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

Before Shri B.R. Baskaran (AM) & Shri Rahul Chaudhary (JM)

I.T.A. No. 581/Mum/2022 (A.Y. 2017-18)

Hindustan Construction Company Limited Hincon House, LBS Marg Vikhroli West, Mumbai-400 083. PAN : AAACH0968B	Vs.	National Faceless Assessment Centre Delhi & DCIT-14(1)(1) Mumbai
(Appellant)		(Respondent)

Assessee by	Shri H.P. Mahajani
Department by	Dr. Yogesh Kamat
Date of Hearing	22.12.2022
Date of Pronouncement	10.03.2023

O R D E R

Per B.R.Baskaran (AM) :-

The assessee has filed this appeal challenging the assessment order dated 28th of March 2018 passed by the assessing officer under section 143(3) r.w.s. 144C(13) of the Act for assessment year 2017-18 in pursuance of directions given by the learned Dispute resolution panel (DRP).

2. The assessee is a multinational company engaged in the business of construction of technically complex and high-value projects across all business segments. It has constructed more than 28% of India's hydro power and over 65% of India's nuclear power generation capacities. The major projects executed across India are roads and expressways, tunnels, bridges, dams and barrages and also India's 1st and longest open sea cable stayed bridge.

3. The assessing officer passed a draft assessment order proposing various additions including transfer pricing adjustment made by the Transfer Pricing

Officer (TPO) and the same were partly confirmed by Ld DRP in the objections filed by the assessee against the draft assessment order. Accordingly, the AO passed the final assessment order, which is being challenged before us by the assessee.

4. The first issue contested by the assessee relates to the transfer pricing adjustment made in respect of Corporate Guarantee given by the assessee in favour of its Associated Enterprises (AE), viz., M/s HCC Mauritius Enterprises Ltd and M/s HCC Mauritius Investment Ltd in respect of loans taken by them from EXIM bank in foreign currency. The aggregate amount of Corporate Guarantee given by the assessee was Rs.213.18 crores. It was submitted that the Corporate Guarantee so given would benefit the assessee and hence it is in the nature of share holder's activity. It was explained that the loan was obtained by the AEs on the strength of the Guarantee given by the assessee and it enabled repayment of Inter Corporate Deposits partly and also enabled acquisition of M/s Karl Steiner AG, Switzerland through the AEs. Accordingly, it was contended that the provision of guarantee was purely towards furthering its own business activities. It was also submitted that the assessee did not incur any expenditure in that regard. Accordingly, it was contended that no transfer pricing adjustment is called for.

4.1 The TPO did not accept above said contentions. He held that an independent enterprise would have charged commission on providing such types of guarantees in respect of credit facilities obtained by other concern. Further, taking support of the decision rendered in the case of Aztec Software & Technology Service Ltd vs. ACIT (2007)(107 ITD 141)(Bang), the TPO proceeded to determine the ALP of provision of corporate guarantee to the AEs. In this regard, he examined the guarantee commission charged by various banks and noticed that the same ranged from 1.75% to 3% and the average rate of commission worked out to 2.18%.

4.2 The TPO further referred to the decision rendered by Hon'ble Bombay High Court in the case of CIT vs. Everest Kento Cylinders Ltd (378 ITR 57)(Bom) and the decision rendered by the Mumbai Tribunal in the case of Glenmark Pharmaceuticals Ltd vs. Addl CIT (2014)(62 SOT 79) and held that a "downward adjustment" to naked quotes made by banks should be made. Accordingly, the TPO made downward adjustment of 0.18% to the average rate of commission worked out by him and accordingly determined that the transfer pricing adjustment should be made by charging commission @ 2%.

4.3 With regard to the guarantee commission of 0.50% determined by Hon'ble Bombay High Court in the case of Everest Kento Cylinders Ltd (supra), the TPO expressed the view that the said decision cannot be followed for the following reasons:-

(a) In the case of Everest Kento, the Indian entity had taken a quote from ICICI Bank of India, where as the actual transaction was obtaining of loan by the assessee's foreign entity from a bank situated in foreign jurisdiction. The quote obtained was related to the rate to be charged for guarantee for Everest Kento and was not for standing as guarantor for loan taken by foreign AE.

(b) The ICICI Bank has actually quoted rate of 0.60% and hence, after making downward adjustment, the rate of guarantee commission was fixed at 0.50%.

Accordingly, the TPO determined the rate of guarantee commission at 2% and made transfer pricing adjustment of Rs.4,46,38,055/- and the same was upheld by Ld DRP.

4.4 We heard the parties on this issue and perused the record. It was submitted by Ld A.R that the co-ordinate bench of the Tribunal has determined the guarantee commission @ 0.50% in the assessee's own case in AY 2011-12 in ITA No.2432/Mum/2018 following the decision rendered by Hon'ble Bombay High Court in the case of Everest Kento Cylinders Ltd (supra). On the contrary, the Ld D.R submitted that the assessee has not benchmarked the above said international transaction of providing corporate

guarantee and hence the TPO has determined the rate of commission @ 2% by obtaining quotes from Indian banks. He further submitted that the TPO has distinguished the decision rendered in the case of Everst Kento Cylinders Ltd (supra).

4.5 We notice that the TPO has expressed the view that the AEs in the case of Everest Kento Cylinders Ltd (supra) had obtained loan from foreign banks located outside India on the basis of guarantee given by an Indian enterprise and further the quote obtained from ICICI Bank was only 0.60%. Accordingly, the TPO has held that the decision rendered in the above said case by Hon'ble Bombay High Court is distinguishable. However, the fact remains that the AEs have obtained loan from EXIM bank in foreign currency only, in respect of business carried on by them outside India. Further, it is not clear as to whether the quotes obtained by TPO from Indian banks were related to foreign currency loans. Hence, the distinction made by the TPO, in our view, is not acceptable. We notice that the co-ordinate bench has restricted the guarantee commission to 0.50% in AY 2011-12 following the decision rendered by jurisdictional Hon'ble Bombay High Court in the case of Everest Kento Cylinders Ltd (supra). Consistent with the view taken by the co-ordinate bench, we direct the AO/TPO to restrict the rate of guarantee commission to 0.50% and compute transfer pricing adjustment accordingly.

5. The next issue contested by the assessee relates to the transfer pricing adjustment made in respect of interest charted on the inter-corporate deposits given by the assessee to its AEs. The assessee had given ICD-1 in FY 2010-11 @ 3 months LIBOR + 300 bps. It had also given two more ICDs in FY 2014-15 @ 6 months LIBOR + 400 bps. Both the loans/ICDs were outstanding during the year under consideration. The TPO considered 6 months LIBOR + 400 bps as internal CUP and made Transfer pricing adjustment of Rs.1,10,54,453/-. The Ld DRP confirmed the same.

5.1 It is the submission of the learned AR that the coordinate bench has determined the interest rate at LIBOR + 300 bps in assessment year 2011-12 and accordingly prayed that the same rate may be adopted in this year in respect of 1st loan. On the contrary, the learned DR has submitted that the assessee itself has paid interest under at LIBOR +400 bps on the subsequent ICDs given in FY 2014-15 and the same constitute internal cup. He further submitted that the Safe Harbour Rules issued by CBDT for the subsequent period has determined the interest rate at LIBOR + 400 bps. Accordingly, the Ld DR contended that the TPO was justified in adopting the ALP of interest on ICDs at uniform rate of 6 months LIBOR + 400 bps.

5.2 We agree with the contentions of Ld DR on this issue. In respect of two items of ICDs placed with the AEs in FY 2014-15, the assessee itself has charged interest @ 6 months average LIBOR + 400 bps. Hence, the same constitutes internal CUP, which should be adopted uniformly on all the ICDs given by the assessee to its AEs, since the transfer pricing adjustment is made for the current year. Hence the situation that prevailed in FY 2010-11 is not relevant for the year under consideration. Since the assessee could collect interest at 6 months average LIBOR + 400 bps during the year under consideration in respect of two of its ICDs, the same was rightly taken as internal CUP. Accordingly, we hold that the AO/TPO was justified in making Transfer pricing adjustment of Rs.1,10,54,453/- on the ICDs placed in FY 2010-11, which were outstanding during the year under consideration. This ground of appeal of the assessee is accordingly rejected.

6. The next issue contested by the assessee is whether the "retention money" in respect of contracts executed by the assessee is liable to be included in the gross receipts in terms of sec. 43CB or not?.

6.1 The AO noticed that the assessee has excluded a sum of Rs.44.75 crores relating to retention money while computing gross receipts as per the

accounting system followed by it, i.e., the retention money shall be offered to tax when it was actually received. The "retention money" is the amount retained by the customer of the assessee out of the gross contract receipts pending assessment of quality of work and settlement of disputes, if any. It shall be released by the customer to the assessee, after settling all disputes, which may result in reducing of contract amount by way of recoveries for damages and rectifications. Hence the assessee followed the system of offering retention money as its contract receipts on "cash system".

6.2 During the year under consideration, the assessee excluded retention money of Rs.44.75 crores retained by the customers. However, it included as sum of Rs.95.91 crores, being retention money of earlier years received by the assessee during the year under consideration.

6.3 The AO took the view that the provisions of sec.43CB r.w ICDS -3 mandate inclusion of retention money in Gross contract receipts. Accordingly, he added the retention money of Rs.44.75 crores to the total income of the assessee. The assessee submitted before Ld DRP that the ICDS-3 contains transitory provisions, whereby in respect of contracts commenced on or before 31st March 2016 and not completed by that date, the contract costs may be recognized on the basis of method of accounting regularly followed earlier. However, the Ld DRP concurred with the view taken by the AO. In respect of reliance placed by the assessee on transitory provisions contained in ICDS-3, the Ld DRP expressed the view that such kind of transitory provision is not available in sec. 43CB and accordingly held that the benefit of ICDS-3 cannot be given to the assessee.

6.4 We heard the parties and perused the record. Sec. 43CB was introduced by the Finance Act. 2018 with retrospective effect from 1.4.2017 and hence the same is applicable from AY 2017-18 onwards. The said section reads as under:-

"Section 43CB: (1) The profits and gains arising from a construction contract or a contract for providing services shall be determined on the basis of percentage of completion method *in accordance with the income computation and disclosure standards notified under sub-section (2) of section 145*:

Provided that profits and gains arising from a contract for providing services,—

(i) with duration of not more than ninety days shall be determined on the basis of project completion method;

(ii) involving indeterminate number of acts over a specific period of time shall be determined on the basis of straight line method.

(2) For the purposes of percentage of completion method, project completion method or straight line method referred to in sub-section (1)—

(i) the contract revenue shall include retention money;

(ii) the contract costs shall not be reduced by any incidental income in the nature of interest, dividends or capital gains."

As per sub-section (1), the profits and gains arising from a Construction Contract shall be determined on the basis of Percentage Completion Method and as per sub-section (2), the contract revenue shall include "retention money". Section 145(2) of the Act enabled the Central Government to notify in the Official Gazzette from time to time "Income Computation and Disclosure Standards" (ICDS). The Central Government has notified ICDS-III with effect from 1.4.2017, i.e., from AY 2017-18 relating to "Construction Contracts". As per sec. 145(2), the ICDS are required to be followed by any class of assessees or in respect of any class of income. As per clause 10 of ICDS-III, the Contract revenue shall comprise of the initial amount of revenue agreed in the contract, including retentions. As per clause 16 of ICDS-III, the contract revenue should be recognized under Percentage Completion Method. The ICDS-III also contains following "Transitional Provisions", which read as under:-

> "Transitional Provisions
> 22.1 Contract revenue and contract costs associated with the construction contract, which commenced on or after 1st day of April, 2016 shall be recognised in accordance with the provisions of this standard.
>
> 22.2 Contract revenue and contract costs associated with the construction contract, which commenced on or before the 31st day of March, 2016 but not completed by the said date, shall be recognised based on the method regularly followed by the person prior to the previous year beginning on the 1st day of April, 2016."

We notice that the assessee has placed reliance on the above said transitory provisions in order to contend that the benefit of above said provisions should be given to it and accordingly, the "retention money" not included by the assessee should not be included as the relevant contracts have commenced on or before 31st day of March, 2016. The same was rejected by Ld DRP with the following observations:-

> "Thus, section 43CB(2) is categorical and unambiguous in stating that the retention money shall be included in the contract revenue for the purpose of computation under ICDS. No reference has been made to the transitory provisions. Thus, the provisions in the Act appear to be at odd with the provisions contained in the Standards. Here our attention goes to the Preamble of the standards which states that *"In the case of conflict between the provisions of the Income tax Act, 1961 ("the Act") and this Income computation and Disclosure Standard, the provisions of the Act shall prevail to that extent."* Hence, there is no scope for any confusion or misunderstanding. The express provisions of the Act shall override any confliction provision in the standards if they are more beneficial to the assessee.
>
> Hence on a closure look this issue is not as what it appeared to be. The assessee is protected neither by the principle of conservatism nor principle of consistency or even the favourable judicial rulings in its favour in the past even by the jurisdictional High Court. This is because of change of Law.
>
> In view of the above the action of the Assessing Officer is upheld and objection no.2 of the assessee is rejected."

6.5 The Ld A.R contended that the basic principle that "the income should accrue" to the assessee before recognizing it as income still prevails even after introduction of sec. 43CB and ICDS-III. In this regard, he referred to ICDS-1, wherein it is stated that "revenue to be recognized as they are

'earned' and also to sec. 5(1)(b) of the Act, which provides for taxation of income which 'accrues or arises or is deemed to accrue or arise…' to the assessee. He also referred to clause 9 of ICDS-III, wherein it is stated that "Contract revenue shall be recognized when there is reasonable certainty of its ultimate collection". Accordingly, he submitted that there is uncertainty about the collection of "retention money", till all claims and disputes relating thereto are settled. Accordingly, he submitted that the term "retentions" used in the meaning of "Contract revenue" should be understood as the "undisputed retentions" over which the assessee has obtained its right of recovery. In this regard, he also invited our attention to Circular No.10/2017 dated 23-03-2017 issued by CBDT, particularly FAQ no.11, which reads as under:-

> "11. Whether the recognition of retention money, receipt of which is contingent on the satisfaction of certain performance criterion is to be recognized as revenue on billing?
> **Answer**:-
>
> "Retention Money, being part of overall contract revenue, shall be recognized as revenue subject to reasonable certainty of its ultimate collection condition contained in para 9 of ICDS-III on Construction Contracts."

6.6 The Ld A.R further submitted that there is no conflict between sec. 43CA and ICDS-III as understood by Ld DRP. He submitted that sec. 43CB(1) itself provides for determination of profits and gains as per ICDS-III, which includes the transitory provision. Accordingly, he contended that the transitory provision given in clause 22 of ICDS-III shall have application to the case of the assessee.

6.7 The question as to whether the "retention money" has accrued to the assessee or not, in our view, would depend upon the terms and conditions of contract entered between the assessee and the contractee. In the facts of the present case, in our view, the said question need not be gone into for the reasons discussed in the succeeding paragraph. Accordingly, we leave this question open so that it can be considered in appropriate case.

6.8 The Ld A.R invited our attention to the Transitory provisions given in ICDS-III. In our view, in the facts of the present case, the question whether the "retention money" should be included in "Contract revenue" or not should be examined by considering the transitory provisions given in clauses 22.1 and 22.2 of ICDS-III. We noticed that the above clauses state that the retention money related to the construction contracts commenced before 31.03.2016 should be recognized in accordance with the method regularly followed by the assessee. In the instant case, it is submitted that the impugned retention money was related to the contracts commenced before 31.3.2016. Hence, in accordance with the transitory provision, referred above, the retention money should be brought to tax in accordance with the accounting method regularly followed by the assessee. We noticed earlier that the assessee has been following cash system of account for accounting retention money and the same should be followed in the current year also. We also agree with the contention of the Ld A.R that there is no conflict between sec. 43CB and ICDS-III as presumed by Ld DRP, since as per the provisions of sec. 43CB, revenue from construction contracts should be recognized as per ICDS-III.

6.9 In view of the foregoing discussions, we are of the view that there is no requirement of including Rs.44.75 crores, being retention money not accrued to the assessee, in the value of contract receipts. Accordingly, we direct the AO to exclude the same from "Contract revenues".

7. The next issue relates to the disallowance of Rs.2,82,55,936/- relating to notional foreign exchange gain or loss. We notice that the Ld DRP itself has observed that

> "there appears to be some disconnect between the factual position as explained by the assessee during the course of DRP proceedings and assumption based on which addition has been made by the assessing officer…"

Accordingly, the Ld DRP has restored this issue to the file of the assessing officer holding that this matter requires factual verification. Accordingly, the Ld DRP has also issued the items that are required to be checked in connection with this issue. However, in the final assessment order, the AO retained the addition made by him on this issue.

7.1 The Ld A.R submitted the claim of Rs.2,82,55,936/- is aggregate amount of two items, viz.,

(a) Rs.68,47,259/- being a gain credited to P & L account on transfer from an account called "Foreign Currency Monetary Translation Account" (FCMTA) and

(b) Rs.2,14,08,677/-, being a loss on restatement of monetary item being inter corporate deposit placed with HCC Mauritius Enterprises Ltd, which is debited directly to FCMTA account.

The Ld A.R submitted that the assessee reduced the amount of Rs.68,47,259/- from Net profit, since it does not pertain to the year under consideration. However, it claimed deduction of Rs.2,14,08,677/- while computing total income, even though not debited to P & L account, since it pertained to the year under consideration. He submitted that both the above said claims are in accordance with the accounting policy regularly followed and also complies with the requirement of sec. 43AA as well as ICDS-VI. He submitted that the AO has not correctly appreciated these factual aspects.

7.2 We heard Ld D.R on this issue and perused the record. We notice that the AO, in the final assessment order, has not made discussions on the questions, which according to Ld DRP requires verification. Further, we notice that the above said factual aspects presented by the assessee have not also been considered by the AO. Accordingly, we are of the view that this issue requires fresh verification at the end of AO. Accordingly, we set aside

the addition made by the AO on this issue and restore the same to his file for examining it afresh in accordance with the law.

8. The next issue relates to the disallowance made u/s 14A of the Act. The Ld A.R submitted that the assessee has earned exempt income of Rs.3,28,150/-, while it was holding investments to the tune of Rs.148.57 crores. The assessee did not make any disallowance u/s 14A of the Act. Hence the AO computed disallowance @ 1% of the value of investments as per Rule 8D(2)(ii) and accordingly added a sum of Rs.1,48,57,000/- to the total income of the assessee. The Ld DRP also confirmed the same.

8.1 The Ld A.R submitted that the disallowance may be computed by considering only those investments which have yielded exempt income, as held by the Special bench of Delhi ITAT in the case of Vireet Investment (P) Ltd (2017)(82 taxmann.com 415).

8.2 We heard Ld D.R on this issue and perused the record. We find merit in the submissions made by Ld A.R. Accordingly, we direct the AO to compute disallowance by considering only those investments which have yielded exempt income, as held by the Special bench of Delhi ITAT in the case of Vireet Investment (P) Ltd (2017)(82 taxmann.com 415).

9. The next ground relates to the addition to be made in respect of expenditure in earning exempt income under clause (f) of Explanation 1 to sec. 115JB for the purpose of computing Book Profit. The Special bench in the case of Vireet Investment (P) Ltd (supra) has held that the disallowance computed u/s 14A should not be imported in clause (f), meaning thereby, the disallowance under clause (f) of Explanation 1 to sec. 115JB has to be computed on the basis of annual accounts. Accordingly, we restore this issue to the file of AO with the direction to compute the addition to be made under clause (f) to Explanation 1 to sec. 115JB on the basis of annual accounts.

10. Next issue urged by the assessee relates to the disallowance of Rs.74.32 lakhs, being expenditure incurred towards Corporate social responsibility. The Assessing Officer disallowed the above said claim by invoking provisions of Explanation 2 to section 37(1) of the Act, which states that any expenditure incurred on the activity relating to the Corporate social responsibility referred to in section 135 of the Companies' Act 2013, shall not be deemed to be expenditure incurred for the purpose of business or profession.

10.1 Before learned DRP, the assessee submitted that the expenses have been incurred at the 'head office' and various project sites in connection with business carried on by the assessee. Accordingly it was claimed that these expenses have been incurred out of commercial expediency in the larger interest of the workers and hence it is allowable as business expenditure. However, the Learned DRP did not accept the contentions of the assessee. Accordingly, it confirmed the disallowance made by the Assessing Officer.

10.2 The Learned AR submitted that the assessee has incurred expenditure towards Corporate social responsibility under various heads like Salary to skill development institution for promoting education, Sanitation facility for community, Rural development works, Sports support, Disaster support, Environmental sustainability etc. He further submitted that there is live nexus with the business carried on by the assessee and hence it is allowable as deduction.

10.3 We have heard learned DR on this issue and perused the record. Even though the assessee claims that the expenses incurred by it towards corporate social responsibility have live nexus with the business carried on by the assessee, yet we noticed from the breakup of the expenses given at page No. 325-326 of the paper book, that these expenses have been incurred

by the assessee as social service activities for the community residing nearby projects undertaken by the assessee. Thus these expenses have been incurred towards community welfare activities as required under the Companies Act as CSR activities only, i.e., the assessee has not demonstrated as to how these expenses have nexus with the business carried on by the assessee. Further Explanation 2 to section 37(1) specifically provides for disallowance of the expenditure incurred towards corporate social responsibility. Accordingly, we are of the view that the Assessing Officer was justified in making this disallowances.

11. The next issue contested by the assessee relates to disallowance of interest expenditure of Rs.33.84 crores. The Assessing Officer noticed that the interest expenditure of Rs.33.84 crores was disallowed by him in the immediately preceding assessment year i.e. A.Y. 2016-17. Since there was no material change on the facts relating to the above said disallowance, the Assessing Officer disallowed the interest to the extent to Rs. 33.84 crores during the year under consideration also.

11.1 Before learned DRP, the assessee submitted that it has challenged the disallowance made by the Assessing Officer in A.Y. 2016-17 by filing the appeal before the learned CIT(A) and the same is pending. It was submitted that the above said interest disallowance related to the interest free loan given by the assessee to its 100% subsidiary named M/s. HCC Real Estate Limited. It was submitted that the above said interest free loan was given to the subsidiary out of commercial expediency and further the assessee is having sufficient interest free funds also. Accordingly, it was contended before learned DRP that no disallowance is called for. However, learned DRP did not accept the contention of the assessee.

11.2 The Ld DRP noticed that the assessee has given interest free loan of Rs.294.27 crores to its subsidiary, while it has incurred finance cost of

Rs.698.88 crores. In view of huge finance expenses incurred by the assessee, the Ld DRP confirmed the disallowance.

11.3 We notice that neither Ld DRP nor the assessing officer has examined two main contentions of the assessee, viz.,

(a) the interest free loans were given out of commercial expediency and

(b) Sufficient interest free funds exceeding the amount of interest free advances are available with the assessee.

There should not be any doubt that if any one of the above said contentions are found to be correct, then no disallowance of proportionate interest expenses is required to be made. Since both these contentions require examination of factual aspects, we restore this issue to the file of AO for examining it afresh.

12. The next issue relates to the contention that the AO has given short credit of TDS. It is submitted that the assessee has made TDS claim of Rs.29.09 crores. However, the AO has allowed credit of Rs.26.54 crores only. Since this matter requires verification of facts, we restore this issue to the file of AO for examining the claim of the assessee in accordance with law.

13. The next issue relates to the correct quantification of carry forward business losses and long term capital losses. Since this matter also requires verification of facts, we restore this issue to the file of AO for examining the claim of the assessee in accordance with law.

14. The last issue relates to the quantification of interest granted u/s 244A of the Act on the refund amount given to the assessee. According to the assessee, it is entitled for interest of Rs.1.89 crores, i.e., upto the date of refund. However, the AO has granted interest of Rs.1.62 crores only.

Accordingly it is prayed that the AO may be directed to grant correct amount of interest. Since this matter also requires verification of facts, we restore this issue to the file of AO for examining the claim of the assessee in accordance with law.

15. In the result, the appeal of the assessee is treated as partly allowed for statistical purposes.

Pronounced in the open court on 10.3.2023.

Sd/-	Sd/-
(RAHUL CHAUDHARY)	(B.R. BASAKARAN)
Judicial Member	Accountant Member

Mumbai; Dated : 10/03/2023

Copy of the Order forwarded to :

1. The Appellant
2. The Respondent
3. The CIT(A)
4. CIT
5. DR, ITAT, Mumbai
6. Guard File.

BY ORDER,

//True Copy//

(Assistant Registrar)
ITAT, Mumbai

PS