IN THE INCOME TAX APPELLATE TRIBUNAL,
BANGALORE BENCH 'C'

BEFORE ABRAHAM P GEORGE, ACCOUNTANT MEMBER
AND
SHRI VIJAYPAL RAO, JUDICIAL MEMBER

ITA No.**677**/Bang/2014
(Asst. Year – 2004-05)

The Dy. Commissioner of Income-tax,
Circle - 12(1),
Bangalore. . Appellant

Vs.

Mphasis Ltd.,
Abacus Square, Bagmane Tech. Park,
C.V Raman Nagar, Byrasandra,
Bangalore. . Respondent

CO No.98/Bang/2014)
(By assessee)

Revenue by : Shri Sunil Kumar Agarwal, Jt. CIT

Assessee by : Shri Padam Chand Khincha, C.A

Date of Hearing : 22-7-2015

Date of Pronouncement : **31**-7-2015

O R D E R

PER VIJAYAPAL RAO, JUDICIAL MEMBER

This appeal by the Revenue and Cross-objection by the assessee are directed against the order dated 28/2/2014 of Commissioner of

Income-tax (Appeals) – III Bangalore arising from the assessment completed u/s 143(3) r.w.s 147 of the Income-tax Act 1961 for the assessment year 2004-05.

2. The Revenue has raised following grounds:

1) *The order of the learned CIT(A) is opposed to law and facts of the case.*
2) *On the facts and in the circumstances of the case the learned CIT(A) erred in law in directing the AO to allow the deduction u/s 10B (wrongly mentioned as 10A) with regard to the income earned by sub contracting of on site part of software development activity through assessee's Associated Enterprise without appreciating the fact that the deduction u/s 10B is to be allowed only for the profits earned from the activity of an site development of computer software and not for the profits earned from the associated enterprises of the assessee by subcontracting the activity.*
3) *On the facts and in the circumstances of the case the learned CIT(A) erred in directing the AO to compute deduction u/s 10B (wrongly mentioned as 10A) in the above*

manner by placing reliance on the decision of Hon'ble ITAT in the case of M/s Mphasis Software and Services India Pvt. Ltd., in ITA No.1209/Bang/2012 which has not become final since the same has not been accepted by the Department.

4) *For these and other grounds that may be urged at the time of hearing, it is prayed that the order of the CIT(A) is so far as it relates to the above grounds may be reversed and that of the Assessing Officer may be restored.*

5) *The appellant craves leave to add, alter, amend and/or delete any of the grounds mentioned above."*

3. The only issue arises in the Revenue's appeal is whether the assessee is eligible for deduction u/s 10B with regard to income earned by the assessee from the on site development of software through its associated enterprises under sub contract.

4. We have heard the learned DR as well as learned AR and considered the relevant materials on record.

5. The assessee is engaged in the business of software development. The assessee received the work order from foreign client for software development. The part of the work has been carried out by the assessee in India and some part of development of computer software on site of the client has been performed by the associated enterprises of the assessee under sub contract. The Assessing Officer has denied the claim of deduction u/s 10B on the ground that the income received by the assessee from the on site development of software through its associated enterprises is not eligible for deduction, as it was not the work of export of software by the assessee.

6. On appeal, the CIT(A) has allowed the claim of the assessee by following the decision of the coordinate bench of this tribunal in the case of other group company of the assessee namely Mphasis Software Services India Ltd., Vs. DCIT in ITA No.1209 of 2012 dated 20/12/2013. We have gone through the agreements as well as the work orders received by the assessee from the clients and found that the work of software development was undertaken by the assessee and risk and reward under the agreements belongs to the assessee and not to the associated enterprises of the assessee. The assessee has

received the entire consideration of development of software in foreign exchange and earned profit on that part of the job executed by the associated enterprises under sub-contract after reducing the expenses incurred by the assessee. We find that an identical issue has been considered by the coordinate bench of this Tribunal in the case of group concern M/s Mphasis Software Services Pvt. Ltd., (Supra) in para 12 to 14 as under :-

> *12. Coming to the main issue in the assessee's appeal i.e reduction/deduction of the claim u/s 10A of the Income-tax Act in respect of 'onsite' software development work performed by the associated enterprises of the assessee outside India, we find that the assessee entered into a contract with the end consumers who are outside India and to discharge its liabilities under the contract, the assesse sub-contracted the work to its AE outside India who in fact develop the software, test and implement the software at the premises or customer's place using its own personnel and infrastructure. The assessee received the payment from the end user i.e the customer and makes the payment of software development charges to the AE for the services rendered by it. The contract development charges paid by the assessee to the AE*

have been held to be at arm's length by the TPO u/s 92CA of the Income-tax Act. What is sought to be disallowed is the claim of deduction u/s 10A of the Act, the income arising out of the onsite development of software by the AE. According to the authorities below, the software is to be developed by the assessee and even the onsite implementation or on site development work to be carried out at the premises of the customer are to be performed by the employees of the assessee company under its direct supervision and control. Undisputedly, the assessee has sub- contracted the entire work of development of software for the customer to its AEs outside India. The assessee has placed reliance upon the Circular No.694 dated 23.11.1994 to submit that the development of software need not be carried out at the premises of the assessee company and if the assessee performs the work at the site of the customer outside India, even then it is eligible for deduction u/s 10A of the Income-tax Act. Thus, it is clear that the CBDT Circular No. 694 only clarifies that the entire work of development or manufacture of the product need not be carried out by the assessee in its own premises in India. The moot question before us is whether the assessee can sub contract part or whole of its development of software work to an agency outside India and claim the income there-from as its income eligible for deduction u/s 10A of the Income-tax Act. The learned counsel for the assessee had placed reliance upon the decisions of

this Tribunal at Delhi and Mumbai in various cases which are cited in para 3 above. In the case of Techdrive India Pvt. Ltd. (cited Supra), the Tribunal was considering whether exemption u/s 10B is allowable to the assessee therein where the product was produced by the sister concern of the assessee. The Tribunal at para 17 has culled out the various steps involved in the development/creation or production of software and at para 19 has also held that sec. 10B of the Act only provides for certain negative requirements such as clause (iii) of sub sec. (2) which says that the undertaking could not have been formed by the transfer to a new business of machinery or plant previously used for any purpose. It was held that the section does not provide for a positive requirement that the assessee who claims the exemption should own plant and machinery. Therefore, even if the manufacture or production is done by an outside agency or contractors under the supervision or control of the assesse, the claim for deduction or exemption has to be allowed. Similar view is expressed by the other benches of the Tribunal on which the assessee has placed reliance upon.

13. Therefore, to apply the principles laid down in the above cases, the next issue to be examined is to whether the development of software by the AE is under the supervision and the control of the assessee?

14. As seen from the Master Services Agreement (which is placed at page 36 of the paper book) entered into by the assessee with its AE at USA, the scope of the work is to provide onsite and offshore services relating to information technology to the assessee company, which shall include products developed by the contractor in accordance with the specifications provided by the assessee company as agreed for the purpose and set out in the task order. Clause (2) of the agreement provides for Task Order Form of the contract while clause (3) sets out the obligation of the assessee company. Clause (4) setsout obligation of the contractor and clause (7) relates to right over the intellectual property. The AO has held that the intellectual property relating to development of products is with the contractor and, therefore, it cannot be said that the work is carried out under the supervision of the assessee company. But a literal reading of the agreement reveals that the rights and responsibilities attached to the deliverables vests with the contractor, only till the company has paid the compensation payable for such portion of the deliverables in accordance with the terms of the agreement and the applicable task order. Therefore, once the compensation is paid for the deliverables, it is to be understood that the intellectual property is owned by the assesse company. The

contractors only possesses the intellectual property rights which are already owned by it and where such intellectual property right is used for the production of the computer software, it shall grant the assessee company a non-exclusive license to use such intellectual property enabling the company to use such source code for forming part of the deliverables developed for the company. The other document to be considered is the agreement of the assessee with the customer and it is seen therefrom that though the assessee company is entitled to sub contract the work, it shall alone be responsible for the risks and rewards arising out of the such sub-contract. Clause (23) of the agreement provides for sub contracting of the work, wherein it is stated that the supplier may not sub contract the performance of any of its obligations set out therein without the prior written consent of the customers and the approval of the contractor or sub contractor and the customer shall not constitute a superseding of events or wavier of any right of customer to reject work which is not in conformation with the standard set forth in the agreement and does not constitute nor imply authorization of expenses in excess of budget. It is also provided that to the extent the supplier subcontracts to third parties any of its obligations to be set out in the agreement, the supplier shall remain fully responsible for such obligation and for all acts or omissions of its subcontractors or agents. From the above clauses, it is

clear that the assessee is solely responsible for the discharge of its obligation under the agreement to the customer and the subcontractor has no say in the matter. It is seen from the Master Services Agreement that it is the assessee which is under an obligation to discharge its obligation of satisfying the requirement of the customers and in pursuance thereof to pass on the specification of the products to the AE and also to reserve right to reject the product if the AE does not produce the product in conformity with the requirement of product as given in the task order. Therefore, it can be safely concluded that the development of the software by the AE is under the supervision and control of the assessee company. In the case laws relied upon by the learned counsel for the assessee, only a part of the development of software work was outsoured and it was held that the assessee was eligible for deduction u/s 10B of the Income-tax Act for the income earned out of such job work done. In the case before us, even though the assessee has outsourced the entire work of development of software to its AE's, in our opinion, the decisions of the coordinate benches relied upon by the learned counsel for the assessee apply to the case on hand also. In view of the same, we hold that the assessee is eligible for deduction u/s 10B of the Income-tax Act with regard to the income earned by the assessee company from the 'onsite development of software' carried out by the AE. It is also noteworthy to mention

that the payment made by the assessee to the AE for the work done by the AE at the site of the customer has been accepted by the TPO to be at Arm's Length Price. Therefore, there cannot be any imputation that the assessee has been trying to shift the profits out of India by outsourcing the work to the AE.

7. Since the facts and circumstances in the case of the assessee are identical to that of the case of Emphasis Software Services India (Supra), therefore, following the order of the Coordinate Bench (Supra), we do not find any error or illegality in the impugned order of CIT(A) qua this issue.

8. In the Cross-objection, the assessee has raised the issue of validity of reopening. Since the appeal of the Revenue has been decided in favour of the assessee and the issue of deduction u/s 10B on merits is decided in favour of the assessee, therefore, we do not propose to go into the technical issue of validity of reopening being academic in nature. Accordingly, the cross-objection of the assessee stands dismissed being infructuous.

9. In the result, the appeal filed by the Revenue as well as the cross-objection filed by assessee are dismissed.

10. Order pronounced in the open court on **31 Jul, 2015.**

Sd/-	**Sd/-**
ABRAHAM P GEORGE	**(VIJAYPAL MEMBER)**
(ACCOUNTANT MEMBER)	**(JUDICIAL MEMBER)**

Vms.

Bangalore
Dated : 31/7/2015

Copy to :1. The Assessee
2. The Revenue
3.The CIT concerned.
4.The CIT(A) concerned.
5.DR
6.GF

By order

Asst. Registrar, ITAT, Bangalore.