IN THE INCOME TAX APPELLATE TRIBUNAL, 'H' BENCH MUMBAI

BEFORE: SHRI AMIT SHUKLA, JUDICIAL MEMBER
&
MS.PADMAVATHY S, ACCOUNTANT MEMBER

ITA No.6753/Mum/2012
(**Assessment Year :2007-08**)

M/s. Tata International Limited Block A, Shivsagar Estates Dr. Annie Besant Road Worli, Mumbai- 400 018	Vs.	The Additional Commissioner of Income tax – 7(3) Mumbai
PAN/GIR No.AAACT3198F		
(Appellant)	..	**(Respondent)**

ITA No.6464/Mum/2012
(**Assessment Year :2007-08**)

DCIT– 7(3) Mumbai	Vs.	M/s. Tata International Limited Block A, Shivsagar Estates Dr. Annie Besant Road Worli, Mumbai- 400 018
PAN/GIR No. AAACT3198F		
(Appellant)	..	**(Respondent)**

Assessee by	Shri Nitesh Joshi a/w. Shri Ninad Patade, Shri Ketan Ved & Ms. Aastha Shah
Revenue by	Shri K.C. Selvamani
Date of Hearing	**11/10/2023**
Date of Pronouncement	**30/11/2023**

आदेश / O R D E R

PER AMIT SHUKLA (J.M):

The aforesaid cross appeals have been filed by the assessee as well as by the department against order dated 28/08/2012 passed by ld. CIT(A)-15, Mumbai for the quantum of assessment passed under Section.143(3) for the A.Y.2007-08.

2. In Revenue's appeal, the department has raised following grounds:-

"1. On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in holding that Letter of Control (LoC) does not constitute an agreement of contract only because it is not accepted by the Bank.

2. On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in holding that such LoC is not an agreement or contract when actually it constitutes an agreement.

3. On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in holding that LoC has no binding force when it morally binds the assessee and the AE and failure to honour this will have widespread repercussions on their business.

4. On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in holding that LoC cannot be treated as equivalent to guarantees merely because they are not enforceable notwithstanding various consequences attached with it in case of failure to honour it.

3. In assessee's appeal the issues which has been challenged before us is, firstly, with regard to disallowance of Rs.2,81,81,000/- made under Section.14A ;and secondly,

disallowance of expenditure incurred by the assessee on settlement claims of Rs.19,12,240/-.

4. We will first take up assessee's appeal. At the outset, it has been submitted that in assessee's appeal, in so far as ground No.1 relating to disallowance of expenditure incurred by the assessee on settlement of commission, same is squarely covered by the decision of the Tribunal in assessee's own case for A.Y.2005-06, wherein disallowance in respect of settlement of claims have been allowed. The relevant observation and finding of the Tribunal in this regard reads as under:-

> *9. Ground No.1 relates to disallowance of expenditure by way of claims settled. The Id. AR of the assessee submits that this ground of appeal is covered by the decision of Tribunal in assessee's own case for Assessment Year 2004-05 in ITA No. 1009 of 2009 dated 13.08.2015. The Id. AR of the assessee further submits that the Id. CIT(A) followed the order of his predecessor for Assessment Year 2003-04 & 2005-05. The appeal for Assessment Year 2003-04 & 2004-05 has been decided by Tribunal as stated above vide order dated 13.08.2015. Thus, this ground of appeal may be allowed in favour of assessee.*
>
> *10. On the other hand, the Id. DR for the revenue after going through the order of Id. CIT(A) and order of Tribunal for Assessment Year 2003-04 relied upon the order of lower authorities.*
>
> *11. We have considered the submission of both the parties and perused the record and find that on similar ground of appeal, the co-ordinate bench of Tribunal by following the order of Assessment Years 2000-01, 2001-02 & 2003-04 passed the following order:*

"6.1 This issue has been discussed by the AO at pages 4 & 5 of the assessment order. The Ld. CIT(A) has considered this issue at page 3 of his order. An identical issue was considered by the Tribunal in A.Y. 2003-04 in ITA No. 3016/Mum/07 and at para-8 and 8.1 the Tribunal has followed the earlier order of the Tribunal for A. Yrs 2000-01, 2001-02 and 2002-03. Respectfully following the orders of the Co-ordinate Bench in assessee's own case, the disallowance made by the AO is deleted. These grounds are accordingly allowed."

12. Considering the order of Tribunal on similar ground on similar set of fact and respectfully following the order of co-ordinate bench in assessee's own case, the disallowance made by Assessing Officer is deleted. Hence, this ground of appeal is allowed.

5. Thus, following the earlier years precedence which are applicable on the facts of this year also as admitted by both the parties, ground No.1 raised by the assessee is allowed.

6. In so far as disallowance under Section.14A is concerned, the ld. Assessing Officer noted that assessee had not made any disallowance u/s. 14A, despite dividend income of Rs.21,59,93,247/- has been claimed as exempt. In response to the show-cause notice, assessee had submitted that no amount is disallowable because all the borrowed funds were utilized only for the purpose of its business and no part of such borrowings were utilized for the acquisition of shares yielding the dividend income. However, ld. Assessing Officer invoked Rule 8D and made disallowance of Rs.1,88,85,000/-. Despite the fact that Rule 8D was not applicable in A.Y.2007-08. Ld. CIT(A) however, has made enhancement on the ground that AO has not done proper working of Rule 8D and computed further disallowance of

Rs.2,81,81,000/- which was enhancement of disallowance over and above the disallowance made by the Assessing Officer. Accordingly, total disallowance made by him was Rs.4,70,66,000/-. The enhancement was on account of computation of disallowance based on Rule 8D and rejecting the contention of the assessee that *firstly,* it has surplus funds and therefore, no disallowance of interest can be made and secondly he held that it cannot be said that no other expenditure was attributable for earning exempt income. The ld. CIT (A) thus, computed the disallowance, both on account of interests Rule 8D(2)(ii) and on indirect expenses under Rule 8D(2)(iii).

7. Before us, ld. Sr. Counsel for the assessee submitted that, first of all, no disallowance of interest could have been made in this case, because assessee had huge surplus funds which far exceeded the utilization of funds in investments, therefore, no interest should have been disallowed. He drew our attention to the copy of balance sheet as on 31/03/2007 and pointed out that reserves and surplus on the share capital aggregated to Rs.262.36 lakhs, where as investment was Rs.195.26 lakhs. He further submitted that the Tribunal in assessee's own case for A.Y.2005-06 has restricted the disallowance u/s.14A to 5% of the exempt income because Rule 8d is not applicable at all in A.Y.2007-08. However, he further submitted that this disallowance has to be scaled down, because investments were made in foreign subsidiary companies where dividend income is taxable and there were investments which have not yielded exempt income during the year and therefore they need to be

removed from the working of the disallowance. He has also filed a chart showing investment which are to be removed, viz., investment in foreign company, investment in non dividend yielding investment and increase in revaluation of investment which became the assessee's investment on 1st April 2004, consequent of the merger of erstwhile company and what investment can be taken for working of disallowance of average investment by taking 0.5%. As per the working the disallowance has to be computed at 0.5% of Rs. 5,635.14 lakhs.

9. After hearing both the parties and on perusal of the impugned order, we find that ld. CIT (A) has made enhancement of disallowance under Section.14A after applying Rule 8D. First of all, it is an undisputed fact that Rule 8D is not applicable in A.Y.2007-08, as it has come into the statute in A.Y.2008-09 and now it is a settled issue that computation of disallowance under Rule 8D cannot be made prior to the A.Y.2008-09. This Tribunal in A.Y. 2005-06 has restricted the disallowance under Section.14A 5% of the exempt income. Before us, ld. Counsel for the assessee submitted the calculation of investments after reducing foreign investment and non-dividend yielding investment and other investments as per working given by him which has also been provided at page 101 of the paper book and has submitted that, based on this, the average of opening and closing of investment worked out and disallowance should be reduced substantially. However, his working is based on formula provided in Rule 8D (2)(iii), but once Rule 8D is not applicable in this year then we are not inclined to work out disallowance as

Rule 8D. Thus, in line with the earlier decisions of the Tribunal, we hold that 5% of exempt income will be taken as disallowance for the purpose of Section 14A and accordingly, assessee gets part-relief.

10. In so far as Revenue appeal is concerned, it has been stated that in all the grounds only issue raised is with regard to transfer pricing adjustment commission on letter of credit, which is covered by the decision of the Tribunal in assessee's own case for A.Y.2005-06.

11. The brief facts are that the Assessing Officer has made addition of Rs.5,75,38,800/- on account of transfer pricing adjustment in respect of non-recovery by the assessee from its AE and the issue of letter of credit holding that assessee has not charged any commission from the AE. The ld. CIT (A) has deleted the said adjustment after observing and holding as under:-

9.4 I have considered the facts of the case and written submissions and oral arguments of the appellant advanced during the course of the appeal as against the observations/findings of the TPO/AO in their orders. The contention of the appellant are being discussed and decided as under:

i. The international transactions of the appellant were analyzed by the TPO during proceedings. The TPO examined in detail the international transactions of the appellant referred to by the AO and proposed no further adjustment to the value of arm's length price of international transactions benchmarked by the appellant in its TP documentation. In respect of the LoCs issued by the appellant to its AEs, the TPO selected Comparable Uncontrolled Price method ("CUP") as the most appropriate method for determining the arm's length price of this transaction

and in determining the price, the TPO mentioned that Indian bank charged a fee ranging from 0.25% to 15% of the value of guarantee given to its customers depending upon the risk involved.

The TPO proceeded to determine the arm's length commission to be 50% of 1.5% at 0.75%. Based on this the TPO proposed an adjustment of Rs. 5,75,38,800/- be made to the total income of the appellant. The adjustment was computed on the value of the LoCs issued by the appellant to its AE's as against the actual draw down of funds from the bank by the AE's.

ii.The AO under Section 143(3) of the Act passed the assessment order in conformity with the addition proposed by the TPO incorporating the proposed addition of Rs. 5,75,38,800/- to the returned income of the appellant.

iii.The appellant has filed detailed submissions distinguishing a letter of comfort with intra-group credit guarantees together with other related issues.

iv.In view of the facts of the case and position of letter of comfort 1 am not inclined to treat letter of comfort (LOC) at par with intra-group credit guarantees or equivalent to guarantees as averred by the TPO. The reasons for this are summarized as under-

a) the LoC is a unilateral letter issued by the appellant and does not constitute an agreement or contract It is not accepted by the Banker to whom it has been issued,

b) it is not enforceable by law as in an event where the AE were to default in respect of the loan given to it by its Banker, the Banker has no legal recourse to the appellant in respect of the LoC issued;

c) again if the appellant were to dispose of its shares in the AE(s) without first obtaining the consent of the Banker or having ensured that the AE's liability to the bank is discharged in full no legal recourse is available to the banker against such dilution or disposal; and

d) as the very title of the LoC suggests, the LoC merely provides comfort to the Bank as to the AE's ability / willingness to perform its obligations and neither creates nor is intended to create any kind of binding recourse which the Banker may have on the appellant.

v. Moreover, it is a incidental benefit arising merely from passive association with the group and are therefore not regarded as giving rise to arrangements subject to remuneration. Para 7.13 of OECD Guidelines, July 2011 deal with the issue which is reproduced hereunder:

"Similarly, an associated enterprise should not be considered to receive an intra- group service when it obtains incidental benefits attributable solely to its being part of a larger concern, and not to any specific activity being performed. For example. no service would be received where an associated enterprise by reason of its affillation alone has a credit-rating higher than it would if it were unaffiliated, but an intra-group service would usually exist where the higher credit rating were due to guarantee by another group member, or where the enterprise benefited from the group's reputation deriving from global marketing and public relations campaigns. In this respect, passive association should be distinguished from active promotion of the MNE group's attributes that positively enhances the profit-making potential of particular members of the group. Each case must be determined according to its own facts and circumstances."

vi. Appellant vide its letter dated 23.08.2012 has submitted that it does not press ground No. 6C(ii) which is in respect of comparable data for benchmarking and accordingly the appellant would not like to press ground No. 6C(ii) of appeal However in view of the position above such letter filed by the appellant becomes in consequential

vii. In view of the facts of the case, discussion herein above and consistent with the decision taken by my predecessor for A.Y. 2005-06 and by me for A.Y 2006-07 in the appellant's case, the adjustment of Rs. 5,75,38,800/- is therefore deleted.

viii Thus, this ground of appeal is allowed.

12. We find that the Tribunal in A.Y.2005-06 has decided this issue in favour of the assessee after observing as under:-

Ground No.6 to 9 relates to Transfer Pricing Adjustment with respect to issuance of "Letter of Comfort". This issue is interconnected with the grounds of appeal raised by revenue in its cross appeal. The Id. AR of the assessee submits that Id. CIT(A) deleted the adjustment against which the revenue has filed its cross appeal. The Id. AR of the assessee submits that the assessee issued Letter of Comfort to Bankers of Associated Enterprises (AE) of assessee. The assessee not reported this transaction (issuance of Letter of Comfort) in its Transfer Pricing Study Report (TPSR). The Assessing Officer made reference to Transfer Pricing Officer (TPO) for computation of Arms Length Price (ALP) of transaction reported by assessee with its AE in its report furnished under Form 3CEB. The TPO noted that the assessee has not reported about issuance of Letter of Comfort to the Banker of AE. The TPO issued show cause notice for determination of ALP with regard to issuance of Letter of Comfort. The assessee filed its reply vide reply dated 07.01.2008 & 18.01.2008. In reply to the show-cause, the assessee submitted that no adjustment is ought to be made as Letter of Comfort would not represent international transaction within the meaning of section 92B(1). It was further stated that merely an unequivocal statement of intention expressed by assessee not being bilateral, is not a transaction and letter is a private affair between the assessee and the lender/banker (non associate and is not a transaction between two associate). The contention of assessee was not accepted by TPO by taking view that transaction relating to provision for Letter of Comfort and payment of commission for the services by AE to the assessee would fall within the definition in term of international transaction 92B of the Act. The TPO made adjustment of Rs. 8.70 crore on account of issuance of Letter of Comfort. The Id. CIT(A) after appreciating the contention of assessee concluded that issuance of Letter of Comfort does not constitute an international transaction. The Id. CIT (A) appreciated the difference between corporate guarantee and Letter of Comfort. The Ld. AR further submits that there is a basic difference between corporate guarantee and Letter of Comfort. In a Letter

of Comfort, the party issues only a letter that a subsidiary or group company would comply term of financial transaction and have no obligation to indemnify, however, in case of corporate guarantee, the party issuing guarantee is under obligation to the lender. The Ld. AR further submits that in fact this ground of appeal is also covered by the decision of Tribunal in case of The India Hotel Company Ltd. vs. DCIT in ITA No. 9087/Mum/2010 dated 06.09.2019, wherein similar ground of appeal was considered and by following the decision of earlier years in that assessee and decision of Hon'ble Karnataka High Court in United Braveries Holding Ltd. Karnataka State Industrial Investment and Development Corporation Ltd. (M.F.A. No. 4234 of 2007 (SFC), wherein it was held that Letter of Comfort merely indicates the parties assurance that respondent would comply with the term of financial transaction without guaranteeing performance in the event of default.

13. Since in the earlier year this precise issue has been decided in favour of the assessee, therefore, as precedence, following the aforesaid decision, we uphold the order of the ld. CIT (A) and consequently grounds raised by the Revenue are dismissed.

14. In the result, appeal of the assessee is partly allowed and Revenue's appeal is dismissed.

Order pronounced on 30th November, 2023.

Sd/-	**Sd/-**
(PADMAVATHY S)	**(AMIT SHUKLA)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

Mumbai; Dated 30/11/2023
KARUNA, *sr.ps*

Copy of the Order forwarded to :

1. The Appellant
2. The Respondent.
3. CIT
4. DR, ITAT, Mumbai
5. Guard file.

BY ORDER,

//True Copy//

(Asstt. Registrar)
ITAT, Mumbai