

**IN THE INCOME TAX APPELLATE TRIBUNAL  
“J” BENCH, MUMBAI**

**BEFORE SHRI ABY T VARKEY, JUDICIAL MEMBER &  
SHRI AMARJIT SINGH, ACCOUNTANT MEMBER**

**ITA Nos.2261 & 5122/Mum/2017**

**(A.Y. 2012-13 & 2013-14)**

UBS AG Level 3, 2 North Avenue Maker Maxity, Bandra Kurla Complex, Bandra East, Mumbai – 400 051	Vs.	Deputy Commissioner of Income Tax (IT)-4(3)(1) Air India Building, Nariman Point Mumbai
स्थायी लेखा सं./जीआइआर सं./PAN/GIR No: AAACU5003G		
Appellant	..	Respondent

Appellant by :	Dhanesh Bafna & Chandni Shah
Respondent by :	Manoj Kumar

Date of Hearing	04.05.2023
Date of Pronouncement	24.05.2023

**आदेश / O R D E R**

**Per Amarjit Singh (AM):**

Both these 2 appeals filed by the assessee are directed against the order of AO made in pursuance to the direction of Dispute Resolution Panel. Since these appeals are based on identical fact and similar issue, therefore, for the sake convenience both these appeals are adjudicated together by taking the ITA No. 2261/Mum/2017 as a lead case and its finding will be applied mutatis mutandis to the other appeal wherever applicable.

**ITA No. 2261/Mum/2017**

- “1. The learned Deputy Commissioner of Income Tax International Tax, Range 4(2)(2) (Ld AO). Mumbai erred on the facts and circumstances of the case and in law in making an addition to the total income of the

*Appellant amounting to Rs. 7,43,22,199, in pursuance to the directions of the Hon'ble Dispute Resolution Panel (DRP) upholding the adjustment to the transfer price proposed by the learned Transfer Pricing Officer (Ld TPO)*

- 1.1 *The Ld DRP/AO/TPO erred in re-computing the Arms Length Price (ALP) of the international transaction pertaining to receipt of fees for marketing of fixed income products, including interest rate derivative products (collectively known as FID business) by the Appellant from its Associated Enterprises (AEs) as Rs.11,14,83,299 as against Rs.371,61,100 and hence making an adjustment of Rs 7,43,22,199, without appreciating the Functions Asset and Risk (FAR) Analysis documented by the Appellant in the Transfer Pricing Study Report and various supporting documents, information, explanation submitted by the Assessee*
- 1.2 *The Ld DRP/ AO / TPO erred in holding that entire market spread belongs to the Appellant and allocation of market spread is without any basis*

*It is prayed that the adjustment be deleted*

2. *On the facts and circumstances of the case, the Ld DRP / AO / TPO erred in questioning the commercial expediency of the manner in which the Appellant and its AEs carry on their business.*
3. *On the facts and circumstances of the case. The Ld DRP/AO/ TPO erred in not accepting the Appellant's transfer pricing policy for FID business which is consistently applied across jurisdictions and has been accepted by Indian tax authorities in prior years i.e from assessment year ('AY') 2006- 07 to AY 2010-11.*

*It is prayed that the adjustment be deleted*

4. *On the facts and circumstances of the case and in law, the Ld DRP erred in confirming the action of the Ld AO in disallowing deduction of employee stock options expenditure amounting to Rs.18,56,34,440/*

*The Appellant therefore prays that the Ld. AD be directed to allow the deduction of employee stock option expenditure amounting to Rs. 18,56,34,440/- as revenue expenditure u/s 37(1) of the Act.*

5. *Without prejudice to Ground No 4, on the facts and circumstances of the case and in law, the Ld. DRP erred in not following the order of the Hon'ble Income-tax Appellate Tribunal in the Appellant's own case for AY 2009-10, thereby confirming the action of the AO in disallowing deduction of employee stock options expenditure amounting to Rs.18,56,34,440-*

*The Appellant therefore prays that the Ld AO be directed to follow the order of the Hon'ble Tribunal in the Appellant's own case for AY 2009-10 and allow the deduction of employee stock option expenditure amounting to Rs 18,56,34,440/- as revenue expenditure u/s 37(1) of the Act.*

6. *On the facts and circumstances of the case and in law, the Ld DRP erred in confirming the action of the Ld. AO in levying interest under section 234B and 234C of the Act.*

*It is prayed that the adjustment be deleted*

*The Grounds stated above are independent of, and without prejudice to one another.*

*The Appellant craves leave to add to, alter, amend or withdraw all or any of the Grounds of Appeal herein and to submit such statements, documents and papers as may be considered necessary either at or before the time of hearing.”*

2. The assessee is a foreign institutional investor registered with the Securities Exchange Board of India (SEBI) for the purpose of making investment in Indian debt securities. The assessee is a tax resident of Switzerland holding a Tax Residency Certificate (TRC) for the year under consideration. During the previous year relevant to assessment year 2012-13, the assessee has a bank branch in India (Mumbai Branch) which has been a permanent establishment (PE) of the assessee. Further facts of the case are discussed while adjudicating the ground of appeal filed by the assessee.

**Ground No. 1 to 3: (International Transaction fees received for marketing of FIP)**

3. During the year under consideration the Mumbai branch constitutes a Permanent Establishment (PE) of the assessee. The Mumbai branch operates in line with UBS group principles and policies of risk management which were aligned to local regulations wherever required.

4. As per the global trading activity, the assessee undertake Fixed Income Distribution (FID) business which includes distribution / marketing and trading operation of secondary market Fixed Income Products (FIP's). During the year under consideration Mumbai branch has carried out distribution/marketing of the Fixed Income Products

(FIP's) and branch had received a marketing commission/fees of 33% of the market spread for FIP based on the Group's Transfer Pricing Policy (FID TP Policy).

5. During the assessment proceedings for assessment year 2012-13 the case of the assessee was referred to TPO for computation of Arm's Length Price (ALP) of the international transaction pertaining to receipt of commission/fees for marketing of FIP's by the assessee. The TPO has computed ALP of the transaction at Rs.11,14,83,299/- as against Rs.3,71,61,100/- computed by the assessee which led to an adjustment of Rs.7,43,22,199/-. Subsequently, the A.O passed a draft assessment order making an addition of income on account of Transfer Pricing adjustment of Rs.7,43,22,199/- made by the TPO.

6. The assessee filed the objections from the DRP against the making of adjustment of Rs.7,43,22,199/-. The DRP vide direction u/s 144C (5) of the Income Tax Act, 1961 dated 07.11.2016 upheld the adjustment proposed by the TPO amounting to Rs.7,43,22,199/-. Thereafter the AO has passed the final assessment order vide order u/s 144C(13) r.w.s 143(3) dated 23.01.2017 and added the adjustment recommended by the TPO as upheld by the DRP in respect of fees received for the marketing of fixed income product of Rs.7,43,22,199/.

7. During the course of appellate proceedings before us the ld. Counsel at the outset submitted that identical issue on similar facts in the case of the assessee itself had been adjudicated by the ITAT, Mumbai for assessment year 2011-12.

On the other hand, the ld. D.R supported the order of lower authorities.

8. With the assistance of ld. Representative we have perused the order of the ITAT in the case of the assessee for AY 2011-12 vide ITA No.

842/Mum/2016 dated 09.12.2012 and the relevant part of the decision on the issue is reproduced as under:

*“8. We have considered the rival submissions and perused the material available on record. The assessee is a leading wealth manager in Switzerland, Europe, and the Asia-Pacific region. The assessee i.e. UBS AG is the parent entity within the UBS group. The assessee has a branch in India, namely, UBS AG, Mumbai Branch. The Indian branch commences banking operations with effect from 14/01/2009, after obtaining the necessary clearance and approvals from the RBI. The Indian branch of the assessee, inter-alia, provides marketing functions of fixed income products/interest rate derivative products to its associated enterprises. The fixed income distribution business is part of the group’s global trading activity, which involves distribution/sales and trading operations of secondary market fixed income products. During the year under consideration, the Indian branch of the assessee has carried out distribution/marketing of fixed income product lines (which are booked in trading locations) in the secondary market for its associated enterprises, for which it has received marketing commission/fee based on group’s transfer pricing policy.*

*9. The fixed income products are securities, which bear a rate of interest (fixed or floating) and a set maturity. In this transaction, the distribution/marketing locations such as the Indian branch are primarily responsible for generating/originating transactions from third-party clients. This may involve either the purchase or sale of these fixed income products. As part of its function, the Indian branch performs general marketing, client relationship management, and liaison internally for trading and research. On the other hand, UBS AG, the trading location, is engaged in carrying out the function of actually executing and booking trades marketed by the distribution/marketing location like the Indian branch. As per the assessee, the expertise and knowledge base required to trade in these fixed income products resides with the trading location. It is further the submission of the assessee that the salesperson at the marketing location cannot commit to a transaction without traders at UBS AG providing a dealing price (i.e. the price at which the trader is willing to either buy or sell the specified product). Such a commitment is the responsibility of the trader and the salesperson at the marketing location does not have the flexibility to adjust the pricing provided by a trader i.e. provide a discount on the price quoted by the trader. Further, as per the assessee, significant risks including marketing risk and funding and liquidity risk are borne by UBS AG. The assessee, on a global basis, by adopting the OECD guidelines considered the commission basis as the most appropriate transfer pricing method to compensate for the distribution / marketing function performed by the marketing location. Accordingly, in respect of the fixed income products, 33% of the ‘market spread’ was allocated to the marketing location i.e. the Indian Branch.*

*10. The ‘market spread’ is the difference between the market price and bid/ offer price. The ‘bid price’ is the price that the trader quotes to buy the product from the clients, while the ‘offer price’ is the price at which a trader is willing to sell the product to the clients. If the marketer is able to achieve the price higher than the price quoted by the trader to sell the product, the difference is allocated to the marketer. Similarly, if the marketer is able to purchase the product at a price lesser than the price quoted by the trader to buy the product, the difference is*

allocated to the marketer. The same is called 'local spread'. Therefore, whatever additional markup is earned is allocated 100% to the marketer. In respect of interest rate derivatives, 50% of the 'market spread' was allocated to the marketer. During the year, as noted by the TPO on page 3 of its order and by the learned DRP on page 21 of its directions, the assessee executed 9 transactions of fixed income products (including interest rate derivatives). Out of these transactions, the transaction at serial No. 4 resulted in 'local spread' of USD 8000, and the entire amount was credited to the marketing location i.e. the Indian Branch in addition to the allocation of 50% market spread, being a transaction in derivatives. Apart from this transaction, no other transaction has resulted in 'local spread'. It is the claim of the assessee that the benchmarking/allocation of 'market spread' has been done on basis of the global scenario.

11. We find that the TPO without appreciating the FAR of the associated enterprise at the trading location allocated the entire 'market spread' of 11,07,404.89 USD to the assessee's marketing location i.e. the Indian Branch. Further, the learned DRP also rejected the objections filed by the assessee on the basis that the assessee company has executed a transaction in India and therefore the entire 'market spread' belongs to the India Branch. We are of the considered view that the lower authorities failed to appreciate that in the entire transaction, the sales/marketing function and its activities (such as trading) cannot be separated from the other functions, all of which together are necessary elements for the assessee to realise income on these transactions. Therefore, it is necessary to take into consideration the functions performed, assets employed and risks assumed by the trader-associated enterprises, while allocating the commission. It is further pertinent to note that the entire 'local spread', i.e. the markup earned by the marketer either over the price offered by the trader to sell or lower than the price quoted by the trader to buy the product, is entirely allocated to the marketer. Accordingly, in view of the above, we find no merits in upholding the transfer pricing adjustment on this issue. Hence, the TPO/AO is directed to delete the transfer pricing adjustment in respect of international transaction of fees receipt for marketing of fixed income products. As a result, grounds No. 1 – 3 raised by the assessee are allowed.”

9. Following the decision of the ITAT on the similar issue and identical facts as supra we consider that issue contested is squarely covered, therefore, ground no. 1 to 3 of the appeal of the assessee are allowed.

#### **Ground No. 4 & 5: (Deduction of Employee Stock options Expenditure ESOP)**

10. During the year under consideration the assessee has claimed on expenditure amounting to Rs.18,56,34,440/- towards ESOP cost as allowable u/s 37(1) of the Act. The A.O was of the view that ESOP expense debited to the profit and loss A/c was notional in nature since

the assessee had neither laid out or expended any amount while choosing to receive no/lesser securities premium. Vide draft assessment order dated 26.03.2016 the AO has disallowed the assessee's claim of ESOP expenditure.

11. The assessee filed objection before the DRP. The DRP vide directions u/s 144C(5) of the Act dated 07.11.2016 directed the AO to verify as to whether the revenue has filed appeal before the Hon'ble Bombay High Court against the relief on this issue provided by the ITAT vide ITA No. 4825/Mum/2014 dated 27.06.2016. Thereafter the AO passed the final assessment order on 23.01.2017 and disallowed the claim of ESOP expenses.

12. During the course of appellate proceedings before us at the outset the ld. Counsel submitted that identical issue on similar facts has been adjudicated by the ITAT, Mumbai in the case of the assessee for assessment year 2009-10 vide ITA No. 4525/Mum/2014.

On the other hand, the ld. D.R supported the order of lower authorities.

13. Heard both the sides and perused the material on record. With the assistance of the ld. Representative we have gone through the order of the ITAT for assessment year 2009-10. Vide ITA No. 4525/Mum/2014 dated 29.03.2016. The relevant part of the decision is reproduced as under:

*"14. After considering the rival submissions and on perusal of the impugned order of the AO as well as CIT(A), we find that the CIT(A) has allowed only ESOP costs incurred by the Head Office for sum of Rs.1,87,25,998/-. The Head Office of the assessee company had granted various employees, stock compensation awards to some of the employees of the Mumbai Branch under various employee share plans, wherein the shares of the assessee company were allotted to the credits of employees. The claim of ESOP cost relating to the Mumbai Branch was identified and such quantification has also been certified by the independent Accountant which has not been disputed. This being the nature of direct expenses, it has been rightly allowed by the CIT(A) under section 37(1). There is no obligation on the Branch to deduct TDS on such ESOP costs,*

*therefore, qua this expenditure, the finding of the AO is not relevant, however, with regard to other expenses it has been confirmed by the CIT(A) that same has to be computed as per section 44C in view of Article 7(3), the same is not in dispute before us. Accordingly, the order of the CIT(A) is confirmed on this point.”*

14. Following the decision of the ITAT as supra we allow the appeal of the assessee.

**Ground No. 6.**

15. Levy of interest u/s 234B & C is of consequential nature, therefore, this ground of appeal stand dismissed.

**Additional Ground No. 7 (Deduction for education cess)**

16. This ground is not pressed therefore, the same stand dismissed.

**ITA No. 5122/Mum/2017**

**Ground No. 1 & 1.2: (Erred in re-computing the Arm's Length Price of International transaction pertains to receipt of fees for marketing of fixed income product)**

17. These grounds of appeal are based on identical facts and issue as adjudicated vide ground no. 1 to 3 vide ITA No.2261/Mum/2017 supra therefore, applying these findings as mutatis mutandis these grounds of appeal are also allowed.

**Ground No. 2 & 3: (Disallowance of expenditure incurred on employee stock options amounting to Rs.6,30,18,121/-)**

18. These grounds involves identical facts and issue as we have adjudicated vide ground no. 4 & 5 vide ITA No.2261/Mum/2017 supra therefore applying the findings of Ground No. 4 & 5 of ITA No. 2261/Mum/2017 as mutatis mutandis these grounds of appeal are also allowed.

**Ground no. 6: (Initiating of penalty proceedings)**

19. This ground is premature at this stage therefore same is not required any adjudication. Accordingly this ground of appeal stand dismissed.

**Ground No. 5: (Regarding surcharge and education cess)**

20. This ground of appeal has become infructuous because of amendment in the relevant provision in the Act, therefore, the same stand dismissed.

**Ground No. 4: (Taxing of Interest paid to the Head office)**

21. During the course of assessment the A.O noticed that UBS AG HO has received interest of Rs.4,08,99,430/- from its Indian branch. This receipt has been claimed as not taxable in India. On query, the assessee explained that such interest receipt in India could not be attributed to the PE within the meaning of Article 7 of the India Singapore DTAA. It is also submitted that head office and branch are the same entity and as such one cannot make profit out of oneself. The assessee has placed reliance on the decision of ITAT Mumbai in the case of Sumitomo Mitsui Banking Corpn. However, the AO has disallowed the claim of the assessee in the draft assessment order dated 26.12.2016. Against the draft assessment order the assessee filed objection before the DRP. The DRP vide direction u/s 144C (5) of the Income Tax Act, 1961 dated 07.11.2016 has rejected the ground of objection filed by the assessee in order to keep the issue alive in the Hon'ble Supreme Court.

22. During the course of appellate proceedings before us at the outset the ld. Counsel submitted that the above issue of interest received by the head office from the branch is covered in favour of the assessee by the decision of ITAT special bench in the case of Sumitomo Mitsui Banking Corpn Vs. DDIT (IT) (2012) 145 TTJ (Mumbai)(SB) 649 and further submitted that coordinate bench of the ITAT, Mumbai in the

case of BNP Paribas SA Vs. ADIT (IT) dated 16.07.2014 after following the decision of Special Bench in the case of the Sumitomo Mitsui Banking Corpn Vs. DDIT (IT), Range -2(1) (2012) 19 taxmann.com 364 (Mum) (SB) has adjudicated the identical issue on similar facts in favour of the assessee.

23. The ld. Counsel has also placed reliance in the case of ITAT, Mumbai in the case of DCIT Vs. Mizuho Bank Ltd. (2023) 147 taxmann.com 523 (Mumbai - Tribu).

On the other hand, the ld. D.R supported the order of lower authorities.

24. Heard both the sides and perused the material on record. On the issue of interest paid by the assessee Mumbai branch to the head office we have perused the decision of ITAT, Mumbai in the case of BNP Paribas SA Vs. ADIT (IT) Range-3 vide ITA No. 339/Mum/2010 dated 16.07.2014 for AY. 2005-06. The relevant part of the decision is reproduced as under:

*“4.5 We have carefully considered the arguments of rival parties, gone through the orders of authorities below as well as orders of the Tribunal in assessee’s own case and also the order of the Special Bench in the case of Sumitomo Mitsui Banking Corporation (supra). Decision of the Hon’ble Supreme Court in the case of Bangalore Club (supra) is distinguishable on facts where interest income was earned by assessee club from third party i.e. banks with which deposit was made. However, in the instant case HO has given funds to its branch i.e. assessee. Following were the observations at para of Special Bench 88 :-*

*“88. Keeping in view all the facts of the case and the legal position emanating from the interpretation of the relevant provisions of domestic law as well as that of the treaty as discussed above, we are of the view that although interest paid to the head office of the assessee bank by its Indian branch which constitutes its PE in India is not deductible as expenditure under the domestic law being payment to self, the same is deductible while determining the profit attributable to, the PE which is taxable in India as per the provisions of art. 7(2) and 7(3) of the Indo-Japanese Treaty read with, para 8 of the Protocol which are more beneficial to the assessee, The said interest, however, cannot be taxed in India in the hands of assessee bank, a foreign enterprise being payment to’ self which cannot give rise to income that is taxable in India as per the domestic law, Even otherwise, there is no express provision*

*contained in the relevant tax treaty which is contrary to the domestic law in India on this issue, This position applicable in the case' of interest paid by Indian branch of a foreign bank to its head office equally holds good for the payment of interest made by the Indian branch of a foreign bank to its branch offices abroad as the same stands on the same footing as the payment of interest made to the head office, At the time of hearing before us, the learned representatives of both the sides have also not made any separate submissions on this aspect of the matter specifically. Having held that the interest paid by the Indian branch of the assessee bank to its head office and other branches outside India is not chargeable to tax in India, it follows that the provisions of s. 195 would not be attracted and there being no failure to deduct tax at source from the said payment of interest made by the PE, the question of disallowance of the said interest by invoking the provisions of s. 40 (a)(i) does not arise, Accordingly we answer question No. 1 referred to this Special Bench in the negative i.e. in favour of the assessee and question No. 2 in affirmative i.e. again in favour .of the assessee.”*

4.6 *In view of the above, since the issue under consideration is covered not only by the order of the Tribunal in assessee’s own case for the AY 2001-02 to 2003-04 but also by the order of the ITAT’s Special Bench in the case of Sumitomo Mitsui Banking Corporation (supra), we hold that the department was not justified in subjecting to tax the interest paid by the Indian Branch of the assessee to its head office and overseas branches applying the provisions of Article 12 of India-France Tax Treaty.”*

25. We have also perused the decision of ITAT, Mumbai in the case of Mizuho Bank Ltd. Vs. DCIT (2023) 147 taxmann.com 523 (Mumbai – Trib) The relevant part of the decision is reproduced as under:

*“5. Heard both the sides and perused the material on record. Without reiterating the facts as discussed supra the A.O treated the interest income received by the Head office from the branch office in India as income deemed to accrue or arise in India and taxed the interest income @ 10% of the gross amount under Article 11(2)(a) of the India, Japan DTAA. We have perused the decision of the ITAT as referred supra for A.Y. 2010-11 wherein identical issue on similar facts has been adjudicated in favour of the assessee. The relevant operating para of the order is reproduced as under:*

*“8. We have considered the rival submissions and perused the material available on record. We find that coordinate bench of the Tribunal in ADIT (International Taxation) vs M/s Mizuho Corporation Bank Ltd., in ITA No 3282/Mum/2009 etc., vide order dated 26/03/2014, for assessment year 2005–06, while deciding similar issue in favour of assessee, observed as under:*

*“16. The issue with regard to addition of interest income earned by the head office from the branch office had already been decided by the Tribunal in assessee”s own case in favour of the assessee by relying on the decision of the ITAT Special Bench in the case of Sumitomo Mitsu Banking Corp. 136 ITD 66 (Mum)(SB), wherein it was held that interest paid by Indian branch of the assessee bank to its overseas head office is not chargeable to tax*

in India. The Tribunal in assessee's own case in ITA No.7479/Mum/2007, vide order dated 25-7-2012, has held as under:-

*“The Ld. DR, however, has fairly and frankly conceded that both the issues involved in this appeal of the revenue are squarely covered by the recent decision of Special Bench of the Tribunal in the case of Sumitomo Mitsu Banking Corp. vs. DDIT 136 ITD 66 (Mum)(SB) wherein it has been held that interest paid by the Indian Branch of the assessee bank to its overseas head office is not chargeable to tax in India. As further held by the Special Bench in the said case, the provisions of sec.195 consequently would not be attracted in case of such payment of interest by the Indian Branch to overseas Head office and the question of disallowance of the said interest by invoking the provisions of sec.40(a)(i) does not arise. Respectfully following the said decision of the Special Bench of this Tribunal, we uphold the impugned order of the Ld. CIT (A) giving relief to the assessee on both the issues involved in this appeal of the revenue and dismiss the said appeal.”*

*6. Following the decisions of the ITAT as supra we don't find any merit in the grounds of appeals of the Revenue. Further, it is also clear from the findings of the ld. CIT(A) wherein held that it is not necessary to invoke provision of section 163 and give notice u/s 163 because the branch and the head office were the same entity and inadvertently at the concluding part he stated it was necessary to issue notice under section 163 of the Act. Therefore, the grounds of appeals no. 1 to 3 of the revenue stand dismissed.”*

26. Following the decision of ITAT special bench and coordinate benches as referred supra we consider that issue contested in the appeal is squarely covered in favour of the assessee, therefore, the appeal of the assessee is allowed,

27. In the result, the appeals of assessee are partly allowed.

Order pronounced in the open court on 24.05.2023

Sd/-

(Aby T Varkey)  
Judicial Member

Sd/-

(Amarjit Singh)  
Accountant Member

Place: Mumbai

Date 24.05.2023

Rohit: PS

**आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :**

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. आयकर आयुक्त / CIT
4. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण DR,  
ITAT, Mumbai
5. गार्ड फाईल / Guard file.

सत्यापित प्रति //True Copy//  
आदेशानुसार/ BY ORDER,

उप/सहायक पंजीकार (Dy./Asstt. Registrar)  
आयकर अपीलीय अधिकरण/ **ITAT, Bench,  
Mumbai.**