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

BEFORE: SHRI AMIT SHUKLA, JUDICIAL MEMBER
&
SHRI GAGAN GOYAL, ACCOUNTANT MEMBER

ITA No.7336/Mum/2010
(**Assessment Year :2004-05**)
&
ITA No.4765/Mum/2016
(**Assessment Year :2005-06**)

The Hongkong & Shanghai Banking Corporation Ltd. Srnior Vice President Tax, India Area Management 5th Floor, Hongkong Bank Building, 52/60, MG Road Fort, Mumbai – 400 001	Vs.	The Joint Director of Income Tax (International Taxation)-3, Mumbai 1st Floor, Scindia House N.M. Marg, Ballard Estate, Mumbai – 400 038
PAN/GIR No.AAACT4652J		
(Appellant)	..	**(Respondent)**

ITA No.7824/Mum/2010
(**Assessment Year :2004-05**)
&
ITA No.4786/Mum/2016
(**Assessment Year :2005-06**)

Deputy Commissioner of Income Tax-(IT)-2(2)(2), Room No.136, 1st Floor Scindia House N.M. Marg, Ballard Estate, Mumbai – 400 038	Vs.	The Hongkong & Shanghai Banking Corporation Ltd. Srnior Vice President Tax, India Area Management 5th Floor, Hongkong Bank Building, 52/60, MG Road Fort, Mumbai – 400 001
PAN/GIR No.AAACT4652J		
(Appellant)	..	**(Respondent)**

Assessee by	Shri Porus Kaka a/w.Divesh Chawla
Revenue by	Shri Anoop Hiwase
Date of Hearing	**23/01/2024**
Date of Pronouncement	**30/04/2024**

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 Revenue against separate impugned orders dated 25/08/2010 & 31/03/2016, passed by Commissioner of Income Tax (Appeals)-56 for the quantum of assessment passed u/s.143(3) for the A.Y.2004-05 & 2005-06.

2. In both the years issues involved are common arising out of identical set of facts, therefore, the same were heard together. At the outset it has been stated and admitted by both the parties that all the grounds are covered by the earlier year's decision of the Tribunal in assessee's case.

3. The effective grounds of appeal raised in both the years which have been agued based on chart submitted by the Ld. Counsel of the assessee are being discussed instead of reproducing the entire grounds of appeal. We will discuss in brief the issues raised in various grounds.

ITAT Appeal No: 7336/MUM/2010 – Assessee's Appeal

2. Ground No. 1: Tax free income – Rs 24,34,88,920

2.1 Brief facts are that, the Assessee had claimed the gross interest of Rs. 24,14,88,425 earned on tax free bonds as exempt under section 10(15)(iv) of the Income Tax Act, 1961 ('the Act') and gross dividend of Rs. 20,00,495 earned on shares as exempt under section 10(34) of the Act.

2.2. The learned AO held that the cost of investment is taken at 3.84% towards interest on borrowed money, which was invested in tax free securities, which generated the tax free income to the assessee, and accordingly, rejected the submission that if the taxpayer owned funds far greater than borrowed funds no disallowance can be made. However, the CIT (A) disallowed 1 per cent of the incremental investment in tax free bonds (Rs 25,00,00,000/-) made during AY 2004-05.

2.3. Details of interest free funds as available from the balance sheet for the year under consideration are:

Particulars	**March 31, 2003 (in Rs)**	**March 31, 2004 (in Rs)**
Capital	715,02,50,000	715,02,50,000
Statutory reserve	284,25,31,000	333,70,20,000
Capital reserve(excluding revaluation reserve)	779,79,30,000	779,79,30,000

Revenue reserve	237,79,52,000	337,79,52,000
Balance in profit and loss account	-	48,52,25,000
Total	2,016,86,63,000	2,214,83,77,000

3. Thus, it has been stated that the Assessee had sufficient free reserves and interest free capital during AY 2004-05 (amounting to Rs 197,97,14,000). During the year under consideration, the Assessee has merely made the investment of Rs 25,00,00,000 in tax free bonds. Hence, the Assessee had sufficient own funds, and no disallowance can be made under section 14A.

4. The Supreme Court of India in the case of **South Indian Bank Ltd. Vs. Commissioner of Income-tax [2021] 130 taxmann.com 178 (SC)** has upheld the contention that if the Assessee has sufficient interest free funds, no disallowance under 14A can be made. The relevant extracts of the said order are reproduced below:

"17. Where the assessee has mixed fund made up partly of interest free funds and partly of interest-bearing funds and payment is made out of that mixed fund, the investment must be considered to have been made out of the interest free fund. To put it another way, in respect of payment made out of mixed fund, it is the assessee who has such right of appropriation and also the right to assert from what part of the fund a particular investment is made and it may not be permissible for the revenue to make an estimation of a proportionate figure....

20....The disallowance would be legally impermissible for the investment made by the assessees in bonds/shares using interest free funds, under section 14A. In other words, if investments in securities is made out of common funds and the assessee has

available, non-interest-bearing funds larger than the investments made in tax-free securities then in such cases, disallowance under section 14A cannot be made.

27. The aforesaid discussion and the cited judgments advise this Court to conclude that the proportionate disallowance of interest is not warranted, under section 14A for investments made in tax-free bonds/securities which yield tax-free dividend and interest to assessee banks where, interest free own funds available with the assessee, exceeded their investments. With this conclusion, we unhesitatingly agree with the view taken by the learned ITAT favouring the assessees."

5. We find that the ITAT, in Assessee's own case for AYs 1997-98 to 2001-02 has decided this issue in the Assessee's favor. Relevant extracts of the ITAT's order dated February 15, 2007, for the assessment year 1997-98 are reproduced below:

"*67. We have given a careful consideration to the arguments placed before us by both the sides vis-a-vis the factual position as mentioned above. It is true that various Benches of the Mumbai Tribunal have held that exemption is available on gross income and not on net income. However, insertion of section 14A in the Income-tax Act with retrospective effect from 01.04.1962 makes a material departure. As per the new provision no deduction shall be allowed in respect of expenditure incurred in relation to income which does not form part of the total income. It is, therefore, clear that if there is any direct nexus between the expenditure incurred by the assesses and the earning of income which does not form port of the total income, no deduction is permissible for such expenditure.* ***However, in the present case there is no material to indicate that the assessee had incurred any expenditure which is directly referable to earning of interest income on tax free bonds.*** *During the year the investment is of about Rs. 219 crores. As against this during the year itself the assessee's own funds by way of capital and reserves and profits increased by more than Rs. 1,319 crores. In these circumstances, there can be no presumption that the assessee borrowed interest bearing funds for investing in tax-free*

bonds. Considering the entire facts, we confirm the order of the learned CIT (A) on this issue." (emphasis applied)

6. However, the ITAT, in Assessee's own case for AYs 2002-03 and 2003-04, has disallowed one percent of the total exempt income under section 14A of the Act. Relevant extracts of the ITAT's order dated November 27, 2019, for AYs 2002-03 and 2003-04 are reproduced below:

"5.2. We have heard rival submissions and perused the material available on record. We find from page 99 of the paper book comprising of letter dated 21/03/2005 filed by the assessee before the Ld. AO wherein it has been categorically stated by the assessee that the incremental investments made in tax free bonds during the year by the assessee was only Rs.49,48,13,717/-, which has been erroneously taken by the lower authorities at Rs.89,48,13,717/-. ***From the perusal of the balance sheet of the assessee, it is very clear that the assessee is having substantial interest free funds which is much more than the investment made in the securities and bonds of the assessee which had yielded exempt income.*** *Hence, by placing reliance on the decision of the Hon'ble Jurisdictional High Court in the case of Reliance Utilities and Power Ltd., reported in 313 ITR 340 and HDFC Bank Ltd. reported in 366 ITR 505, there cannot be any disallowance on account of interest on borrowed funds u/s.14A of the Act. However, certain administrative expenses certainly need to be disallowed u/s.14A of the Act as the law has been amended with retrospective amendment from 01/04/1962 onwards. In this regard, we find that the Hon'ble Calcutta High Court in the case of CIT vs. R.R. Sen & Brothers P Ltd in GA No.3019/2012 in ITA No.243/2012 dated 04/01/2013 had held as under:-*

> *The assessee did not show any expenditure incurred by him for the purpose of earning the money which is exempted under income tax. The Tribunal has computed the expenditure at 1% of such dividend income, according to them, as the thumb rule applied consistently. We find no reason to interfere. The appeal is dismissed.*

5.3. Respectfully following the aforesaid decision of Hon'ble Calcutta High Court, we direct the Ld. AO to disallow 1% of total exempt income u/s.14A of the Act. Accordingly, the ground No.4 raised by the assessee is partly allowed"(emphasis applied).

7. Moreover, in subsequent AYs 2005-06 to 2007-08 (i.e., until Rule 8D: *Method for determining amount of expenditure in relation to income not includible in total income* of the Rules was introduced), the CIT(A) deleted the *ad hoc* disallowance under section 14A of the Act made by the learned AO and held in favour of the Assessee (that no disallowance is warranted under section 14A of the Act), and the AO has not filed an appeal against the CIT(A) order on this ground. Without prejudice, the Assessee submitted that the disallowance cannot exceed 1% of the total exempt income earned during the year, as determined by the Tribunal in AY 2002-03 and 2003-04.

8. Thus, consistent with the past precedence, we hold that disallowance of 1% of the total exempt income is justified for the purpose of disallowance u/s 14A. Accordingly, this ground is partly allowed.

Ground No. 2: Depreciation of Rs 11,80,900 – GESCO

9. The Ld. AR submitted before the ITAT that this ground has become infructuous as the ITAT has already granted relief in respect of the amounts paid to the erstwhile tenant GESCO as revenue expenditure in its order for AY 1999-2000 (i.e., in the year of payment to GESCO) and, accordingly, the depreciation claim has become infructuous. Accordingly, this ground is dismissed as infructuous.

Ground No. 3: Depreciation of Rs 1,50,000 to Gillanders Arbuthnot and Company Ltd ('Gillanders')

10. The Assessee's was the owner of the building, and the Assessee branch was situated in the same building, part of which was let out to Gillanders. The Assessee, being the owner of the building, initiated various proceedings for Gillanders to vacate the premises. Since HSBC was facing a space constraint and Gillander's presence was hindering the free and effective use of premises owned by the Assessee, it requested Gillanders to vacate the premises. Gillanders entered into a Memorandum of Understanding with the Bank to vacate and handover the said premises to the Bank on payment of Rs 30 lakhs by the Assessee.

11. The AO and CIT denied the depreciation of Rs 1,50,000/- towards the compensation of Rs 30,00,000/- for vacating the premises towards Gillanders.

12. While the Assessee before the learned AO and CIT (A) had requested a tax depreciation claim on the amount paid to Gillanders, based on the ITAT's judgement in the Assessee's own case for AY 1999-2000 (in the case of GESCO) the Assessee vide letter dated September 29, 2022 filed an additional ground before the ITAT to request that the Assessee be allowed a tax deduction for the payment made to Gillanders to vacate and hand over peaceful possession of premises as revenue expenditure.

13. It is seen that the facts of this ground are similar to ground 2 of Assessee's appeal before the ITAT, i.e., payment to another tenant, GESCO, wherein the ITAT vide its order for AY 1999-2000 had already allowed a claim of a similar nature as revenue expenditure. The relevant extracts of the ITAT's order dated November 20, 2015, for AY 1999-2000 are reproduced below:

"69. After hearing the contentions of both the parties and on perusal of records including the decisions relied upon by the assessee, we are of the considered opinion ***that the expenditure incurred by the assessee for vacating the premises given to the tenant is a business expenditure and allowable as revenue expenditure****, Therefore, we allow Ground 4 in part.*

70. Since we allow the main claim taken by the assessee in respect of business expenditure, we reject the alternative plea taken by the assessee."

14. Accordingly, the Assessee prayed that the additional ground raised by the Assessee should be admitted, and the expenditure of Rs 30,00,000 towards vacating the premises should be allowed as revenue expenditure, following the decision of the Hon'ble Tribunal for AYs 1999-2000. Without prejudice, if the Tribunal intends to deny the claim for revenue expenditure, the Assessee requests that the original plea for tax depreciation on payment to Gillanders be allowed.

15. Here in this case, the Tribunal as noted above has already held that expenditure incurred by the assessee for vacating the premises given to the tenant is business expenditure and allowable as Revenue expenditure as paying compensation to the tenant for vacating premises cannot be capital expenditure.

Since ITAT has allowed similar amount as revenue expenditure, therefore, consistent with the same we allow same as revenue expenditure. Accordingly, this ground is allowed in favour of the assessee.

Ground No. 4: Deferred guarantee commission – Rs 1,44,37,836/-

16. Brief facts qua this issue are that, guarantee commission was received in respect of the period for which the guarantee was issued and assessee had spread the guarantee commission over the period for which it is issued. It was stated that under the accrual method of accounting, such commission was required to be spread over the validity period of the guarantee. The Assessee consistently follows this method of accounting. Thus, it was submitted that in view of the provisions of Section 145 Act, the accrual method of accounting has to be respected while computing the total income of the Assessee.

17. The learned AO held that the guarantee commission is taxable in the year of receipt and cannot be spread over the period of the guarantee. The CIT (A) confirmed the additions by relying on the decision of their predecessor's order for earlier AYs.

18. We agree with the contention of the assessee that no adjustment is required to be made to the total income in respect of the guarantee commission received in advance, which has

been rightly recognized as income over the life of the guarantee and not at the time when the guarantee is issued. The sample copies of the guarantees placed before us evidence that, with respect to big relationship customers, the Bank refunds a portion of the guarantee commission relating to the unexpired period after obtaining special internal approvals if a guarantee were to be revoked before its maturity date. The deferred guarantee commission did not accrue or arise in the year in which guarantee agreements were entered. Accordingly, we hold that the guarantee commission should be spread over the period to which it relates and should not be taxed upfront in the year of receipt.

19. We find that the Tribunal has held this issue in favor of the Assessee in respect of previous A.ys. 2001-02 to 2003-04. The relevant extracts of the ITAT's order for the assessment year 2001-02, dated November 20, 2015, which has relied on the decision of the Calcutta High Court in the case of CIT v/s Bank of Tokyo (71 Taxman 85), are reproduced below:

"After hearing both the parties on the issue and perusal of the records including the case relied upon by the parties, we find that the Ld. CIT(A) has passed well reasoned order and directed the AO to delete the addition. For the sake of convenience, we also reproduce the relevant findings of the Hon'ble Calcutta high court viz CIT(A) Bank of Tokyo Ltd as under:

> *"The Revenue contends that the right to receive the commission being a one-time right, its accrual shall coincide with the commencement of the service rendered by way of guaranteeing the debt repayment; it is immaterial that the repayment covers more than on previous year. Therefore the entirety of commission accrues at a time. The assessee bank on the other hand submits,*

that the service having a spread of years over the accrual should be year by year. The Revenue's contention that the accrual of the entire commission is a point of time accrual is not tenable. The contesting submissions boils down to one question, whether accrual is co-eval with the pay ability, the same may be payable but may not be apportionable until the happening of an event; in the present case, the expiry of the period, for, the guarantee beyond the expiry date of the previous year remains in suspense. It may or may not fructify into an actual right to revive for the subsequent period of the term of the guarantee as the sooner determination of the guarantee is a contingency not ruled out by the agreement. It Is only upon certain conditions being fulfilled, viz, the guarantee running the full course or the period if the debt guaranteed, that the right to entirety of the commission can be said to have accrued…

Accordingly, we dismiss ground no 7 taken by the revenue."

20. This proposition has also been upheld by the **Bombay High Court** in the case of **BNP Paribas SA (32 taxmann.com 276).** Relevant extracts of the said order are reproduced below:

"4. So far as question © is concerned, the issue is whether the commission received by the respondent from its client to provide Guarantee is to be taxed in the year of the agreement (the year of the receipt) to provide the guarantee or to be spread over the period for which the guarantee is provided. In the present facts, CIT(A) has come to a finding of fact that the guarantee which has been issued for a certain period of time are cancelled by the client before the expiry of the tenure of the guarantee, resulting into the respondent- assessee returning to its clients the part of the guarantee commission attributable to the unexpired period of the guarantee. This finding of fact was upheld by the Tribunal while following the decision of the Calcutta High Court in the matter of CIT v. Bank of Tokyo Ltd. [1993] 71 Taxman 85 wherein it has been held that the income earned from deferred guarantee commission did not accrue or arise to an assessee in the year in which the guarantee agreements were entered into but should be spread over the period of the guarantee proportionally. In these circumstances, the decision of the Tribunal in upholding the order

of the CIT(A) is a conclusion based on a finding of fact and hence, we do not see any reason to entertain question (c).”

21. Thus we hold that no adjustment can be be made to its total Income in respect of the guarantee commission received in advance, which is rightly recognized as income over the tenure of the guarantee and not in the year in which the guarantee is issued. This ground is thus allowed.

Ground No. 5: Expenditure incurred on separation/ termination of employees-Rs 19,19,64,640.

22. Facts in brief qua this issue are that, as part of the rationalization of operations and workforce, some employees of the Assessee were terminated from bank services during AY 2004-05. Such employees were either redundant, and hence, their employment contract was terminated by the Assessee, or they resigned from the services on account of redundancy. The Assessee made a provision of Rs. 33,00,00,000 towards such separation costs during the subject year. As against this, an amount of Rs.19,19,64,640 was actually paid to the separating employees. Tax under section 192 of the Act has been withheld from the same and paid into the Government treasury. The Learned AO and CIT(A) treated the expenditure as falling within section 35DDA of the Act.

23. It is not disputed that the payments made to the redundant / separating employees have been incurred wholly and exclusively in relation to the Assessee's business and are deductible under

section 37 of the Act. Further, tax was deducted at source from such employees and deposited in relation to the said payments.

24. It has been stated that, the Assessee operated a separate VRS scheme from July 7, 2003, to July 31, 2003, which was considered for section 35DDA of the Act. The said VRS scheme is included on page 17 of the factual paper book filed by the assessee before us. The said scheme applied to the clerical and subordinate staff of Assessee that had attained 40 years of age or completed 10 years of service with the Assessee. The specific scope and eligibility enunciated in the said VRS scheme was in accordance with Rule 2BA of the Rules. The payments made to the redundant / separating employees did not conform to the VRS scheme of the Assessee / guidelines laid down under Rule 2BA of the Rules. Since the said payment is not pursuant to a VRS scheme, section 35DDA of the Act should not apply.

25. The Assessee has submitted the statement showing details of severance cost paid to the employees. It has submitted the method of computation of expenses in code on separation and termination of employees. Additionally, as directed during the course of the hearing, assessee has attached sample copies of letters of termination/separation of employees**.** It has been further submitted that the method of computation for payments to redundant employees per the sample letters of separation / termination of employees is different than the manner contained in the VRS scheme.

27. The said proposition has also been upheld by the Mumbai ITAT in the case of Warner Lambert (India)(P.) Ltd (143 TTJ 571), which has identical facts to the Assessee's. The relevant extracts of the said order are reproduced below (emphasis supplied):

"17. We have considered the submissions of both the parties. Sec. 35DDA (1) of the Act reads as under :

> *"35DDA. (1) Where an assessee incurs any expenditure in any previous year by way of payment of any sum to an employee at the time of his voluntary retirement, in accordance with any scheme or schemes of voluntary retirement, 1/5th of the amount so paid shall be deducted in computing the profits and gains of the business for that previous year, and the balance shall be deducted in equal instalments for each of the four immediately succeeding previous years."*

18. A bare perusal of this section would reveal that the applicability of this section is attracted only when the payment has been made to an employee in connection with his voluntary retirement, in accordance with any scheme or schemes of voluntary retirement. Since the payment reduces the burden on the assessee relatable to subsequent years, the legislature inserted this section in order to allow only 1/5th of the total sum paid by the assessee to its employees. This amount in the hands of the employee has been exempted under s. 10(10C) of the Act to the extent of Rs. 5 lacs. The relevant part of s. 10(10C) reads as under :…"

19. The submission of the learned Departmental Representative is that the provisions of s. 35DDA are applicable because the payment has been made in pursuance to scheme of voluntary retirement and it is not necessary that the said scheme should comply with guidelines as per s. 10 (10C). We are not inclined to accept the plea of the learned Departmental Representative. In the present circumstances, in order to resolve the dispute, we are of the opinion that principles of harmonious construction of statute have to be applied. As per these principles a statute must be received as a whole and one provision of the Act should be

conformed with reference to other provisions in the same Act so as to make a consistent enactment of the whole statute. The provisions relating to voluntary retirement scheme are contained in s. 10(10C) and all the conditions laid down therein have to be fulfilled before exemption can be availed under the said section. The income and expenditure go together and it is difficult to appreciate that while considering the expenditure part any kind of claim could be taken into consideration whereas while allowing exemption only those claims are to be taken into consideration which conform to the guidelines under r. 2BA. The language in s. 35DDA and s. 10(10C), as noted above, clearly refers to scheme or schemes of voluntary retirement. It is true that s. 35DDA does not specifically refer to s. 10(10C) but principles of harmonious construction have to be applied here and it is to be held that the requirements as laid down under r. 2BA have to be met before deduction under s. 35DDA could be allowed. There is no dispute that the scheme adopted by the assessee did not conform to the guidelines laid down under r. 2BA. Therefore, it cannot be held that provisions of s. 35DDA are applicable in the present case. We are in agreement with the pleading of the learned Departmental Representative that deduction of tax under s. 192 out of sum of Rs. 17 lacs without allowing any exemption is not of much relevance, because that does not determine the correct tax liability of the assessee. However, it is an important factor to be taken into consideration in deciding the issue since the assessee has deducted the tax from the entire sum of Rs. 17 lacs. Therefore, the plea of the assessee that the claim of the assessee is not in conformity with r. 2BA, cannot be disputed. It has not been brought on record by the Department that in the assessment order Ms. Chitra Dhoke was allowed exemption as contemplated under s. 10(10C). In view of the above we confirm the order of the learned CIT(A). In the result, this ground is dismissed."

28. Thus, following the aforesaid decision, we hold that expenditure of Rs 19,19,64,640/- is fully deductible under section 37 of the Act, since the expenditure is incurred wholly and exclusively for its business and the rationalization was not a part of voluntary separation scheme and, as such, was not

covered by the provisions of Section 35DDA of the Act. Accordingly, this ground is allowed.

Ground No. 6: Salary of Mr. C Trench (3 days of salary and perquisites), Mr. Peter E. Davies – 12 days of salary

29. This is ground is similar to ground No 1 of the department and same shall be decided while deciding the appeal of the department.

Ground No. 7: Salary of Mr. Ashok Bhatia – 50 per cent of total salary and perquisites.

30. Brief facts qua this issue is that, Mr. Ashok Bhatia was employed by HSBC Asia Holdings BV as the Chief Information Officer of India, Middle East and Africa located in the HSBC Software Development Centre, India. He had been deputed to the Indian branch of the Assessee for three years. As a part of his global role, Mr. Ashok Bhatia spent 50 per cent of his time rendering services to the Indian branch of the Assessee and the balance of 50 per cent of time was spent rendering services to the overseas associated enterprise ("AE') of the Assessee. The salary paid to Ashok Bhatia has following three components:

Sr No	Particulars	Amount	Deduction claimed by the Assessee in its income-tax return	Remarks
1.	Onshore salary	Rs 74,45,620	Rs 74,45,620	Debited to the profit & loss account of the Assessee and paid by the Assessee.
2	Cash	Rs	Rs	Paid by the overseas

	component of the offshore salary	1,99,53,328	1,08,08,053 (i.e., Rs 1,99,53,328 minus (Rs 1,99,53,328 x 50% x11 / 12)	entity and not debited to the profit & loss account of the Assessee. The Assessee claims deduction of the said component under section 37 of the Act since they are direct expenses that have been incurred by the overseas entities wholly and exclusively for the business of the Assessee. However, in respect of Mr. Ashok Bhatia, the Assessee has restricted the deduction claim of the said component to 50 percent for 11 months (as the services to the AE were rendered for 11 months).
3	Perquisite component of the offshore salary	Rs 19,95,333	Nil	The said payment has neither been debited to the profit & loss account of the Assessee nor claimed as a deduction in the income-tax return by the Assessee.

32. The total salary has been taken into account by Mr. Ashok Bhatia in computing his income from salary, and due tax on the

total salary has been deducted at source and deposited by the Assessee. Our attention was drawn to Form 16 issues to Mr. Ashok Bhatia at page 125 of the factual paper book which contains income-tax return form filed by Mr. Ashok Bhatia.

33. The learned AO held that the cash component of the offshore salary cannot be allowed as a deduction under section 37 of the Act and should be considered part of the head office expenditure. While the CIT (A), in the case of Mr Ashok Bhatia, directed the learned AO that 50 percent of the total salary and perquisites be disallowed since it is not related to the business of the Indian branches. Reference was also made to the appointment letter issued to Mr. Ashok Bhatia for his employment with HSBC Asia Holdings BV in relation to his global role as the Chief Information Officer of India, Middle East and Africa located in HSBC Software Development Centre, India. The letter indicates that Mr. Ashok Bhatia has been seconded to the Assessee's office in India for three years. Further, point 7.0: Duties of the letter indicates that:

"You will perform such duties as are in the opinion of the Group IT director appropriate to the Chief Information Officer India, Middle East and Africa and will perform such other duties and exercise such powers in HBAP or any HSBC. Group company as may from time to time be delegated to you by, or with the authority of the Group IT director. The Group's earning Ratings will be determined by group Finance. Your personal rating will be determined by the Group IT Director."

35. At the time of hearing, assessee without prejudice claimed that the cash component of the offshore salary cannot be

considered as head office expenditure as it is a direct cost of the Indian branch of the Assessee. Further, in order to avoid further litigation, the Assessee has restricted its claim to the following two contentions:

(a) Though the CIT(A) directed the learned AO to disallow 50 per cent of the total salary and perquisite, in respect of the perquisite component of the offshore salary, no disallowance should be made as the said amount has not been claimed as a deduction in the return of income and thus, there is no question of a disallowance. Moreover, even the learned AO had also not disallowed the perquisite component of the offshore salary.

(b) The disallowance of 50 per cent of both onshore salary and offshore salary (cash component) should be restricted proportionately to 11 months (since Mr. Ashok Bhatia has rendered services to the AE for 11 months) and not the entire year.

36. Thus, in view of the fact that Ld. CIT (A) has directed the AO to disallow 50 per cent of the total salary and perquisite, in respect of the perquisite component of the offshore salary, therefore, no disallowance can be made as the said amount has not been claimed as a deduction in the return of income; and secondly we agree with the contention of the Ld AR that the disallowance of 50 per cent of both onshore salary and offshore salary (cash component) should be restricted proportionately to 11 months only and not the entire year. Accordingly, this ground is allowed partly.

ITA No: 7824/MUM/2010 – Department Appeal

Ground No. 1: Salaries paid to expatriate officers employed in India – Rs 9,43,73,653 and HSBC's Appeal Ground No 6: Salary of Mr. C Trench (3 days of salary and perquisites), Mr Peter E. Davies (12 days of salary and perquisites)

37. Brief facts are that, some of the expatriate officers have been deputed to the Assessee's Indian branches, who render services to the Indian branches of the Assessee. As they have been deputed from overseas, a portion of their salary costs are not reflected in the financial accounts of the India branches of the Assessee. However, since these costs were incurred wholly and exclusively for the business of the India branches, the same was claimed by the Assessee deductible under section 37 of the Act. Such salary has been considered in computing salary income of the expatriate officers chargeable to tax in India since it is earned for services rendered by them in India and due income tax has been paid on such salary into the Indian Government treasury.

38. The learned AO held that the cash component of the offshore salary, which is paid by the overseas branch, cannot be allowed as a deduction under section 37 of the Act and should be considered part of the head office expenditure as defined in section 44C of the Act. While the CIT(A) held that the salary paid to the expatriate officers could not be considered as a head office expense, since it is not covered by section 44C(iv)(b) of the Act

(based on the favourable judgements of the ITAT in Assessee's own case from AY 1992-93 to AY 2003-04), and to allow the expenditure fully, since it is related to the Indian operations of the Assessee, except in case of Mr Ashok Bhatia, Mr C Trench and Mr Peter E Davies, where the CIT(A) directed the learned AO to disallow 50 per cent of 3 days and 12 days of the total salary and perquisites respectively since it is not related to the business of the Indian branches.

39. Before us, the details of expatriate officers employed in India together with their designation and remuneration, copies of Form no 16 issued to the expatriate employees, the income-tax return forms filed by the expatriate employees, and secondment letters / posting letters justifying the aforesaid facts have been filed which was already been filed before the learned AO / CIT(A). It has been submitted that these employees were deputed to the Indian branch of the Assessee and worked exclusively for the India operations; the cash component of their offshore salary, which the overseas entity has paid, is an expenditure incurred exclusively for the Assessee's Indian branch, and hence, cannot be covered by section 44C of the Act, as it is not a part of the head office cost but a direct cost of the Indian branch.

41. We find that the Tribunal, in Assessee's own case (including that of the British Bank of Middle East now merged / amalgamated with the Assessee) for AYs 1992-93 to 2003-04, has decided this issue in the Assessee's favor. Relevant extracts

of the ITAT's order dated February 15, 2007, for AYs 1992-93 to 1997-98 are reproduced as under:

"18. There is no dispute that the expatriate employees in question were working exclusively for the Indian operations. Following the discussions in paragraph 5 above, these expenses can not be treated as head office expenses and have to be allowed in computation of income of India operations which is taxable in India. This view is also directly approved by Tribunals decision in the case of ABM Amro Bank Vs JCIT a copy of which was placed before us at page 13 of the compilation. In this view of the matter and having heard the rival contentions on the issue, we see no reason to disturb the findings of the CIT (A). We confirm the same and decline to interfere in the matter."

42. In relation to the disallowance of 50 percent of the total salary and perquisites in the case of Mr. Ashok Bhatia, we have already discussed in assessee's appeal in Ground No. 7 above.

43. Now in relation to the disallowance of salary pertaining to Mr. C. Trench and Mr. Peter E. Davies, it is not in dispute that a nominal time of 3 days and 12 days, respectively, was spent on internal audit work for overseas branches. As a part of their global role in a multinational group, these expatriate employees were required to undertake certain co-ordination work for overseas branches. The Tribunal in the Assessee own case for AY 2002-03 and 2003-04 has held that; "*These are mere incidental activities carried out by the employees, which acquire group wise liaising and coordination and the same need not be required to be compensated."* Given the nominal amount of time spent on the same, the portion of the salary paid to these employees continues to relate to the Assessee's India operations,

and that has been claimed as a deduction by the Assessee in its books of accounts, in our opinion ought not to be disallowed. Accordingly this ground of the revenue is dismissed.

Ground No. 2: Expenses incurred for mobilization of deposits from Non-resident Indians (NRIs) – Rs 8,88,50,535.

45. Brief background qua this issue are that, NRIs form a large resource pool with potential sources for foreign currency funds for India both in terms of deposits and investment, and the large extensive network of HSBC's branches and offices, particularly in countries in the Middle East, is of great assistance to the Assessee in their marketing efforts. To persuade NRIs to invest in India, it is not merely enough to offer financial incentives; considerable selling efforts are also required. To mobilize and garner deposits, the Assessee has NRI desks in the Middle East, UK, USA, Singapore and Hong Kong 'desks'. The expenditure is in respect to activities exclusively related to the marketing for NRI deposits and to provide personalized and expert service to the NRIs. The expenses incurred toward these NRI desks are in the nature of salaries, travelling, advertising and other incidental expenses. Though the relevant offices outside India have debited this expenditure to the Assessee's head office in Hong Kong, it must be noted that the expenditure has been incurred wholly and exclusively for the purpose of the Assessee's Indian operations and is allowable as a deduction in computing the Assessee's income in respect of its Indian operations. The Indian branch of the Assessee alone benefits from the NRI deposits collected. The income generated forms part of the taxable income

of the Assessee. The expenditure that has been incurred in earning such income should, therefore, be fully deducted when arriving at the taxable income.

46. The learned AO held that the expenditure could not be allowed under section 37 of the Act and should be considered part of head office expenditure under section 44C of the Act. While the CIT(A) held that the NRI mobilisation expenses cannot be considered as a head office expense since it is not covered by section 44C of the Act, based on the favourable judgements of (a) the ITAT in Assessee's own case (including that of the British Bank of Middle East now merged / amalgamated with the Assessee) from AY 1992-93 to AY 2003-04), and (b) Bombay High Court in Assessee's own case in respect of AY 2000-01 and directed the learned AO to allow the expenditure fully since it is related to the Indian operations of the Assessee.

47. The expenditure incurred is specifically for the purpose of deposit mobilization of the Indian branch of the Assessee and rendering related services to customers. It is not in the nature of general administration expenses and is also not in the nature of common expenditures allocable to the branches. The expenses incurred and the benefit derived is directly attributable to the Indian branch of the Assessee, and therefore, such expenditure cannot be held to be covered under section 44C of the Act. The Assessee has also furnished the details of expenditure incurred which is duly supported by Independent accountants' certificates

and expenses statement. We find that, the Tribunal in Assessee's own case (including that of the British Bank of Middle East now merged / amalgamated with the Assessee) from AY 1992-93 to AY 2003-04 has held in favorof the Assessee. Relevant extracts of the ITAT order for AY 1992-93 to 1997-98, dated February 15, 2007, are reproduced below:

"5. Having heard of the rival contentions and having perused the material on record, we find that the objections taken to the deduction of the said expenditure are devoid of legally sustainable reasons. As far as the question of the expenses incurred abroad being hit by the provisions of section 44C is concerned the law is not settled by the hon'ble Bombay High court in the case of CIT Vs Emirates Commercial bank limited (265 ITR 55) wherein Their lordship have held that 'the expenditure which is covered by Section 44C is of a common nature, which is incurred for various branches or which is incurred for the purpose of head office and the branch'. Their Lordship held that the expenditure incurred exclusively for the purposes of the branch cannot be covered under section 44C. It would thus follow that the provision of section 44C will hit only such expenditure which are not being capable of being allocable to any particular profit centre and which are required to be allocated on some general basis. The expenses on mobilisation of NRI deposit can not be said to fall in this category because these expenses are for the purpose of India specific operations where non resident Indian deposits are of relevance. These expenses, therefore cannot be allocated to operations in other countries or to the head office. This kind of an expenditure, in our considered view, does not fall under scope of head office expenditure under section 44C of the Act. In the caseof American Express Bank Ltd in which a different view was take by the Tribunal has since been reversed by the Hon'ble Bombay High Court vide judgement dated 17th July, 2003 and a copy of the said judgement was placed before us at pages 16 to 18 of the paper book. Learned counsel has invited our attention to Tribunal decisions, in favour of the assessee on the same issue in the cases of Abu Dhabi Commercial Bank and ABM Amro Bank as well . Copies of these decisions were also placed before us in the paper

book. In light of these decisions, we are of the considered view that the objection of the revenue is devoid of legally sustainable merits. As far as expenditure not being debited in the books of account of Indian operations is concerned, this is not really relevant in the light of law laid down by Hon'ble Supreme Court in the case of Kedarnath Jute Mills Limited (82 ITR 363). As long as the expenditure is really incurred and is otherwise deductible, the deduction cannot be declined on the ground that it has not been debited in the books of accounts. We have also noted that as noted in the Assessing officer's orders itself, the requisite details were duly furnished by the assessee. Keeping all these factors in mind, as also entirely of the case, we deemed fit and proper to delete the impugned disallowance of Rs 86,75,490. The assessee gets relief accordingly".

49. Further, the Hon'ble Bombay High Court has held in favour of the Assessee in respect of AY 2000-01 by dismissing department's appeal on this ground on the basis that the department had not challenged the ITAT's order on this ground for earlier years. Accordingly ground no.2 raised by the revenue is dismissed.

Ground No. 3: Disallowance on payments towards canteen subsidy, holiday home subsidy, contribution to staff cultural committee and payment to recreation club – Rs 1,10,66,662.

Ground No. 4: Disallowance on payments for membership and subscription fees – 50 percent of Rs 41,56,860

Ground No. 5: Disallowance for guest house expenses – Rs 1,11,65,404

Ground No. 6: Disallowance of entertainment expenses – Rs 2,80,43,079

50. In relation to the department's ground numbers 3 to 6 above, before the ITAT, the AR states that the expenses incurred by the Assessee are wholly and exclusively for its business and, therefore, deductible under section 37 of the Act. Accordingly, the question of any disallowance does not arise.

51. We find that the ITAT, in Assessee's own case in previous AYs, has decided these issues in the Assessee's favor and before us detail chart on department's grounds has been given enclosed which contains the list of decisions of the ITAT in the Assessee's own case as well as other rulings on which the Assessee has placed reliance.

52. Since the grounds No.3-6 have been dismissed and allowed in favour of the assessee and therefore, following the same we hold that ld. CIT(A) has rightly deleted the said disallowance and consequently, these grounds raised by the Revenue are dismissed.

Ground No. 7: Disallowance on increased provision made towards pension fund – Rs 30,67,20,000.

52. Brief facts are that during the year ended March 31, 2004 (relevant to AY 2004-05), the Assessee had made a provision of Rs. 30,67,20,000/- towards funding of overall deficit in the pension fund, which has arisen on account of changes in annuity rates. The said provision was based on an independent actuarial report. Such deficit arose since the total liabilities of the pension fund exceeded its total assets. The Assessee paid the

said amount to the pension fund in the months of July and August 2004. The provision / payment of the aforesaid amount of Rs 30,67,20,000 was not a "contribution" to the pension fund within the meaning of section 36(1)(iv) of the Act and the Rules made there under.

53. On perusal of the relevant provision, it is een that the term "contribution" is defined in Rule 2(c) of Part A of the Fourth Schedule to the Act read with Rule 1 of Part B thereof to mean "*any sum credited by or on behalf of any employee out of his salary, or by an employer out of his own moneys, to the individual account of an employee, but does not include any sum credited as interest*'. In the present case, the payment is not credited to the individual account of an employee but paid to the pension fund to enable it to fund the overall deficit as determined by an independent actuary.

54. The learned AO held that the payment made to the pension fund is covered under section 36(1)(iv) of the Act; that the amount paid exceeds the prescribed limit of 27 per cent and accordingly disallowed the said amount. The CIT (A) has held in favour of the Assessee and directed the AO to allow the expenditure of Rs 30,67,20,000.

55. As indicated in aforesaid para, the payment was not credited to the individual account of the employee but paid to the pension fund to enable it to fund an overall deficit. Moreover, it has been pointed before us that the said payment was based on

an actuarial valuation report. Consequently, the question of applying the provisions of section 43B read with section 36(1)(iv) of the Act does not arise and the payment is deductible under section 37 of the Act.

56. It has been stated that the said contention of the Assessee has been upheld by the Surat ITAT in case of Surat District Coop. Bank Ltd. Vs ACIT (152 taxmann.com 549)which has similar facts as that of the Assessee. The relevant extracts of the said order are reproduced below:

"15. We have heard both the parties. Learned DR for the Revenue submitted that on the facts and circumstances of the case and in Law, the Ld. CIT(A) has erred in deleting the disallowance of expenses towards Employees contribution to provident fund/shortfall Rs. 29,00,000/- without appreciating the fact that the assessee is using this fund to cover up shortfall and pay employees contribution which is in fact to be collected from its employees and hence not an allowable expenses in the hands of the assessee. On the other hand, Ld. Counsel submitted that the assessee bank has made the contribution towards the shortfall in Provident Fund's Statutory Interest Rate of 9.5%. This shortfall has been made good from the Fund created namely, "Staff Provident Fund (Interest)", specifically for this sole purpose. The fund has been created from Profit remained after payment of income tax. Hence, in the year of actual expenditure (i.e. Contribution towards Shortfall in maintaining the Statutory Rate of Interest of Provident Fund) the expenditure claimed under section 37(1) of the Act is allowable. The expenditure made from the Fund does not change its nomenclature. It is an expense. If the actual expenditure made by the assessee is not allowable than there is certainly double taxation in the hands of the assessee. It is the statutory requirement under the Provident Fund Rules notified by the Central Government. As per Rule 17, any deficiency/shortfall in the maintenance of Provident Fund Interest Rate shall be made

good by the Employer. The Statutory Provisions of the Rules are reproduced as under:..."

"16. Thus, ld Counsel submitted that from the above, it is very much evident that in case of any Shortfall in maintaining the Interest Rate in the Provident fund of the employees, it is the responsibility of the Employer. Further, the creation of Employees Provident Fund Trust is Statutory Duty of the employer. The assessee co-operative bank has fulfilled all its statutory liability towards the Employees Provident Funds Act and hence, the payment made towards maintenance of Statutory Interest Rate is allowable expenditure u/s 37(1) of the Act. The CIT(A) in his order rightly allowed the same. However, the assessing officer in his order without verifying the records available with him i.e. the computation of income that amount contributed to the "Staff Provident Fund (Interest)" is tax paid amount and held that the expenditure made from such fund is not allowable u/s 37(1) of the Act.

17. Considering the above facts, we note that the records and documents produced before the AO, were also produced before the CIT(A) by the assessee and every details are explained to the CIT(A) and after considering the material on records and the facts of the case, as well as the legal position of the case, the CIT(A) has rightly allowed the claim of the assessee, therefore we do not find any infirmity in the conclusion reached by ld CIT(A). Hence, we confirm the findings of ld CIT (A) and dismiss ground no. 5 raised by the revenue."

57. Following the above decision, we allow that a deduction of the said expenditure of Rs 30,67,20,000 under section 37 of the Act as it is not a 'contribution credited to any individual account of any employee', and hence, not covered under the provisions of section 36(1)(iv) of the Act but allowable under section 37 of the Act.

A. <u>Transfer Pricing Grounds</u>

58. The Assessee has already submitted a chart showing most of the transfer pricing issues are in favor of the Assessee by the Hon'ble Tribunal's orders for AY 2002-03 and 2003-04. Additionally, as directed, the Assessee has also filed detailed submissions on each of the grounds:

ITA No: 7336/MUM/2010 – Assessee's Appeal

Ground No 8 - Correspondent Banking Activity

59. At the outset, the Ld. Counsel for the Assessee submits that the issue is covered in favor of the Assessee by order of the Hon'ble Tribunal in the Assessee's own case for AY 2002-03 and 2003-04 ('the order'), wherein the Hon'ble Tribunal has deleted the TP adjustment. Our attention was drawn to paras 14.12.1 to 14.15 of the order for the findings of the Hon'ble Tribunal.

60. Brief facts are that, the Assessee is engaged in providing banking services and is part of an international banking company that provides services around the globe. The Assessee has a Correspondent Banking Division ('INM IB'), which manages relationships with Indian Banks / Financial Institutions operating in India ('Indian FIs'). The Assessee sells financial products to the Indian FIs, and the revenue earned is booked by the Assessee and offered to tax in India. During the year under consideration, the INM IB division of the Assessee earned 246.89 million. Further, the Assessee has earned a floating income of INR 18.805 million from the Nostro Account.

62. Further, Indian banks have to establish relations with overseas banks as they do not have a network of branches outside India. The Assessee, while dealing with the Indian bank/FIs would also acquaint its customers of the financial products available with the Assessee globally. This would encourage the FIs to bank with the Assessee considering its global reach. Separately, the overseas branches of HSBC would acquaint their customers of global financial products/ global reach of the Assessee (including the Indian branch). No payment is made by the Assessee for such incidental services as primary benefit of FIs choosing to bank with the Assessee in India is obtained by the Assessee. As a result of such services of overseas HSBC branches, the Assessee has earned income from banks domiciled outside India. The details of the income earned were provided in the submission made by the assessee to the TPO vide dated September 1, 2006.

63. It has been submitted that, the Assessee's marketing activities and HSBC's overseas branches were purely incidental and reciprocal. The benefit that the Assessee receives from marketing its products by its AEs was ignored by the TPO while making a unilateral one-way adjustment. The Ld. TPO rejected the Assessee's arguments and adopted the Transactional Net Margin Method ('TNMM') as the most appropriate method. While applying TNMM, the TPO aggregated the entire direct and indirect cost of the correspondent banking department of the Assessee along with Head office ('HO') expenses to calculate the

cost base and subsequently applied mark-up on this cost to arrive at the adjustment.

65. The CIT (A) provided an ad hoc relief by restricting the cost base to only 75%.

66. Ld. Counsel submitted that neither the Ld. TPO nor the CIT (A) complied with the provisions of transfer pricing by identifying either the transaction or the AE for the purposes of transfer pricing as required by the law.

66. Further he submitted that, the global network of the Assessee is a direct asset and mainly benefits the Assessee by having global reach and the ability to offer services under its network. The Assessee has earned revenue from the sale of products to Indian FIs, which has been offered to tax. Overseas branches of HSBC also provide incidental and services that benefit the Assessee, and the Assessee makes no payment for such services. Hence, services provided are incidental and derive reciprocal benefits. The total Cost of the INM IB division for AY 2004-05 is only 20.75 million, whereas income earned from the activity performed by the INM IB division is 246.89 million. The profit margin that arrived at 1090 per cent is for higher than the margin reached by the Ld. TPO of 20.59 per cent. Thus, the Assessee's is adequately compensated, assuming.

68. More importantly, Ld. Counsel submitted that the Assessee has reported more than 100 transactions in Form 3CEB, and the same were accepted to be at ALP by the Ld. TPO. Admittedly these transactions include items which are marketed by INM IB division such as custodian charges, guarantee commission charges etc. as evident from Form 3CEB. Once the primary business transactions are found to be at ALP, one cannot separately treat incidental benefits as a separate transaction unless it is shown that it is separate from the main transaction.

69. Without prejudice to the above, Ld. Counsel submitted that there is no international transaction identified by the Ld. TPO, no Associated Enterprises identified by the Ld. TPO, no search process identified by the Ld. TPO, and no comparable identified by the Ld. TPO. Hence, the Assessee contends that no adjustment on account of corresponding banking activity is warranted.

70. He also drew our attention to the order from the Hon'ble Tribunal in the Assessee's own case for AY 2002-03 & 2003-04 with respect to such activities wherein the entire adjustment has been deleted, and it has been held:

"14.12.1....The INM IB division does not use any additional facility, and the employees providing this support do not have any special marketing skills or knowledge of the products provided by the overseas HSBC branches. It is important to emphasize that the global network of the assessee is a direct asset and mainly benefit the assessee to have global reach and the

ability to offer services under its network. This directly encourages FI's to approach the assessee for the services as compared to others who may not have such global reach. It may also be noted that the overseas HSBC branches also provide services that benefit the assessee, i.e., in selling INR Vostro accounts of HSBC India to banks domiciled outside India, The assessee does not pay any amount to overseas HSBC branches for such marketing services. It is also pertinent to note that as a result of various services of overseas HSBC branches, as above, assessee had earned float income of Rs.1.97 Crores on the interest free balances maintained by the Indian banks which have maintained Nostro account with the assessee. This fact is not disputed by the revenue before us. Hence, ***it could be safely concluded that the assessee and the overseas HSBC offices being a part of the HSBC group derived reciprocal benefits*** *and thus the* ***non-charging of costs for providing the incidental marketing support services to overseas HSBC entities would not cause any prejudice to the interest of the assessee as well as the revenue****.*

14.12.2…Further, the total cost of INM IB division is only Rs 1.55 Crores, whereas the income earned from the activity performed by INM IB division is Rs 4.48 Crores (including income from Indian FI and Rs 1.97 Crores float income from Vostro account). Even if only the float income from Vostro Account is considered, still the assessee has earned a profit of Rs. 42 Lakhs (1.97-1.55 cr) resulting in profit margin of 27%, which has been already offered to tax. The profit margin arrived is much higher than the margin of 22 percent arrived at by the LD. TPO. If both the income (income from Indian FI and Float income) are considered, the profit margin stands at 189 percent. ***This shows that the assessee is adequately compensated for the activities carried out by INM IB division.*** *Hence the allegation of the revenue that the assessee has not been adequately compensated has no merits.*

14.13 In view of the aforesaid observations in the peculiar facts and circumstances of the case herein and respectfully following the aforesaid decision of this Tribunal, we hold that the ***assessee had considerably benefitted out of earning income from Indian Fis and float income pursuant to correspondent***

banking activities *and the said benefit directly flows to the assessee.*

14.14 It would be crucial to note that assessee had reflected more than 100 international transactions in form No.3CEB filed along with the return of income and the same were accepted to be at arm's length by the Ld. TPO. Admittedly these transactions include items which are marketed by INM IB division such as custodian charges, guarantee commission charges etc. as is evident from Annexure' C to form 3CEB. Hence, it could be seen that the main transactions were found to be at arm's length and the incidental benefit arising out of such transaction has been considered as a separate transaction. We find in the instant case ***that the main business transactions have been accepted to be at arm's length and hence, the Ld. TPO cannot separately treat the incidental benefit as a separate transaction unless it is shown that they are separate*** *from the main business activities..."*

14.15 .....the nature of these services are such that ***they are reciprocal in nature and hence, there cannot be any attribution of markup on the same.*** *Hence, we hold that no markup should be loaded on the attribution of costs towards incidental marketing activities undertaken by the assessee in connection with correspondent banking activities...".*

71. Since similar issue has been discussed and decided by the Tribunal in assesse's own case for the earlier years, therefore, following the same reasoning, we hold that the TP adjustment made by the ld. TPO is deleted.

Ground No 9 - Services provided by employees of the Assessee to overseas' AE's

72. At the outset, the Ld. Counsel for the Assessee submitted that the issue is covered in favor of the Assessee by order of the Hon'ble Tribunal in the Assessee's own case for AY 2002-03 and

2003-04, wherein the Hon'ble Tribunal has deleted the TP adjustment. Relevant extracts of para 15.6 of the order for the findings of the Hon'ble Tribunal.

Certain employees of the Assessee oversee activities related to foreign AEs due to their functions and roles. The employees held key positions in the day-to-day operations of the Assessee's business, i.e., manager group or internal audit, head of information technology, and service quality training. Additionally, they are required to coordinate activities at the group level, spending an insignificant amount of time on tasks related to overseas AE. Predominately, these employees render services for India, and the activities undertaken by the employees were insignificant and merely incidental.

The Assessee has provided details of local employees working for Indian branches who have spent an insignificant amount of time on tasks related to overseas AEs, along with the estimated number of days and the proportionate salary costs incurred.

The Ld. TPO considered the liaison and coordination at the group level as separate international transactions. The Ld. TPO adopted TNMM as the most appropriate method to benchmark this transaction. Based on proportionate time spent, the Ld. TPO aggregated proportionate direct and indirect costs along with HO expenses to compute the cost base and then applied markup on this cost to arrive at the adjustment.

Since the facts were identical to AY 2003-04, the CIT (A) has relied upon the decision given by his predecessor and directed the AO to disallow 50% of Mr. Ashok Bhatia's salary and perquisites (paid in India & abroad). In the case of Mr. Peter Trench and Mr. C. Davis, he directed the AO to disallow only a certain portion of the salary and perquisites not related to the business of Indian branches.

In the earlier assessment years 2002-03 and 2003-04, the Hon'ble Tribunal held that the roles played by the employees are merely an oversight on account of their functions and roles. These employees are primarily engaged in the day-to-day operations of the Assessee's business and predominantly provide services to the

Assessee. These activities cannot be viewed as separate international transactions by segregating them from routine functions. The Hon'ble Tribunal in the preceding years held as follows:

".....generally in a multinational group, several oversight roles would arise within one's functions as an employee. These are mere incidental activities carried out by the employees, which acquire groupwise liaising and coordination and the same need not be required to be compensated. These employees are not employed for day-to-day functioning of the group companies. The activities carried out by the employees were considered as a separate international transaction by segregating them from routine functions by the Ld. TPO. We also find that in case of certain employees, the Assessee had Suo-moto not claimed deduction of proportionate salary pertaining to services provided to foreign AEs. Hence, the same cannot be subject matter of consideration while making TP adjustment as it would lead to double disallowance. In any case, ***these employees render liaising and coordination of services at group level as a mere incidental activity*** *and the same need not be even considered as separate international transaction warranting any benchmarking thereon.* ***As we have already held, that the main banking transactions carried out by the Assessee have been accepted to be at ALP, the incidental activities cannot be separated and benchmarked independently****. Hence, the transfer pricing adjustment made in this regard by the Ld. TPO in respect of role of certain employees of the bank for the A.Y.2002-03 is directed to be deleted.*

72. Thus, respectfully following the above order of the Tribunal in assessee's case, we delete the adjustment made by the TPO. Furthermore, the Assessee has voluntarily disallowed a proportionate salary for certain employees in relation to services rendered to foreign AEs. Given the fact that the primary banking transactions have been accepted at ALP, then separately benchmarking the incidental activities is not feasible. As held by

the Tribunal, the oversight role provided by the employees at the group level is part of the functions of the employees in a multinational group. These employees (other than Mr Bhatia, who has been dealt with separately) are not functioning on a day-to-day basis for any group entity. Hence, it cannot be considered as a separate international transaction as the liaison and coordination services provided by the employees at the group level cannot be regarded as distinct transactions. Accordingly, this ground is decided in favour of the assessee following the past precedent.

ITA No: 7824/MUM/2010 – Department's Appeal

Ground 11 - Marketing/support services as regards ECB transactions

73. At the outset, the Ld. Counsel for the Assessee submitted that the issue is covered in favor of the Assessee by order of the Hon'ble Tribunal in the Assessee's own case for AY 2002-03 and 2003-04, wherein the Hon'ble Tribunal has deleted the Transfer Pricing adjustment relating to the aforesaid issue. Our attention was drawn to para 17.12 of the order for the findings of the Hon'ble Tribunal.

74. From the records it is seen that the marketing/ support services of ECB transactions, the Assessee performs the following functions:-

- *Engaging in discussions with the Indian customer to understand their requirements.*

- *Providing the requirements to the overseas lender AE*
- *Providing credit data to overseas lender AE. Since Indian corporates are customers of the Indian Branch, the credit appraisals are, in any case, done by the Bank from time to time for their local business. Accordingly, the credit data provided to overseas AE does not require additional effort from the Bank.*
- *Liaising between Indian corporate and overseas AE.*

75. The Assessee does not assume any risks in the transaction; all risks lie solely with the overseas lender AE. The charging of fees by the Assessee is based on commercial parameters such as the relationship with Indian Corporate, the efforts required by the Assessee, the overall cost of borrowing of the client, etc. During the year under consideration, the Assessee earned INR 1,33,70,278 on the ECB transaction. These ECB transactions were transfer priced between the Assessee and AE in the year in which the ECB was given by the AE, and the transaction was accepted as an arm's length price.

76. Regarding the ECB transactions entered during the year under consideration, the Ld. TPO accepted the transaction at arm's length. However, for the old continuing transaction, the Ld. TPO, based on his predecessor's findings, concluded that compensation at 25% of the total income received on ECBs by foreign branches was also to be paid in subsequent years.

77. The CIT (A), noting that the transaction was continuous from earlier years and in the absence of risks assumed and considering the nature of the services provided, deleted the

addition made by the Ld. TPO. Since there were no changes in the facts of the case for the years under consideration, the CIT (A) relied on his predecessor's findings for AY 2002-03 and AY 2003-04. In those years, the CIT (A) held as follows:

"...I have carefully considered the appellants submissions. The appellant's contention is that in respect of ECBs given by HSBC foreign branches in earlier years, it is undertaking normal monitoring of accounts and follow up with the customers and that no compensation is received from the foreign branches. The appellant's contention appears to be justified since even the services enumerated at page 13 of the Ld. TPO order would show that the work is of normal monitoring and follow up....

78. In respect of ECBs given by HSBC foreign branches in earlier years, in the absence of risks assumed and taking into consideration the nature of the services provided, **the appellant's contention that no adjustment is to be made in respect of the services is accepted**..."

79. Ld. Counsel submitted that the original ECB transactions with the associated enterprise have been transfer-priced and accepted at arm's length. Therefore, there cannot be any further attribution towards the said transaction. This finding has not been contradicted by the Revenue. In the subsequent years, the Assessee does not assume any risk nor conduct any services except for the credit appraisals, which the Assessee conducts from time to time for their local business. Based on the said facts, the Hon'ble Tribunal in the preceding years held as follows:

"...We find that the Ld. CIT (A) had categorically observed that ***HSBC India does not assume any risk in respect of continuing ECBs compared to the nature of service rendered by them****. This categorical finding has not been controverted by the*

Revenue before us. Hence, ***we hold that no transfer pricing adjustment in respect of the services rendered by HSBC India in respect of continuing ECBs more so when the entire commission income / Debt Syndication Fee income received by the Assessee have already been accepted to be at arm's length.*** *Accordingly, ground no. 6 raised by the Revenue is dismissed."*

Furthermore, the Ld.TPO relied on secret comparables not available in the public domain, engaged in controlled transactions between foreign banks and Indian branches, and adopted an ad hoc 25% as compensation. It is asserted that using secret comparables not available in the public domain is arbitrary and contrary to the law. Additionally and wholly contrary to the Transfer Pricing Rules, the Ld. TPO utilized "controlled" data of foreign banks that had engaged in transactions with Indian branches. Rule 10B of the Income Tax Rules, 1962 ('Rules') specifies that the comparability of an international transaction should be assessed with an uncontrolled transaction. Hence, the utilization of controlled transactions by the Ld. TPO as comparables is not in line with the prescribed rules and is contrary to the law. Hence, the CIT (A) order should be upheld, and the adjustment should be deleted.

Accordingly, following the aforesaid order this ground of the department is dismissed.

Ground No 10 – Marketing of Derivatives Services

80. Brief facts on this adjustment are that, the Assessee primarily interacts with Indian customers to understand their requirements and communicates this information to the overseas AE. Subsequently, the overseas AE may directly engage in transactions with Indian customers. The derivative contract is solely between the Indian customer and the overseas AE; thereby, all risks associated with the derivative contract, including credit risk, market risk, liquidity risk, and country risk, are borne entirely by the overseas AE. The Assessee does not assume any risks in these transactions. For the activities

performed, the Assessee earns a marketing fee from the AE, amounting to 30% of the Net New Business Value (NNBV). The AE earns the remaining 70% to manage the transaction over its life and assumes all the risk associated with the transaction. All HSBC group entities consistently follow this remuneration policy globally, which is not specific to India. Since this issue has been discussed by the Tribunal and decided in favour of the assessee accordingly, we hold that the order of the ld. CIT(A), consequently, the ground raised by the Revenue is dismissed.

82. The Ld. TPO held that certain foreign banks had conducted similar transactions with their branch offices, compensating them for marketing and sales services at a rate equivalent to 60% of the Initial Net Present Value (INPV). Ld. Counsel submitted that the Ld. TPO did not provide details regarding the foreign banks or the functions, assets, and roles of the Indian branch office. The Ld. TPO gave show cause notice to apply 60% of INPV. However, upon being shown that the value was lower than 30% of NNBV, the Ld. TPO ultimately and without any basis or reasoning applied ad-hoc 60% of NNBV.

83. The CIT (A), based on the case's facts, concluded that the Ld. TPO selected secret comparables and failed to disclose the details to the Assessee. These secret comparables were engaged in controlled transactions with group entities and were not independent transactions. In previous years (2002-03 and 2003-04), the Ld. TPO accepted the ALP without making any adjustments, and there have been no changes in the facts.

Moreover, the application of INPV would result in a lower value compared to NNBV. The relevant finding of the Ld. CIT (A), deleting the addition is below:-

*"....The **Ld. TPO's order suffers from various infirmities**. He has **picked up secret comparables and not made available the details to the appellant for its reply**. Secondly, **the secret comparable is in respect of a controlled transaction and hence not independent and not liable to be used as sole benchmark**. Thirdly, no prescribed method has been followed to determine the ALP. On the other hand, the appellant has been **adopting a remuneration (Transfer) policy consistently followed by HSBC group entities across the glob**e. The **Ld. TPO in the earlier year (2002-03 and 2003-04) have accepted the Arm's Length Price and no adjustments was made.** There is no material change in position so far as the transaction was concerned. The **NNBV base is higher than INPV base** and so the compensation based on this model will have lower % share than in the case of INPV model. Taking all the above facts and circumstances cumulating, there is merit in the arguments put forth by the assessee, **remuneration policy of the appellant @ 30% of NNBV is in order**."*

84. We have gone through the order of the Tribunal and the relevant finding given by the ld. CIT(A) and the arguments from both the parties. The manner in which TPO has made the adjustment cannot be accepted for the reasons that-

(a) The TPO has utilized "controlled" data of foreign banks that had engaged in transactions with Indian branches. Rule 10B of the Rules stipulates that the comparability of an international transaction should be judged with an uncontrolled transaction. Therefore, the use of controlled transactions by the TPO as

comparables is not in accordance with the prescribed rules and is contrary to law.

(b) The TPO failed to furnish details of the comparables used in the assessment. Furthermore, no information regarding the foreign banks or the functions, assets, and roles of the Indian branch office was provided. Consequently, the use of "secret comparables," inaccessible in the public domain, cannot be deemed appropriate for comparison purposes. Therefore, the adjustment made based on such secret comparables is unjustified.

(c) In previous years (2002-03 and 2003-04), the Ld. TPO accepted the Arm's Length Price (ALP) without making any adjustments, and there have been no changes in the facts. Furthermore, the Ld. TPO disregarded the Assessee's global transfer pricing policy, which remunerates 30% of the NNBV from derivative transactions.

(d) The TPO rejected all prescribed methods under the Act and arbitrarily adopted a 60% of NNBV allocation without adhering to any prescribed methods and even country to his own show cause notice. Thus, this approach is wholly flawed, ad-hoc and contrary to the Act.

(e) Despite assessee provided the requisite details during the assessment proceedings, including the global policy and a theoretical comparison between the two methods, i.e., 30% of NNBV vs. 60% of INBV, the TPO disregarded the entire

submissions, his own showcase notice and details provided during the proceedings.

85. Before us Ld. Counsel has submitted the following difference in the application of the two methods:-

As per 30 per cent of the Net New Business Value (NNBV) method

Notional: USD 11,000,000

Tenor of the deal: 3.5 years

Value on the deal per annum: 10 basis points per annum (say)

Credit Risk: 3.5 basis points per annum (say)

Net New Business Value (NNBV) on the deal: PV of (USD11 mio * 6.5bps * 3.5years) equals USD 22599 (i.e., Present Value of USD 25025)

30% of this is USD 6,780 /-

As per 60 per cent of the INPV method

Notional: USD 11,000,000

Tenor of the deal: 3.5 years

Value on the deal per annum: 10 basis points per annum (say)

Credit risk on the deal: 3.5 basis points per annum (say)

Other event risk/uncertainty, etc.: 4 basis points per annum (say)

INPV on the deal: PV of (USD11 mio * 2.5bps * 3.5 years) equals USD 8692 (i.e., Present Value of USD 9625)

60% of the above: USD 5215/-

86. From the working of the difference in the application of two methods as given by the ld. Counsel, we do not find any

justification given by the ld.TPO to adopt 60% of NNBV allocation so as to take a contrary stand from the facts of the case presented by the assessee and the transaction of marketing of derivative services. Specially looking to the fact that derivative contract is solely between derivative contract is solely between the Indian customer and the overseas AE; and all risks associated with the derivative contract, including credit risk, market risk, liquidity risk, and country risk, are borne entirely by the overseas AE and the Assessee does not assume any risks in these transactions. For the activities performed, the Assessee has already earned a marketing fee from the AE, amounting to 30% NNBV and the AE is earning the remaining 70% to manage the transaction over its life and assumes all the risk associated with the transaction. Nowhere, ld. TPO has done any analysis of the comparable data as to why it should be adopted at 60%. Thus, we agree with the observation and finding of the ld. CIT(A) and adjustment made by the ld.TPO is deleted.

85. We have perused the relevant finding given in the order passed by Ld. TPO as well as Ld. CIT(A) Further, Ld. Counsel submitted that the actions of the Ld. TPO are contrary to the provisions of the Act and the provisions of transfer pricing. The Ld. TPO has not followed any method and disregarded his own show cause notice and relied upon undisclosed secret comparables in respect of controlled transactions. Thus he submitted that the Ld. CIT (A) findings ought to be upheld, especially since the pricing policy of the Assessee of 30% of the NNBV is a globally accepted practice, followed by the HSBC

group. Further, the Ld. TPO has accepted the same in AY 2002-03 and AY 2003-04. Hence, the CIT (A) order should be upheld and the adjustment deleted.

ITAT Appeal No: 4765/MUM/2016 – Assessee Appeal

Ground No. 1: Expenditure incurred on separation/ termination of employees - Rs 25,60,37,182

87. Brief facts are that, as a part of the rationalization of operations and the workforce, the Assessee terminated the employment contracts of some employees, or they resigned from the services on account of redundancy. During the captioned year, the amount of Rs. 32,00,46,478 has been paid by the Assessee to such employees, representing lump sum compensation on account of separation. Appropriate taxes have been deducted on such amounts paid to employees, and the taxes were deposited to the central government. The details of employees, along with sample copies of the termination letter, were handed over to the Bench during the course of the hearing.

90. The said termination was not part of any Voluntary Retirement Scheme (VRS); hence, the provisions of section 35DDA of the Income-tax Act, 1961 (the Act) are not applicable.

91. We have already given our finding in A.Y.2004-05 and accordingly, in the finding given above, this issue is allowed in favour of the assessee.

Ground No. 2: Depreciation of Rs 2,85,000 on amount paid to Gillanders Arbuthnot and Company Ltd ('Gillanders')

92. This issue has already been dealt by us in A.Y.2004-05 wherein we have allowed this issue treating it as 'Revenue expenditure'. Accordingly, ground No.2 raised by the assessee is allowed.

ITA No 4786/MUM/2016– Department Appeal

Ground No. 1: Expenses incurred for mobilization of deposits from Non-resident Indians (NRIs) – Rs 9,29,19,828

94. Again this issue is similar to the ground raised in Revenue appeal for A.Y.2004-05 and accordingly, in view of the finding given hereinabove, the ground raised by the Revenue is dismissed.

Ground No. 2: Addition of Rs. 10,70,000 on account of overfunding of Employees Gratuity Fund (Income Tax Approved Fund)

95. The facts are that the Assessee makes a contribution to the approved gratuity fund. The Assessee has contributed to the employee's gratuity fund in excess of the amount required to meet the accrued liability for the current year. The details of the same are as under:

Particulars	**Amount (in Rs.)**

Net Surplus as on 31 March 2005 as per actuarial valuation report	86.25 million
Net Surplus as on 31 December 2004 (as per actuarial valuation report)	85.18 million
Overfunding/Excess contribution	1.07 million

96. The Assessee has recognized the over funding/excess contribution as an asset in its books and credited the Profit & Loss A/c. by an aggregate amount of Rs. 10,27,000. This amount has been reduced from the contribution payable for AY 2006-07 as it was already discharged in AY 2005-06. The Assessee has contributed in excess of the required amount. The Assessee cannot claim deduction for expenses over and above what is required for the particular purpose as determined by the actuary for the previous year As the Assessee has itself credited the same to the Profit & Loss A/c., it is taxed.

98. The relevant para of Ld. CIT (A) order allowing the ground in favour of Assessee is as under:

"I have considered the facts of the case, AO's contention and the Appellant submission. I find that the aforesaid issue is covered in the Appellants' favour by the Supreme Court decision in the case of Sugauli Sugar Works (P) Ltd. (1999) (236 ITR 518). Thus, on the basis of the factual submissions and the above decision, the addition of Rs.10,70,000/- made by the AO on account of Overfunding of Employees Gratuity Fund is deleted. Accordingly, this ground of appeal is allowed."

99. We have considered the relevant finding and facts of the case. It has been submitted that oonce the payment has been made to the employees' gratuity fund and there is no provision in the Trust Deed for refunds, the Assessee neither obtained nor received any amount from the Trust nor has the Trust agreed to refund any amount to the Assessee. Furthermore, by making these payments, the Assessee did not obtain any benefit regarding liability remission or cessation, nor did it write off any liabilities in its accounts. Hence, the unilateral credit to the Profit & Loss A/c. did not amount to any cessation of liability that could be taxed. The Supreme Court of India in case *of* **Sugauli Sugar Works (P) Ltd. (1999) (236 ITR 518)** has held as under:

"The principle that expiry of period of limitation prescribed under the Limitation Act could not extinguish the debt but it would only prevent the creditor from enforcing the debt, has been well-settled. It is enough to refer to the decision of this Court in Bombay Dyeing & Mfg. Co. Ltd. v. State of Bombay 1958 SCR 1122. If that principle is applied, it is clear that mere entry in the books of account of the debtor made unilaterally without any act on the part of the creditor will not enable the debtor to say that the liability has come to an end. Apart from that, that will not by itself confer any benefit on the debtor as contemplated by the section"

100. Further, it has been submitted that the excess funds have been adjusted against the contribution of liability payable to the gratuity fund in AY 2006-07. The Ld.CIT(A) in AY 2006-07 has not allowed the deduction of Rs. 10,70,000, as the same has been allowed in AY 2005-06. If assessee has recongnised the excess contribution as asset in its books and credited to profit and loss account amounting to Rs.10,70,000/- and has been

reduced their contribution payable for A.Y.2006-07 as it was already discharged in A.Y.2005-06. Then it has been allowed in this year because in A.Y.2006-07 ld. CIT(A) has not allowed deduction of this amount on the ground that same has been allowed in A.Y.2005-06. Even if we agree with the ld. AO that it should be disallowed in this year, then the same has to be allowed in A.Y.2006-07. Thus, no prejudice is cost to the department and accordingly, there is no point tinkering with the finding of the ld. CIT(A) and same is confirmed.

101. In the result, ground No.2 raised by the Revenue is dismissed

Ground No. 3: Addition of Rs. 40,27,00,000 on account of overfunding of Employees defined benefit pension fund (Income Tax Approved Fund)

101. Brief facts are that, the Assessee makes a contribution to the approved pension fund. The Assessee has contributed to the employee's Pension fund in excess of the amount required to meet the accrued liability for the current year. The details of the same are as under:

Particulars	**Amount (in Rs.)**
Net Surplus as on 31 March 2005 (as per actuarial valuation report enclosed as **Annexure 2**)	165.84 million (504.04 – 338.20)
Net Actuarial Gain as on 31 December 2004 (as per actuarial	403.41 million

valuation report)	
Overfunding/excess contribution	**569.25 million**
Funded	402.73 million
Unfunded	166.50 million
Total	**69.25 million**

102. The pension liability was short funded to the extent of Rs. 306.72 million as on 31 March 2004. This deficit was replenished by the Assessee by crediting a sum of Rs. 75 million on 7 July 2004 and a sum of Rs. 231.72 million on 12 August 2004. Subsequent to this, the Assessee moved to new terms by the freezing of pensions at the time of conversion, effective from 1st April 2004, in respect of certain categories of employees. As on 31 March 2005 the fund showed a surplus to the tune of Rs. 504.04 million primarily driven by the freezing of pension under the new terms. Since the fund was over funded, it was decided to discontinue the contribution of the Assessee with effect from 1st January 2005 till the time a deficit arose. The financial statements of the Hong Kong and Shanghai Banking Corporation Pension Fund as on 31 March 2005 have been enclosed before us.

103. The Assessee has recognized the over funding/excess contribution as an asset in its books and credited the Profit &

Loss A/c. by an aggregate amount of Rs. 40,27,00,000. This amount has been reduced from the contribution payable for AY 2008-09, 2009-10, 2011-12 and 2012-13 as it was already discharged in AY 2005-06.

104. The Assessee has contributed in excess of the required amount. The Assessee cannot claim deduction for expenses over and above what is required for the particular purpose as determined by the actuary for the previous year. As the Assessee has itself credited the same to the Profit & Loss A/c., it is taxed.

105. The relevant para of CIT (A) order allowing the ground in favour of Assessee is as under:

"I have considered the facts of the case, AO's contention and the Appellant submission. I find that the aforesaid issue is covered in the Appellants' favour by the Supreme Court decision in the case of Sugauli Sugar Works (P) Ltd. (1999) (236 ITR 518). Thus, on the basis of the factual submissions and the above decision, the addition of Rs.40,27,00,000/- made by the AO on account of Overfunding of Employees Defined Benefit Pension Fund be deleted. Accordingly, this ground of appeal is allowed."

106. Here again once the payment has been made to the employees' pension fund, there is no provision in the Trust Deed for refunds. The Assessee neither obtained nor received any amount from the Trust nor has the Trust agreed to refund any amount to the Assessee. Furthermore, by making these payments, the Assessee did not obtain any benefit regarding liability remission or cessation, nor did it write off any liabilities in its accounts. Hence, the unilateral credit to the Profit & Loss A/c. did not amount to any cessation of liability that could be

taxed. The Supreme Court of India in case *of* **Sugauli Sugar Works (P) Ltd. (1999) (236 ITR 518) (**supra)

107. Further, the excess funds have been adjusted against the contribution of liability payable to the defined benefit pension fund in the AY 2008-09, AY 2009-10, AY 2011-12 and AY 2012-13. The ld. CIT (A) in AY 2008-09, AY 2009-10, AY 2011-12 and AY 2012-13 have not allowed the deduction of provision, as the same has been allowed in AY 2005-06. Since we have already made similar observation with regard to ground No.2 that even if deduction has to be denied, then direction has to be given for the allowance of expenses AY 2008-09, AY 2009-10, AY 2011-12, and AY 2012-13 wherein, the ld. CIT(A) has not allowed deduction of the provision on the ground that same has been allowed in A.Y.2005-06.

108. If the Tribunal intends to deny the deduction, appropriate directions should be given for the allowance of expenses AY 2008-09, AY 2009-10, AY 2011-12, and AY 2012-13 as under

Assessment year	**Amount in Rs**	**Page no of CIT(A) order**
2008-09	3,31,69,000	43
2009-10	21,29,21,000	29
2011-12	8,80,21,830	29
2012-13	2,80,61,000	25

109. Instead of tinkering with the allowability and disallowability in the subsequent year, we are of the opinion that the order of the ld. CIT(A) dealing the addition here is justified instead of giving direction to the ld. AO for allowing it for A.Y.2008-09 to 2012-13.

110. In the result, this ground raised by the Revenue is dismissed.

Ground No. 4: Addition of Rs. 16,64,97,286 on account of reversal of provision towards unfunded pension liability in respect of ex-employees

109. Brief facts qua this issue are that, provision made in AY 2004-05 of Rs. 37,42,55,286 has been *suo moto* offered and taxed in AY 2004-05. During the current year, in the books out of Rs. 37,42,55,286 an amount of Rs. 16,64,97,286 has been credited to the Profit & Loss A/c.

110. The Assessee has contributed in excess of the required amount. The Assessee cannot be allowed to claim the deduction for expenses which are over and above what is required to incur for the particular purpose.

111. Before us Assessee submitted that as this have already been offered and taxed in AY 2004-05 and therefore, taxing the same would amount to double addition. Since, this amount has already been offered in tax in A.Y.2004-05 and therefore, same cannot be taxed in this year. Accordingly, the said reversal is excluded while computing income of the assessee.

Ground No. 5 & 6: Addition of Rs. 55,45,78,123 on account of loss on certain security transactions undertaken by the Assessee

112. Brief facts are that, the Assessee had undertaken certain security transactions with Canbank Financial Services Limited (Canbank). The Assessee had to deliver certain securities to Canbank. However, Canbank stated that the securities were never delivered to them.

113. The Canbank Financial Services Limited had filed suit against the Assessee for default in honoring the said transaction. The summary of the court proceedings is as under:

Date	**Remarks**
Order dated 30 June 2004	Special Court (Trial of offences relating to transactions in securities) at Bombay – refer para 16 (page no. 31) of the order directed to pay the amount of Rs. 18,59,71,808 along with interest at 15 per cent from 24 June 1991 – refer page 185 of the factual paper book. Hence, the Assessee lost the suit at Bombay Special Court.
Order dated 31 August 2004	The Assessee challenged the order the Bombay Special Court before the Supreme Court of India. Supreme Court of India admitted the appeal subject to Assessee depositing the entire amount in Canbank in a fixed deposit account - refer page 187 of the factual paper book.
Orders dated 15 July 2013 and 5 August 2013	Supreme Court of India dismissed the Assessee's appeal as having no merits. The amount deposited was directly disbursed to Canbank Financial Services

	Limited

114. AO held that, since the liability of the Assessee has not been crystallized during the captioned year, the claim of the Assessee cannot be allowed.

115. The Assessee submitted before us that the liability to pay has accrued and quantified in current year pursuant to order dated 30 June 2004 passed by the Bombay Special Court. Reliance was also placed on the following decisions:

- *Supreme Court in the case of Bharat Earth Movers vs CIT (245 ITR 428)*
- *Supreme Court in the case of Rotork Controls India (P) Ltd Vs CIT (180 Taxman 422)*
- *Supreme Court in the case of Kedarnath Jute Mfg. Co. Ltd vs CIT (82 ITR 363)*
- *Supreme Court in the case of CIT vs Bharat Carbon & Ribbon Mfg. Co. (P) Ltd (239 ITR 505)*
- *Gujarat High Court in the case of Gujarat Steel Tubes Ltd vs CIT (210 ITR 358)*

116. We find that the decision of the ITAT Delhi Special Bench in the case of NAFED (ITA No. 1999 & 2000/Del/2008) dated 16.10.2015 which has been relied upon by the income-tax department has been reversed by the Delhi High Court *vide* order dated 19 April 2017 (393 ITR 666). Further, the Special Leave Petition filed by the income tax department has also been dismissed by the Supreme Court of India. The relevant para of the Delhi High Court decision is as under:

"In the present case, with the Award having been made rule of the Court by a learned Single Judge of this Court, ***the mere fact that the said judgment and decree was stayed by a DB would not relieve NAFED of its obligation to pay interest in terms thereof to Alimenta****. Such liability commenced in the previous year in which the said judgment and decree was passed by the learned Single Judge. To borrow the phraseology of the Supreme Court in Shree Chamundi Mopeds Ltd. (supra), it cannot be said that merely because there is a stay granted by the DB of this Court that the order of the learned Single Judge has been "wiped out from existence."*

For the aforementioned reasons, this Court is unable to sustain the impugned order of the Special Bench of the ITAT. Accordingly, the question framed is answered in the negative i.e., in favour of the Assessee NAFED and against the Revenue." (emphasis applied)

117. Accordingly, we held that the liability to pay has accrued and quantified in current year and hence the deduction of Rs. 55,45,78,123 is allowed in this year.

Ground No. 7,8 and 9: Addition of Rs. 41,33,021 on account of interchange income received by the offshore (non-India) branches of the Assessee

118. This issue is covered in Assessee's own case for AY 2000-01, 2001-02 and 2003-04 (3688/Mum/09, 3689/Mum/09, 2358/Mum/14) – the relevant para of the decision is reproduced as under:

"We have heard the rival submissions and perused the material before us. We find that in the matter of Standard Chartered Grindlays Bank Ltd.(supra), the issue of taxability of commission with regard to Credit Cards was deliberated upon and decided by the Tribunal. We would like to re-produce the relevant portion of the order that deals with the facts as well as the reasoning, given

by the FAA and the Tribunal, for deciding the issue against the AO. It reads as under:

"43. Next ground of appeal is against deletion of addition of Rs. 10 crores being made on alleged commission earned by foreign branches of ANZ Grindlays Bank on their credit card business overseas where transactions have taken place in India.

44. During the course of assessment the AO required the assessee to give details of total commission received by the foreign branches of the assessee bank on international credit cards issued by them where the transactions were completed in India by the card holders and the cards were honoured by the branches of the assessee bank or branches of any other bank in India. The AO was of the view that whatever income arose in or from India to any foreign branch of the assessee is also taxable in India. The assessee could not furnish any details; at the same time it did not deny that no income arose from the transaction in India on credit cards issued by its foreign branches. The AO, therefore, estimated the income. The AO stated that commission income from cards issued by Indian branches was Rs. 9.90 crores. It would be reasonable to estimate income of Rs. 10 crores earned by foreign branches from transactions entered into India. The learned CIT(A) held that the income earned either by way of issuing bank of credit card or acquiring bank of credit card, transaction is accounted for. He also held that under s. 9 of the IT Act all incomes accruing or arising directly or indirectly through or from any business connection in India or through or from any source of income in India can be taxed. As per s. 9(1)(v)(c), income can be deemed to have accrued in India only if payment is made for the debt that has been incurred in India by a non-resident which will not be the case here since the issuing bank which provides debt is outside India being a foreign branch. As per art. 7 of Indo-UK DTAA, income that can be brought to tax in India must be directly or indirectly attributable to the PE in India. Since the transactions were with appellant's foreign branches where the issuing bank and the acquiring bank in India was some bank other than the Indian branch of the assessee, it cannot be said that Indian branch was in any way connected with the transaction or that income earned could in any way be said to have been directly or indirectly through PE in India. He accordingly held that the income arising in India from transaction in India by using credit cards of

foreign branches should be taxed in India. This income can only be the income received by the Indian branch and such commission income being already included as an acquiring bank. The income to the foreign branch from the credit given to its card holders outside India cannot be taxed in the hands of the Indian branch since it is not arising in India and also it cannot be attributed to the assets and activities of the Indian branch as is required under art. 7 of DTAA. Therefore, there is no need to further estimate any income. He accordingly deleted the addition.

XXXXXXXXXX

48. We have considered the rival submissions. We are in agreement with the finding of the learned CIT(A). Where the foreign branch has issued credit card and even if the transaction takes place in India, the credit is given to the customer outside India and the debt has also arisen outside India. The merchant shipments in India may receive the payment but the merchant shipments do not incur any debt. They merely receive charges for the goods sold or services rendered. However, the charges are received by the foreign branch for providing credit to their card holders outside India. The amount payable by the card holders who have acquired the credit card from branches outside India incurs the debt outside India. Therefore, the fees in respect of such transaction are not taxable in India. We, therefore, uphold the deletion of addition of Rs. 10 crores."

As the issue is squarely covered by the decision of the above referred order of the Tribunal, so we hold that the order of the FAA does not suffer from any legal or factual infirmity as far as issue of taxability of ICMED is considered. Confirming his order, we decide the effective ground of appeal against the AO.

118. Thus, following the aforesaid decision of the Tribunal in assessee's own case by various earlier years, the addition of Rs. 41,33,021/- is deleted.

Ground No. 10: CIT(A) is correct in directing to allow the expenditure to an extent of 5 per cent on adjusted total income, which comes to Rs. 98,98,69,000 against an amount of Rs. 32,62,95,162 as claimed in the P and L Account

without verifying the details in respect of said claims and not calling from the AO in respect of the assessee's claim through remand report

119. First of all, as per section 44C, the deduction of head office expenses is allowed in the following manner:

- An amount equal to 5 per cent of adjusted total income; or
- Amount of so much of the expenditure in the nature of head office expenditure incurred by the Assessee as is attributable to the business or profession of the Assessee in India whichever is the least.

120. From perusal of the computation of income along with notes to return of income, wherein the details of Head Office expenses incurred and claimed are mentioned. The same is summarized as under:

Particulars	**Amount in Rs.**
Head Office expenses incurred	98,98,69,000
Head Office expenses debited to the Profit & Loss A/c	35,36,04,000
Deduction claimed under section 44C	32,62,39,678

121. Thus, for the purpose of allowing deduction under section 44C, the amount equal to 5 per cent of adjusted total income or the expenditure or the amount incurred and attributable to the India branch (i.e., 98,98,69,000) is to be considered. The amount of Rs. 35,36,04,000 debited to the Profit & Loss A/c is irrelevant. We do not find any infirmity in the order of the ld. CIT(A)

directing to allow expenditure to the extent of 5% of adjusted total income. Accordingly, ground No.10 raised by the Revenue is dismissed.

Ground No. 11: CIT(A) is correct in directing to allow the expenditure to an extent of 5 per cent and computing deduction under section 44C @ 5/100 times of average adjusted total income against @5/105 times of average adjusted total income as worked out by the AO without giving any reasons.

122. Since AO has grossed up the amount while computing the deduction under section 44C. Section 44C does not provide for grossing up. Hence, grossing up is not required. Accordingly, this ground is dismissed.

B. <u>Transfer Pricing Grounds</u>

123. Since transfer pricing grounds are similar to the grounds raised in the earlier year and same are covered by the Tribunal orders for A.Y.2002-03 and 2003-04, the same are dealt herein as per the grounds raised in both the appeals.

<u>ITA No: 4765/MUM/2016 – Assessee's Appeal</u>

Ground No 3: Correspondent Banking Activity

124. At the outset, this issue is covered in favor of the Assessee by order of the Tribunal in the assessee's own case for AY 2002-03 and 2003-04, wherein the Hon'ble Tribunal has deleted the TP adjustment relating to the aforesaid issue.

125. Further, facts pertaining to the correspondent banking activity and similar to ground No.8 of assessee's appeal for A.Y.2004-05 and accordingly, in view of the finding given hereinabove, the adjustment is deleted.

Ground No 4: Services provided by employees of the bank to overseas AEs

126. This issue is also covered in favor of the Assessee by order of the Tribunal in the assessee's own case for AY 2002-03 and 2003-04, wherein the Hon'ble Tribunal has deleted the TP adjustment relating to the aforesaid issue.

127. Further, the facts pertaining to services provided by the employee of the bank to overseas AE is similar to the issue which has been discussed in ground No.9 of the assessee's appeal for A.Y.2004-05, accordingly, in view of the finding given hereinabove, this issue is decided in favour of the assessee.

ITAT Appeal No: 4786/MUM/2016 – Department's Appeal

Ground No 17 - Marketing / support services as regards ECB transactions

128. This issue is covered in favor of the Assessee by order of the Hon'ble Tribunal in the Assessee's own case for AY 2002-03 and 2003-04, wherein the Tribunal has deleted the TP adjustment relating to the aforesaid issue.

129. Further, regarding ECB transactions for the captioned appeal, the facts pertaining to Marketing/support services are similar to ground no. 11 of the Department's appeal for AY 2004-05. Since we have already discussed this issue in Revenue's appeal for A.Y.2004-05 and accordingly, in view of the finding given herein, the ground No.17 is dismissed.

Ground No 16 - Marketing of derivatives services provided by the Assessee

130. The facts pertaining to the marketing of derivative services for the captioned appeal are similar to ground no. 10 of the Department's appeal for AY 2004-05. Again this issue is similar to ground decided in Revenue's appeal for A.Y.2014-15, accordingly, our finding given therein will apply *mutatis mutandis* in this year also. Accordingly, this issue is allowed in favour of the assessee and consequently, the Revenue's ground is dismissed.

Ground No 18 - Interest received from HSBC Bank USA

131. Brief facts are that the Assessee maintains an account with HSBC USA denominated in USD, which is used for settling dollar clearance. The credit balance in the account initially did not earn interest for the Bank. To earn revenue out of the surplus credit balances (balance exceeding 250,000 USD), the

Bank has entered into an Investment Service Agreement with HSBC USA.

132. Under this agreement, the credit balance in the bank account exceeding USD 2.5 lac is invested by HSBC USA in approved securities on behalf of HSBC India on an overnight basis. The interest earned by the Assessee from HSBC USA on the deployment of the surplus fund is at the following rates:

Balance	**Interest Rate**
Up to USD 100,000,000	Generally, 37 basis points below the Overnight Fed Fund Rate
Above USD 100,000,000	Best Efforts

133. The Assessee benchmarked the transaction using the CUP method. Various Indian banks avail similar services from HSBC USA. The rate of interest earned by some of the third-party Indian banks from HSBC USA on the overnight placement of dollar funds was as follows:

Sr. No	**Name of the Bank**	**Balances**	**Interest Rates**
1	Bank of Maharashtra	Up to USD 15,000,000	Effective Fed Fund Rate (-) 35 basis points
		Over USD 15,000,000	Best Efforts
2	State Bank of Travancore	Up to USD 15,000,000	Effective Fed Fund Rate (-) 35 basis points
		Over USD 15,000,000	Best Efforts

3	Vysya Bank Ltd	Up to USD 5,000,000	Effective Fed Fund Rate (-) 50 basis points
		USD 5,000,000 to USD 15,000,000	Effective Fed Fund Rate (-) 50 basis points
		Over USD 15,000,000	Best Efforts

134. Further, the Ld. Counsel for the Assessee clarified that "Best Efforts" should not be equated with "Best rate", and based on best efforts and prevailing market conditions, such best effort rate is determined. An example was provided where the best effort rate has been lower than the generally committed rates:

Date	**Balance in USD**	**Effective rate (i.e., Best efforts rate)**	**Fed Fund rate minus 37 basis points**
27 Jan 05	143,400,000	1.996	2.02
28 Jan 05	163,600,000	2.044	2.11
29 Jan 05	163,600,000	2.044	2.11
30 Jan 05	163,600,000	2.044	2.11

135. Thus, the Assessee is not at a disadvantage compared to transactions between HSBC USA and unrelated banks; the transaction between the Assessee and HSBC USA is at an arm's length price. Further, considering the volume involved compared to the third-party banks, the effective rate for the Bank is far greater than the rate earned by the third-party banks.

137. The LD. TPO has determined the arm's length price at LIBOR + 15 basis points based on the borrowing rate of the Assessee on a USD loan taken from HSBC London. While the CIT (A) deleted the addition made by the LD. TPO and held as follows:

"…the Appellant has highlighted that the Fed Fund rate has been accepted as an appropriate benchmark rate in AY 2002-03 by the LD. TPO as well as my predecessor in AY 2002-03 for benchmarking the overnight lendings in USD. I agree with the decision of my predecessor and beg to differ as to why the Fed Fund rate should be considered as an appropriate benchmark."

138. Before us Ld. Counsel submitted that the TPO ought to have considered the Fed Fund rate to benchmark the international transaction. The Federal Funds rate is a target interest rate that is fixed by the Federal Open Market Committee ('FOMC') for implementing the USA's monetary policies. The Fed Funds rate is achieved through open market operations at the Domestic Trading Desk at the Federal Reserve Bank of New York, which deals primarily in domestic securities.

140. He further submitted that the bank had placed the funds with HSBC USA. The relevant geographic market governing the placement of the funds is the USA, for which the Fed Fund rate used in USA markets would be the most appropriate for the purposes of benchmarking. LIBOR rates cannot be considered as a market-determined rate and hence are inappropriate for benchmarking, as LIBOR is calculated as an average of the submissions made by the major banks to the market intelligence

agency - Thomas Reuters, which then calculates and publishes the rates for the British Bankers association every day.

142. The calculation of the US Dollar LIBOR is based on data submitted daily from a panel of 16 major financial institutions. This means that the LIBOR is based on the rates bank reports and not actual rates on real loans.

143. Further, there have been allegations that the rate was manipulated by some major banks for their own benefit by submitting falsified numbers to the pool used for computing LIBOR. In view of the above, the LIBOR rates cannot be considered an appropriate benchmarking rate for international transactions during the assessment years under consideration.

144. Ld. Counsel further submitted that, the Assessee is not disadvantaged as the best effort rate has been lower than the generally committed rates compared to transactions between HSBC USA and unrelated banks. Hence, the transaction between the Assessee and HSBC USA is at an arm's length price.

145. The use of Fed Fund rates has been accepted by the LD. TPO and Ld. CIT (A) in the Assessee's own case in AY 2002-03

146. The Ld. Counsel also drew our attention towards the case law of '**Commissioner of Tax v/s Tata Autocomps system ltd**' **– [2015] 56 taxmann.com 206**, wherein the Bombay High Court

held that "….*ALP in the case of loans advanced to Associate Enterprises would be determined on the basis of rate of interest being charged in the country where the loan is received/consumed"*

147. Ld. Counsel further confirmed that there is no connection between the borrowings in the UK and the placement of funds in HSBC USA.

148. We have heard both the parties and perused the relevant finding given in the impugned orders. The assessee maintains account with HSBC USA denominated in USD, which is used for settling dollar clearance. The interest earned by the assessee from HSBC USA, department of the assessee has already been incorporated above. The assessee has benchmarked the transaction using CUP method thereby various Indian banks have applied similar services from HSBC USA which have also been incorporated above. Assessee stated that "Best Efforts" are based on similar marketing conditions and the best effort rate has been lower than the generally committed rates. Thus, assessee is not at disadvantage compared to transaction between HSBC USA and unrelated banks, therefore, we agree with the ld. Counsel that the transaction between the Assessee and HSBC USA is at an arm's length price. The ld. AO has applied ALP at LIBOR + 15 basis points based on the borrowing rate of the assessee on a USD loan taken from HSBC London. Such approach is not correct because LIBOR rate cannot be applied on

the US loan taken from HSBC USA. The ld. TPO ought to have considered the Fed Fund which is a target interest rate that is fixed by the Federal Open Market Committee ('FOMC') for implementing the USA's monetary policies, plus the relevant geographic market funds is the USA, for which the Fed Fund rate used should be the most appropriate for the purposes of benchmarking rather than taking LIBOR rates. Accordingly, we agree with the contention of the ld. Counsel. Accordingly, we hold the order of the ld. CIT(A) and accordingly, the ground raised by the Revenue is dismissed.

149. In the result, assessee's appeals are allowed wherein Revenue's appeals are dismissed.

Order pronounced on 30th April, 2024.

Sd/-	**Sd/-**
(GAGAN GOYAL)	**(AMIT SHUKLA)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

Mumbai; Dated 30/04/2024
KARUNA, *sr.ps*

Copy of the Order forwarded to :

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

//True Copy// BY ORDER,

(Asstt. Registrar)
ITAT, Mumbai