

- b) Disallowance made under section 14A of the Act in respect of exempt income.
 - c) Addition made on account of transfer pricing adjustment in respect of revenue received
3. The Revenue is in appeal in respect of following issues :
- a) Deduction allowed under section 10A of the Act without adjusting loss of other eligible units.
 - b) Computation of deduction under section 10A without deducting telecommunication expenses.
 - c) Relief granted in respect of transfer pricing adjustment in respect of revenue received.
 - d) Relief granted in respect of notional interest charged on delayed receivable by way of transfer pricing adjustment.
 - e) Transfer pricing adjustment in respect of interest undercharged on the loan given to AEs.
4. The assessee company is engaged in the business of providing information technology solutions to banks and financial institutions worldwide.
5. Certain common issues are urged in these appeals. We shall first take up the common issues urged by both the parties. The first common issue urged by the parties relates to deduction under section 10A of the Act.
- 5.1 The assessee is aggrieved on the decision of tax authorities in denying deduction u/s 10A of the Act in respect of interest income earned by the assessee.
- 5.2 We heard the parties and perused the record. We noticed that the identical issue has been considered by the Tribunal in the assessee's own case in A.Y. 2003-04 in ITA No. 5023/Mum/2007 and the Tribunal vide its order dated 12.10.2021 has held that the assessee is eligible for deduction under section 10A in respect of interest income earned on temporary parking of surplus funds in the ordinary course of business. We notice that in

support of this proposition, the Tribunal has followed the decision rendered by Hon'ble Karnataka High Court in the case of CIT Vs. Hewlett Packard Global Ltd. (2017) 87 taxman.com 182. In this year also, it is stated that the interest income was earned from deposit of surplus funds with banks. Since there is no change in facts, consistent with the view taken by the Tribunal in assessee's own case in A.Y. 2003-04, we reverse the order passed by the learned CIT(A) on this issue and direct the Assessing Officer to allow deduction under section 10A of the Act in respect of interest income earned by the assessee from parking of surplus funds with banks.

5.3 The revenue is aggrieved by the decision of Ld CIT(A) in allowing deduction under section 10A of the Act without setting off of loss incurred from other eligible units against profit of eligible units.

5.4 We notice that an identical issue has been examined by the Coordinate Bench of the Tribunal in assessee's own case in A.Y. 2005-06 in the appeal of the revenue in ITA No. 5079/Mum/2010. The Coordinate Bench has held that the loss incurred in one unit need not be set off of against the profits of other units for the purpose of computing deduction u/s 10A of the Act in respect of profit earning units. We notice that, in this regard, the Coordinate Bench has followed the decision rendered by the Chennai Special Bench of the Tribunal in the case of Scientific Atlanta India (ITA No. 536/Mds/2007), wherein it was held that section 10A of the Act is a deduction section and not an exemption section. Further it was held that the deduction has to be computed "undertaking-wise". The Hon'ble Supreme Court has held in the case of CIT vs. Yokogawa India Ltd (2017)(77 taxmann.com 41)(SC) that the deduction u/s 10A of the Act should be computed at the stage before arriving at the Gross total income of the eligible undertaking. Following observations made by Hon'ble Supreme Court are relevant here:-

"16. From a reading of the relevant provisions of Section 10A it is more than clear to us that the deductions contemplated therein is qua the eligible undertaking of an assessee standing on its own and without reference to

the other eligible or non-eligible units or undertakings of the assessee. The benefit of deduction is given by the Act to the individual undertaking and resultantly flows to the assessee. This is also more than clear from the contemporaneous Circular No. 794 dated 9.8.2000 which states in paragraph 15.6 that,

"The export turnover and the total turnover for the purposes of sections 10A and 10B shall be of the undertaking located in specified zones or 100% Export Oriented Undertakings, as the case may be, and this shall not have any material relationship with the other business of the assessee outside these zones or units for the purposes of this provision."

Accordingly, we are of the view that the Ld CIT(A) was justified in holding that the losses incurred in other eligible units are not required to be set off against the profits of the undertaking against which the deduction u/s 10A was allowed.

5.5 One more issue urged by the revenue with regard to the computation of deduction u/s 10A is whether the telecommunication charges are required to be deducted from the "Export turnover" while computing deduction u/s 10A of the Act or not?.

5.6 While the AO held that the telecommunication charges are required to be deducted from the "Export turnover", the Ld CIT(A) reversed the same. Before us, the Ld A.R submitted that the telecommunication charges may be directed to be deducted from both "Export turnover" and "Total turnover" while computing deduction u/s 10A of the Act as held by Hon'ble Supreme Court in the case of CIT vs. HCL Technologies Ltd (2018)(404 ITR 719)(SC). We agree with the submissions of the Ld A.R. Accordingly, we direct the AO to compute the deduction u/s 10A of the Act by excluding telecommunication charges both from export turnover and total turnover while computing deduction u/s 10A of the Act.

6. The next common issue relates to the addition relating to Transfer pricing adjustment in respect of income. We noticed earlier that the assessee

is engaged in the business of providing information technology solutions to banks and financial institutions worldwide. The assessee has appointed two types of sales channels (distributors), viz., unrelated distributors and related distributors. The related distributors are overseas subsidiaries of the assessee company located in USA, Netherlands and Singapore. According to the assessee, the role of “unrelated distributors” is limited to only sale of software products and they are not assigned to source customization work for the assessee. On the contrary, the overseas subsidiaries undertake various functions, viz., marketing, distribution of software products, software customization and client management services in their respective jurisdictions. The business model is that the overseas subsidiaries enter into contracts with third party customers in their own names and then outsource the same to the assessee for execution by entering into a Marketing Service agreement and License Agreement. Hence the Overseas subsidiaries retain 15%/20% of the contract value and remit the balance amount to the assessee.

6.1 The assessee selected itself as tested party and adopted TNM method as most appropriate method. The Net Profit Margin was selected as Profit Level Indicator (PLI) and the assessee’s margin was 22%. The assessee identified 43 companies, whose average margin was 9%. Accordingly, the assessee contended that its international transaction with AEs is at arms length.

6.2 The TPO rejected the T.P study of the assessee. He took the view that the assessee is performing complex functions, while the AEs are performing least complex function. Accordingly, he held that the foreign AEs should be considered as “tested parties”. The TPO selected 3 Indian companies for the purpose of bench marking. It is pertinent to note that the TPO did not disclose the names of those companies either to the assessee or in the order passed by him. The said three companies was mentioned as “X Ltd”, “Y Ltd”

and “Z Ltd” by the TPO in his order. Based on the margins of the above said three unknown companies, the TPO held that the Associated Enterprises (AEs) should have been remunerated by the assessee @ cost plus 10% margin only. We noticed that the overseas subsidiaries retained earning of 15%/20%. Accordingly, the TPO proposed transfer pricing adjustment of Rs.31.93 crores.

6.3 Before Ld CIT(A), the assessee made detailed submissions and hence the Ld CIT(A) called for a remand report. However, the TPO did not furnish the report despite several reminders issued by Ld CIT(A). Hence the Ld CIT(A) proceeded to decide the issue on the basis of available materials. The Ld CIT(A) rejected the approach of the TPO in selecting foreign AEs as tested parties. The Ld CIT(A) examined the comparable companies selected by the assessee and held that only 11 companies (out of 43 companies) selected by the assessee are comparable with the assessee. The average margin of the those 11 companies was 22.53% and accordingly, the Ld CIT(A) reduced the transfer pricing adjustment to Rs.7,88,14,000/-.

6.4 We heard the parties and perused the record. We noticed that the TPO, after holding that the foreign AEs should be taken as “tested parties” have selected three unknown Indian comparable companies. Accordingly, he has held that the assessee should have remunerated the AEs at Cost plus 10% margin. Admittedly, the above said approach of the TPO is against the Transfer pricing provisions and also in gross violation of principles of natural justice. Accordingly, we are of the view that the Ld CIT(A) was justified in rejecting the above said approach of TPO.

6.5 We notice that the Net profit margin declared by the assessee is 22%. We noticed that the average margin of 11 comparable companies selected by the Ld CIT(A) was 22.53%. Hence the difference in the margin rate falls within the tolerance limit of 5%, in which case, the international transactions

of the assessee should be considered to be at arms length. Accordingly, no transfer pricing adjustment is called for. Accordingly, we modify the order passed by Ld CIT(A) on this issue and hold that no transfer pricing adjustment is called for. Accordingly, we delete the addition of Rs.7,88,14,000/- sustained by Ld CIT(A).

7. We shall now take up individual issues urged by each of the parties. The individual issue urged by the assessee relates to the disallowance made under section 14A of the Act. The assessee had earned exempt income of Rs. 22.35 lakhs from UTI bonds. The Assessing Officer noticed that the assessee did not disallow any expenditure relating to earning of above exempt income under section 14A of the Act. Accordingly the Assessing Officer disallowed a sum of Rs. 1,65,615/- by applying provisions of rule 8D of the I.T. Rules. The learned CIT(A) confirmed the same.

7.1 We heard the parties on this issue and perused the record. The year under consideration being A.Y. 2006-07, the provisions of Rule 8D will not apply to the year under consideration as per the decision rendered by Hon'ble Bombay High Court in the case of Godrej Boyce Mfg Co Ltd (328 ITR 81). Accordingly the tax authorities are not justified in applying provisions of rule 8D to the year under consideration. However, since the assessee has earned exempt income, a portion of expenditure needs to be disallowed in terms of section 14A of the Act. The Hon'ble Bombay High Court has upheld the disallowance of 2% of exempt income in the case of Godrej Agrovet Limited (ITA No.934/2011). Following the same, we direct the Assessing Officer to restrict the disallowance under section 14A to 2% of the exempt income. The order of the learned CIT(A) would stands modify accordingly.

8. We shall take up the individual issues urged in the appeal filed by the Revenue.

9. First individual issue contested by the Revenue relates to transfer pricing adjustment made in respect of delayed receivable from the AEs. The Transfer Pricing Officer (TPO) noticed that the assessee has received money from its AEs with considerable delay and accordingly made transfer pricing adjustment of Rs. 3.80 crores on account of delayed receivable by adopting interest at 6.87% on average quarterly balance due from AEs. The learned CIT(A) deleted the same following the decision rendered by him in AY 2005-06. He also further held that the AEs are not charging interests from their customers and the delay is on account of delayed collection by AEs from their customers.

9.1 The learned AR submitted that an identical issue has been decided by the Coordinate Bench in assessee's own case in A.Y. 2003-04 in ITA No. 5023/Mum/2007 and the adjustment made by the TPO was deleted on the reasoning that the AEs are realizing amounts from its debtors with delay. The Learned AR submitted that the said order passed by the Tribunal in A.Y. 2003-04 followed A.Y. 2004-05 & 2005-06. Accordingly, the learned AR submitted that the transfer pricing adjustment made in respect of delayed receivable is liable to be deleted.

9.2 On the contrary, learned DR submitted that the assessee has furnished details of period of realisation by the AEs in the paper book and a perusal of the same would show that the AEs have remitted money to the assessee after considerable delay after realisation from its customers. Accordingly, the learned DR submitted that the reasoning given in A.Y.2003-04 by the Tribunal that there was corresponding delay for receipt of money from customer of AEs would not apply to the facts of the present case.

9.3 We heard the rival submissions on this issue and perused the record. In A.Y. 2003-04 the Tribunal has accepted the contention of the assessee that the delay in realization from AEs has occurred for the reason that there was

corresponding delay in realization of debts by the AEs from their customers. However, on a perusal of the details furnished by the assessee in page No. 635 to 865 of the paper book, we noticed that the AEs have remitted money to the assessee with delay ranging from 1 day to a period exceeding 1 year, after realization from their debtors. Hence the reasoning given by the Tribunal, as rightly pointed by Ld D.R, would not apply to the facts of the year under consideration.

9.4 We also noticed that the TPO has computed the interest by taking average quarterly balances. In our view, the same is not correct method of computing interest on delayed receivables. Since the details of realization of individual bills are available, it will be possible for the assessee/TPO to compute interest individually after allowing accepted credit period.

9.5 In view of the above said discussions, we are of the view that this issue requires fresh examination at the end of the Assessing Officer/TPO. Accordingly we set aside the order passed by the learned CIT(A) on this issue and restore the same to this file for examining this issue afresh in the light of discussions made supra.

10. Next individual issue contested by the revenue relates to transfer pricing adjustment made in respect of loan given to AEs. The assessee had given loans to two of its AEs namely, i-flex, America and ISE Mauritius Company, Mauritius. The assessee had received interest from the above said AEs. However, the TPO took the view that the assessee has undercharged interest and accordingly made transfer pricing adjustment of Rs. 2.29 crores. The learned CIT(A) however deleted the addition by following the decision rendered by the Tribunal in assessee's own case in A.Y. 2004-05 in ITA No. 5078/Mum/2010.

11. We heard the parties and perused the record. We noticed that the TPO has arrived at ALP rate of interest for i flex America at 8.37% and for ISE Mauritius Company Mauritius at 11.75%. For this purpose, the TPO had adopted prime lending rate at which AEs could have obtained loan in respective jurisdiction and then added 1.75%, being the rate charged for giving bank guarantee. The TPO added the bank guarantee rate on the reasoning that the AEs could be able to obtain loan, only if the assessee gives corporate guarantee to the financial institutions. Accordingly the TPO has arrived transfer pricing adjustment at 2.29 crores.

11.1 We notice that the assessee has furnished a letter obtained from HDFC bank, wherein the bank has quoted rate of interest on the query raised by the assessee in respect of loan to be taken by its American Subsidiary. The Ld D.R submitted that the above said letter is a general letter and it is not clear as to whether the terms and conditions mentioned therein are in parity with the terms and conditions agreed for giving loan to the AE by the assessee. We notice that, with regard to Mauritius subsidiary, no material has been furnished by the assessee to substantiate the ALP of interest charged.

11.2 It is the submission of Ld A.R that the ALP of interest income should be determined by considering LIBOR rate, to which certain points are added to bring the same to market rate. We notice that the TPO has considered Prime Lending rate plus Guarantee charges, which according to Ld A.R is not correct. We agree with the contentions of Ld A.R on this point. Thus, we notice that both the parties have not substantiated their stand properly. Accordingly, we are of the view that this issue also requires examination at the end of AO/TPO. Accordingly, we set aside the order passed by Ld CIT(A) on this issue and restore the same to the file of AO/TPO for examining this issue afresh.

12. Needless to mention, the assessee should be given proper opportunity of being heard.

13. In the result, the appeal of the assessee is partly allowed and the appeal of the revenue is treated as partly allowed.

Pronounced in the open court on 23.6.2023.

Sd/-
(KAVITHA RAJAGOPAL)
Judicial Member

Sd/-
(B.R. BASKARAN)
Accountant Member

Mumbai; Dated : 23/06/2023

Copy of the Order forwarded to :

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

//True Copy//

BY ORDER,

(Assistant Registrar)
ITAT, Mumbai

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