observations:

"6. The Lrd AR at the time of hearing submitted that the comparable FCS Software Solutions pvt Ltd is only pressed for inclusion, which is functionally comparable and is engaged in providing Software Development Services. The learned Authorised Representative relied on the co-ordinate bench decision Finastra Software Solutions (India) Pvt. Ltd. Vs. ACIT (supra) and VMware Software India Pvt Ltd. Vs. DCIT in IT(TP)A No.1311/Bane/20141 Dt.6.1.2017. We found the co-ordinate bench in the case of Finastra Software Solutions (India) Pvt. Ltd. Vs. ACIT (supra) observed at para 19 page 10 as under :

> *" 19. As far as the plea for including the other two companies viz., Thinksoft Global Ltd., and FCS Software Ltd., we find both these companies were excluded by the*

TPO for the reason that the working capital adjustment was very high. ITAT Bangalore Bench in the case of VMware Software India Pvt.Ltd. Vs. DCIT in IT (TP) A.No.1311/Bang/2014 order dated 6.1.2017 has held that a company which is otherwise comparable cannot be excluded for the reason that the working capital adjustment to be done was very high. In view of the aforesaid decision, we are of the view that this company, which was otherwise found to be comparable, be included in the list of comparable companies."

Whereas the comparable FCS Software Ltd. was included for the purpose of determination of ALP. and it was also considered for inclusion in the case of VMware Software India Pvt. Ltd. in IT(TP)A No.1311/Bang/2014 dt.6.1.2017."

12. Respectfully following the aforesaid decision, we direct exclusion and inclusion of the comparable companies set out in Grd.No.2.6 and 2.7 respectively of the assessee's appeal. The connected TP issue in revenue's appeal is with regard to the order of the DRP in allowing risk adjustment, which in our opinion is correct and calls for no interference. In terms of Rule 10B(2)(b) of the Rules, it is necessary that comparability has to be done keeping mind the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions. The DRPs direction to allow working capital adjustment after considering the difference in different risk profile of the parties is therefore correct and hence upheld. Grd.No.2 raised by the Revenue in its appeal is therefore dismissed. No other grounds were pressed for adjudication with regard to transfer pricing issue. We direct the TPO to compute the ALP of the international transaction in accordance with the directions given in this order after affording the assessee opportunity of being heard.

13. As far as corporate tax grounds are concerned, Grd.No.6 to 6.4 is with regard to deduction u/s.80JJA of the Act and these grounds read thus:

> *6. While doing so, the learned DRP/ AO erred in:*
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> *6.1. Not appreciating the fact that deduction under section 8oJJAA of the Act is Assessee specific and not undertaking / unit specific.* ***[corresponding to ground no. 6.1]***
>
> *6.2. Invoking the provisions of section 8oA(4) in the context of deduction under section 8oJJAA for 10A units* ***[corresponding to ground no. 6.2]***
>
> *6.3. Not appreciating the fact that the amendment made in the Finance Act 2013, restricting the deduction to an Indian Company deriving profits from the manufacture of goods in a factory, is applicable with effect from April 1, 2014 and is prospective in nature.* ***[corresponding to ground no. 6.3]***
>
> *6.4. Considering the orders for earlier years while disallowing the deduction u/s 80JJAA of the Act without considering the fact that each year should be considered separately.* ***[corresponding to ground no. 6.4]***

14. As far as the aforesaid ground of appeal are concerned, the assessee claimed deduction under section 80JJAA of the Act a sum of Rs.4,26,67,792/-. The AO denied the claim of the assessee for deduction on 2 grounds namely: (1) that persons working in software units cannot be regarded as workmen as contemplated by the provisions of section 80JJAA of the Act. (2) Deduction under section 80JJAA cannot be allowed in respect of additional wages paid to employees who are working in 10A units because under the provisions of 80A(4) of the Act, the assessee cannot enjoy benefits both under sections 10A and 80JJAA of the Act in

respect of the same income. On objections by the assessee before the DRP, the DRP rejected the claim of the assessee. The DRP also took the view that, the assessee has not given Form 10DA for each 10A unit separately. The AO in the order giving effect to the order of the DRP on this aspect has observed as follows:

> *"7.5 Apart from the above, I would like to highlight the fact that as per the provisions of section 80JJAA, deduction is allowable taking each unit as a basis rather than the assessee as an undertaking. Accordingly, the assessee is required to compute deduction u/s 80JJAA in respect of each eligible unit separately. While doing so, all the conditions stipulated would be applied taking each unit as the reference point, i.e*
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> i. *The additional wages are required to be restricted by excluding the additional wages payable to 100 workmen in respect of each unit.*
> ii. *There should be increase in workmen in each year to the extent of minimum 10% of the existing workmen at each unit level.*
> iii. *It is required to be seen that the workmen employed for less than 300 days during the previous year under reference to be excluded from the computation of additional wages payable.*
>
> *In the instant case, the assessee has not considered each unit as a basis for the purpose of fulfillment of conditions enumerated above as per working given in Form 10DA. In a sense, the assessee has considered total number of employees/workmen working in all the units put together as basis in order to reckon 10% increase in workforce during the year under reference, inclusion of only 100 employees in respect of all the units for the purpose of quantifying the additional wages paid instead of considering 100 employees for inclusion in each and every unit.*

7.6 In view of the above, I am of the opinion that in the absence of furnishing unit wise certificate in respect of fulfillment of conditions stipulated u/s 80JJAA, the assessee is rot eligible to claim deduction u/s 80JJAA. On this specific ground itself, I have no hesitation to deny the deduction u/s 80JJAA for the current year also."

15. The learned Counsel for the assessee has accepted the decision of the DRP in so far as ground No.6.1 is concerned and is willing to give the details as per each unit. The deduction can therefore be considered for each 10A unit separately. The assessee is directed to furnish the necessary details in this regard and the AO may examine the same in accordance with law. As far as ground 6.2 is concerned, it was agreed by the parties that in assessee's own case for Assessment Year 2007-08 in IT(TP)A No.1006/Bang/2011 by order dated 30.06.2016, this Tribunal rejected the claim of the assessee by observing as follows:

"25. However coming to the second limb of the reasoning given by the lower authorities, which is section 80A(4), the said section is reproduced hereunder :

> *"(4) Notwithstanding anything to the contrary contained in Section 10A of section 10AA or section 10B or section 10BA or in any provisions of this Chapter under the heading 'C.- Deductions in respect of certain incomes", where, in the case of an assessee, any amount of profits and gains of an undertaking or unit of enterprise or eligible business is claimed and allowed as a deduction under any of those provisions for any assessment year, deduction in respect of, and to the extent of, such profits and gains shall not be allowed under any other provisions of this Act for such assessment year and shall in no case exceed the profits and gains of such undertaking or unit or enterprise or eligible business, as the case may be."*

26. However coming to the second limb of the reasoning given by the lower authorities, which is section 80A(4), the said section is reproduced hereunder :

As per the assessee even if deduction under section 10A of the Act is allowed for these units, a further deduction u/s.80JJA of the Act, is also allowable. Argument of the assessee's counsel is that the limitation put in by Section 80A(4) of the Act, would apply only to profit linked deductions. There can be no dispute that deduction under Section 10A of the Act, is profit linked. In so far as deduction u/s.80JJA is concerned, a look at sub-section (1) of the said section is required, which is reproduced below :

> *80JJAA(1) : Where the gross total income of an assessee, being an Indian company, includes any profits and gains derived from any industrial undertaking engaged in the manufacture of production of article or thing, there shall, subject to the conditions specified in sub-section (2)m be allowed a deduction of an amount equal to thirty per cent of additional wages paid to the new regular workmen employed by the assessee in the previous year for three assessment years including the assessment year relevant to the previous year in which such employment is provided.*

27. A reading of the above sub-section would clearly show that the deduction is given on profits and gains derived from industrial undertaking engaged in manufacture of production of article or thing. It is only for quantification of the amount that 30% is applied. In our opinion the deduction is very much linked to the profits of the undertaking. We are therefore unable to accept this line of argument taken by the counsel. In the result, we hold that assessee is not eligible for deduction u/s.80JJAA of the Act, in respect of its units 2 , 3 and 4. However, denial of such claim in respect of unit-1, where it was not claiming any deduction, in our opinion is incorrect. We, therefore set aside the orders of authorities below for the limited purpose of quantifying the eligible deduction u/s.80JJA in respect of Unit-1. In the result, ground no.6 is treated as partly allowed for statistical purpose."

16. As far as ground No.6.3 is concerned, the issue has been decided in Assessment Year 2007-08 in the order referred to above and this Tribunal held that the employees engaged in software industry cannot be regarded as workmen for the purpose of section 80JJAA of the Act. The following were the relevant observations of the Tribunal:

> *"24. We have perused the orders and considered the rival contentions. The claim of assessee with regard to additional wages paid to new workman was denied for a reason that engineers who were newly employed by the assessee were not considered as workers by the lower authorities. However, in a similar situation in the case of Texas Instruments India P. Ltd, (supra), it was held by the coordinate bench at para 6 and 7 of its order, as under :*
>
> > *6. We have heard the rival submissions and carefully perused the records. Considering the factual position after referring to the various documents filed by the assessee, the learned CIT(A) held as under :*
> >
> > *"According to the AO if an employee or workman is getting a salary of more than Rs. 1,600 per month he is not covered by the definition of workman. However as per cl. (iv) of s. 2(s) of the Industrial. Disputes Act a worker, employed in supervisory capacity and getting a salary of more than Rs. 1,600 per month only be excluded from the definition of workman. In appellant's case the software engineers in respect of whom deduction under s. 80JJAA has been claimed have not been employed in a supervisory capacity even though they may be getting a salary of more than Rs. 1,600 per month. As the software engineers were not employed in supervisory capacity they cannot be excluded from the definition of workman. Further as per the notification of the Karnataka Government, the appellant company engaged in the development of software is covered by the Industrial Disputes Act. As such, I am of the considered opinion that the appellant has satisfied all the conditions for claiming relief under s. 80JJAA. However, I find that the appellant has claimed deduction of Rs. 2,55,81,220 with reference to the additional*

wages of Rs. 8,52,70,736 which included the wages of Rs. 4,87,64,029 in respect of the new workmen employed during the year ended 31st March, 2000 relevant to the asst. yr. 2000-01. As there was no claim for relief under s. 80JJAA for the asst. yr. 2000-01, the relief in respect of the workers employed in asst. yr. 2000-01 cannot be considered for relief under s. 80JJAA in the asst. yr. 2001-02. As such the appellant will be entitled for relief under s. 80JJAA of Rs. 1,09,52,012 being 30 per cent of the additional wages of Rs. 3,65,06,707 (Rs. 8,52,70,736 Rs. 4,87,64,029) in respect of the new workmen employed during the previous year relevant to the asst. yr. 2001-02. Similarly, for asst. yr. 2002-03 the appellant has claimed deduction of Rs. 4,78,05,176 being 30 per cent of the wages of Rs. 1,59,30,588 which also included the wages of Rs. 4,38,68,182 pertaining to the new workers employed in the previous year 1999- 2000. For the reasons mentioned above the appellant is not entitled for relief under s. 80JJAA in respect of the wages pertaining to the workers employed in the previous year 1999-2000. As such the appellant would be eligible for relief of Rs. 3,46,44,722 being 30 per cent of the additional wages of Rs. 11,54,82,406 (Rs. 15,93,50,588 Rs.4,38,68,182) in respect of the workmen employed in previous years 2000-01 and 2001-02. The learned Authorised Representatives of the appellant vide order-sheet noting dt. 24th Aug., 2004 agreed that the relief under s. 80JJAA in respect of the employees who joined in the previous year relevant to the asst. yr. 2001-02 onwards only may be considered and in respect of the employees who joined in earlier years the appellant is not pressing for relief under s. 80JJAA. In the circumstances, the AO is directed to allow the relief under s. 80JJAA of Rs. 1,09,52,012 and Rs. 3,46,44,722 for asst. yrs. 2001-02 and 2002-03 respectively."

7. As stated earlier the assessee had filed the details of the software engineers employed during the years under consideration containing the names of the employees, designation and date of joining. Further, in the same list the details of total number of employees joined during both the assessment years, number of employees without supervisory roles, workmen joined, number of supervisors joined and

workmen joined and relieved during the years under consideration. A cursory perusal of this list shows that the assessee had claimed deduction in respect of employees, who had joined as engineers in their respective field such as systems engineer, test engineer, software design engineer, IC design engineer, lead engineer etc. A cursory perusal of those lists establishes that the assessee had claimed deduction in respect of the engineers employed not in the category of supervisory control. All these details were filed before the AO during assessment proceedings. These facts were not properly considered by the AO. Further, from the order of the CIT(A), it is seen that he had taken note of the notification issued by the Government of Karnataka and concluded that as per the notification issued, the assessee company engaged in the development of software is covered by the Industrial Disputes Act, 1947. Further it is not the case of the Revenue that the assessee did not fulfil the conditions extracted elsewhere in this order. Considering all those factual matters we do not find any infirmity in the order of CIT(A) according relief to the assessee. In fact he had clarified the relevant portions related to Industrial Disputes Act, 1947 and IT Act while granting relief to the asssessee which are extracted at pp. 5 and 6 of this order. After carefully considering the same, we are inclined to accept the reasons shown by the learned CIT(A). The learned CIT-Departmental Representative could not assail the finding reached by the learned CIT(A) by bringing in any valid materials. The order of the CIT(A) is confirmed. It is ordered accordingly.

There is no case for the Revenue that assessee had failed to file details of software engineers employed by it. In our opinion software engineers newly employed by it fell within the meaning of the word 'workmen'."

17. We are of the view that ground Nos.6 and 6.4 should be decided in the light of the directions given above by the AO afresh after affording opportunity of being heard to the assessee.

18. As far as Grd.No.7 of the rephrased ground of appeal of the assessee is concerned, the same can be conveniently discussed and decided together with Ground No.4 raised by the Revenue in its appeal. These grounds read as follows:

> *7. On the facts and circumstances of the case and in law, the learned DRP/ AO erred in not considering the adjustment made under section 4o(a)(ia) in arriving at the profits from business eligible for a deduction under section ioA of the Act. [corresponding to ground no. 7]*

Ground No.4 of Revenue's appeal:

> *4. On the facts and in the circumstances of the case, the DRP erred in directing the Assessing Officer not to exclude the amount disallowed u/s 40(a)(ia) for the purpose of disallowance u/s 10A. The DRP's decision is not in conformity with the ratio of the decision of the Hon'ble ITAT, Ahmedabad Bench 'C' in the case of DCIT, Circle-2(2) Vs. Ramesh Bhai C. Prajapati (29 Taxman.com 64), wherein it was held that the amount disallowed u/s 40(a)(ia) cannot be taken into account to determine profits of business for the purpose of computing deduction u/s 80IB.*

19. The learned counsel for the assessee submitted that with regard to the sum disallowed as expenses which are in violation of Section 40(a)(ia) of the Act, i.e., non deduction of TDS, the business profits eligible for deduction under Section 10A of the Act has not been increased by the expenses disallowed under Section 40(a)(ia) of the Act. Accordingly, the learned Assessing Officer has to compute deduction under Section 10A of the Act on such increased amount. He relied on certain judicial pronouncements in this regard. The DRP has allowed relief to the Assessee

in this regard against which revenue is in appeal. As far as the Assessee is concerned, despite the DRP's direction, the AO in the order passed pursuant to DRP's order did not give effect to the said directions.

20. We have heard the rival submissions. 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.80-IC of the Act and consequently the deduction u/s.10A 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".

21. 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?"

18. 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:-
>
> > 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".

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:

"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."

22. In view of the aforesaid decisions and the CBDT Circular No.37/2020, we are of the view that there is no merit in ground no.4 raised by the revenue. As far as Grd.No.7 raised by the assessee, the same projects the grievance of the assessee that despite directions by the DRP to allow deduction on profits as enhanced by the disallowance u/s.40a(ia) of the Act, the AO in the order giving effect to the directions of the DRP, which is impugned in this appeal did not allow the claim of the assessee. The AO is directed to allow the claim of the assessee as directed by the DRP which is now confirmed by us.

23. As far as Grd.No.3 raised by the revenue is concerned, the same relates to the exclusion of expenses incurred in foreign currency from total turnover and export turnover while computing deduction u/s.10A of the Act. We have considered the rival submissions. Taking into consideration the decision rendered by the Hon'ble High Court of Karnataka in the case of CIT v. Tata Elxsi Ltd [2012] 349 ITR 98 (Karn), we are of the view that communication charges and expenses incurred in foreign exchange should be excluded both from export turnover and total turnover. We are of the view that as of today, law declared by the Hon'ble High Court of Karnataka which is the jurisdictional High Court is binding on us. Moreover, the order of the Hon'ble Karnataka High Court has been upheld by the Hon'ble Supreme Court in the case of CIT v. HCL Technologies Ltd. in Civil

Appeal No.8489-98490 of 2013 & Ors. dated 24.04.2018. The ground of the revenue is therefore dismissed.

24. The next ground that requires adjudication is the additional ground of appeal with regard to allowing as deductible expenses education cess. The additional ground of appeal being a legal ground which can be adjudicated on the basis of facts already available on record and which has a bearing on the tax liability of the assessee is admitted for adjudication keeping in mind the ration of Hon'ble Supreme Court in the case of NTPC Ltd. 229 ITR 383 (SC). As far as this issue is concerned, this is again settled by the ITAT, Bengaluru Bench, in the case of apten India Pvt. Ltd., ITA 2679/Bang/2017 dated 06.11.2020 wherein it was held that education cess and secondary and higher education cess is deductible as business expenditure under section 37 (1) of the Act for determining the assessed income. The view so taken was on the basis of the decisions in the case of Sesa Goa Ltd. vs. Joint Commissioner of Income-tax. 1(2020) 117 taxmann.com 96 (Bombay High Court)] Reckitt Benckiser (I) Pvt. Ltd. vs. Deputy Commissioner of Income-tax [(2020) 117 taxmann.com 519 (Kolkata Tribunal)] ITC Limited vs. Assistant Commissioner of Income-tax [I.T.A No. 1267 /Kol/2014(Kolkata Tribunal)] The Peerless General Finance & Investment Co. Ltd. vs. Deputy Commissioner of Income-tax [ITA No. 1439/Kol/2018 (Kolkata Tribunal)] Tata Steel Limited vs. Assistant Commissioner of Income-tax [ITA No. 5573/Mum/2012 (Mumbai Tribunal) wherein it was held that education cess and secondary and higher education cess is not in the nature of tax which is not deductible expenditure. Following the decisions referred to above, we allow the additional ground of appeal.

25. In the result, the appeal of the assessee is partly allowed while the appeal of the Revenue is dismissed.

Pronounced in the open court on the date mentioned on the caption page.

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

Bangalore,
Dated : 29.11.2021.
/NS/*

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

By order

Assistant Registrar
ITAT, Bangalore.