**IN THE INCOME TAX APPELLATE TRIBUNAL**
**DELHI BENCH 'I': NEW DELHI**

**BEFORE SHRIS.RIFAUR RAHMAN, ACCOUNTANT MEMBER**
**and**
**SHRI RAJ KUMAR CHAUHAN, JUDICIAL MEMBER**

**ITA No.1842/DEL/2014**
**(Assessment Year: 2009-10)**

**ITA No.2327/DEL/2015**
**(Assessment Year: 2010-11)**

**ITA No.1645/DEL/2016**
**(Assessment Year: 2011-12)**

**AND**

**SA No.197/Del/2026**
**(in ITA No.1842/Del/2014)**
**(Assessment Year : 2009-10)**

**SA No.198/Del/2026**
**(in ITA No.2327/Del/2015)**
**(Assessment Year : 2009-10)**

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| HCL Technologies Limited,<br>806, Siddhartha,<br>96, Nehru Place,<br>New Delhi.<br>**(PAN :AAACH1645P)** | vs. | DCIT, Central Circle 2,<br>New Delhi. |
| (ASSESSEE) | | (RESPONDENT) |

ASSESSEE BY : Shri Ajay Vohra, Sr. Advocate
Shri Neeraj Jain, Advocate
Shri Aditya Vohra, Advocate
Shri Ramit Katyal, AR
Shri Arpit Goyal, AR
Ms. Konika Sharma, AR

REVENUE BY : Shri Nikhil Kumar Govila, CIT DR

Date of Hearing : 04.05.2026
Date of Pronouncement : 30.07.2026

## ORDER

## PER S.RIFAUR RAHMAN,AM:

1. These appeals preferred by the assessee are directed against the assessment order dated 28.02.2014, 26.02.2015 and 27.01.2016 passed by the DCIT. Central Circle – 2, New Delhi under section 143(3) read with section 144C(13) of the Income-tax Act, 1961 (for short 'the Act") for AYs 2009-10, 2010-11 and 2011-12 pursuant to the directions of the Dispute Resolution Panel u/s 144C(5) of the Act.

2. Since the issues are common and the appeals are connected, hence the same are heard together and being disposed off by this common order. We take up the assessee's appeal being ITA No.1842/Del/2014 for AY 2009-10 as lead case, however, we tried to adjudicate the ground/issue wise for the assessment years under consideration.

3. The assessee has raised the following grounds of appeal in the aforesaid assessment years :-

**AY 2009-10**

1. That in the facts & circumstances of the case the Ld. assessing officer erred in law in computing the taxable income of the appellant at Rs. 435,80,77,806/- as against the returned income of the appellant of Rs. 189,21,54,500/-.

2. That the learned TPO/AO erred on facts and in law in making a TP adjustment of Rs. 14, 17, 70,826/- on account of interest charged @ 9.50% p.a. from HCL Bermuda Limited by arbitrarily taking the arm's length interest rate to be 15.77 % p.a..

2.1. That the learned TPO erred on facts and in law in failing to discharge his statutory obligation of rebutting the judicial pronouncements which the appellant had cited in the justification of an arm's length nature of interest rate of 9.50% p.a. charged by the appellant.

2.2. That the Hon'ble DRP erred on facts and in law in upholding the TP adjustment proposed by the TPO on account of interest charged by the appellant @ 9.50% p.a. from HCL Bermuda Limited.

3. That the learned TPO/AO erred on facts and in law in making a TP adjustment of Rs.20,16,34,101/- in the case of the appellant by arbitrarily imputing a guarantee fee in respect of guarantees which the appellant had furnished in the normal course of its business on behalf of its AEs.

3.1. That without prejudice to the above Ground no. 3, in the facts & circumstances of the case the Id. TPO/ AO erred in law in imputing the Guarantee Fee at an extremely high rate of 2% p.a. ignoring the comparable rates provided by the appellant.

3.2. That the learned TPO erred on facts and in law in failing to discharge his statutory obligation of rebutting the judicial pronouncements which the appellant had cited in justification of non charging of any guarantee fee from its AEs.

3.3. That the Hon'ble DRP erred on facts and in law in upholding the TP adjustment proposed by the TPO by arbitrarily imputing the guarantee fee in respect of guarantees which the appellant had furnished in the normal course of its business on behalf of its AEs.

4. That the assessing officer erred on facts and in law in denying proper deduction under Section 10A of the Income-tax Act, 1961 ("the Act") in respect of the profits derived from the various undertakings owned by the appellant in the complete disregard of actual facts and circumstances.

4.1. That the assessing officer erred on facts and in law in drawing an adverse inference regarding the eligibility of some of the undertakings owned by the appellant for the purpose of claiming deduction under Section 10A of the Act even without considering all the documentary evidence filed and placed by the appellant on record in support of its claim.

4.2. That the assessing officer erred on facts and in law in denying deduction under Section 10A of the Act in respect of the profits derived from the various undertakings owned by the appellant alleging that (a) the original 32' undertakings were split into 61 undertakings by the appellant in the return of income (b) no separate license was obtained by the appellant from STPI Authorities in respect of these undertakings and (c) that deduction in respect of these undertakings was deliberately not claimed by the appellant in the initial years.

4.3. That the assessing officer erred on facts and in law in drawing an adverse inference regarding the independent and separate nature of the undertakings owned by the appellant not appreciating that each of such undertaking of the appellant is an independent viable unit registered with STPI Authorities and were eligible for deduction under section 10A of the Act.

4.4. That the assessing officer erred on facts and in law in arbitrarily concluding that the ratio of the decision of the Hon'ble apex court in the case of Textile Machinery Corporation Ltd. vs. CIT : 107 ITR 195S (SC) is not applicable in the case of the appellant without considering the actual facts and circumstances and also overlooking the necessary evidence filed by the appellant in the course of impugned assessment proceedings in support of new and independent nature of undertakings owned by the appellant.

4.5. That the assessing officer erred on facts and in law in not appreciating that Section 10A of the Act is a complete code in itself and only those conditions which are prescribed by Section 10A of the Act are liable to be fulfilled by an undertaking for being eligible for the purpose of deduction under Section 10A of the Act.

4.6. That the assessing officer erred on facts and in law in arbitrarily concluding that the different undertakings covered under a single STPI License represent a single undertaking with multiple locations in the complete disregard of the certificate issued by the Chennai STPI Authorities upon the request made by the appellant to the said authorities.

4.7. That the assessing officer erred on facts and in law in concluding that the undertakings owned by the appellant do not represent new undertakings despite the fact that these undertakings have separate identifiable work force and set up as independent viable units.

4.8. That the assessing officer erred on facts and in law in concluding that the undertakings owned by the appellant do not represent new undertakings despite the fact that these undertakings were clearly engaged in newer and different technology areas.

4.9. That the assessing officer erred on facts and in law in drawing an adverse inference regarding the fulfillment of condition of setting up of each undertaking with substantial new investment without considering the details of capital investment made by each undertaking and the necessary evidence in support thereof filed by the appellant in the course of impugned assessment proceedings.

4.10. That the assessing officer erred on facts and in law in concluding that in a number of cases, the ultimate customer of the assessee is a group company in the complete disregard of the contention of the appellant that the group company represents only the immediate customer of the appellant and the ultimate customer always is third party independent customer.

4.11. That the assessing officer erred on facts and in law in drawing an adverse inference regarding the eligibility of the undertakings owned by the appellant for the purpose of claiming deduction under Section 10A of the Act merely on the ground that all the undertakings do not have their separate bank account without appreciating the fact that no such condition has been prescribed under Section 10A of the Act.

4.12. That the assessing officer erred on facts and in law in concluding that it is not possible to verify whether the condition regarding the setting up of each undertaking with substantial fresh investment is satisfied in the first year or not despite the fact that all the necessary details and evidence in support of substantial new capital investment is very much available on record.

4.13. That the assessing officer erred on facts and in law in drawing an adverse inference regarding the eligibility of the different undertakings owned by the appellant without appreciating the fact that the basis of determining the profits derived by the appellant from each of the undertakings were duly explained by the appellant and the same were duly verified by the learned assessing officer in the course of impugned assessment.

4.14. That the assessing officer erred on facts and in law in concluding that the condition regarding the filing of a separate Form 56F by each undertaking has not been fulfilled in the earlier years without appreciating that the said condition was not applicable in the earlier years.

4.15. That the assessing officer erred on facts and in law in discharging his statutory obligation to rebut all the judicial pronouncements relied upon in support of claiming of deduction under Section 10A of the Act.

4.16. That the Hon'ble Dispute Resolution Panel ("DRP") erred on facts and also in law in arbitrarily upholding the proposed action of the assessing officer of drawing adverse inference regarding the eligibility of the some of the undertakings to separately claim deduction under Section 10A of the Act even without considering all the facts and evidence on record.

5. That the assessing officer erred on facts and in law in arbitrarily concluding that 60% of the aggregate amount of expenses incurred by the appellant in the convertible foreign exchange during the year under consideration was incurred in connection with technical services rendered by the appellant and was required to be reduced from "export turnover", in view of the term "export turnover" as defined in the Explanation of Section 10A/10AA/10B of the Act.

5.1. That the assessing officer erred on facts and in law in making the reduction of expenses incurred by the appellant in the convertible foreign exchange from "export turnover" following the assessment order for assessment year 2004-05, without appreciating that the said issue has already been decided by the Hon'ble ITAT in favor of the appellant for the Assessment Year 2004-05 and even the departmental appeal against the said order of the ITAT has been rejected by the Hon'ble Delhi High Court.

5.2. Without prejudice and in the alternative, the assessing officer erred in not excluding the expenses incurred by the appellant in the convertible foreign exchange from 'total turnover' while reducing these from 'export turnover' for calculation of deduction u/s 10A/10AA/10B of the Act leading to absurd results.

5.3. That the Hon'ble DRP erred on facts and in law in upholding the proposed action of the learned AO of reduction of expenses incurred by the appellant from "export turnover" and, without prejudice, in not excluding the same from 'total turnover' as well for computing deduction under section

10A/10AA/10B of the Act by merely observing that the said issue is under litigation.

6. That the assessing officer erred on facts and in law in reducing link charges attributable to delivery of computer software outside India from "the export turnover" in view of the term "export turnover" as defined in the Explanation of Section 10A/10AA/10B of the Act, without making the similar adjustment from "the total turnover" resulting into absurd and unintended results.

6.1. That the assessing officer erred on facts and in law in making the reduction of link charges incurred by the appellant from "export turnover" without making the corresponding adjustment from "total turnover" following the assessment order for assessment year 2004-05, without appreciating that the said issue has already been decided by the Hon'ble ITAT in favor of the appellant for the Assessment Year 2004-05 and even the departmental appeal against the said order of the ITAT has been rejected by the Hon'ble Delhi High Court.

6.2. That the Hon'ble DRP erred on facts and in law in upholding the proposed action of the learned AO of reduction of expenses incurred by the appellant from "export turnover" for computing deduction under section 10A/10AA/10B of the Act without making the corresponding adjustment from the "total turnover" by merely observing that the said issue is under litigation.

7. That the assessing officer erred on facts and in law in enhancing the expenditure disallowed under section 14A of the Act by arbitrarily invoking the provisions of Rule 8D of the Income-tax Rules to 8,50,18,256/- from an amount of Rs. 4,35,018/- which the appellant had originally disallowed itself in the return of income.

7.1. That the Hon'ble DRP erred on facts and in law in upholding the proposed action of the learned AO of disallowing further amount u/s 14A r/w Rule 8D.

8. That the assessing officer erred on facts and in law in making disallowance of ESOP expenditure of Rs. 52,38,71,027/- incurred by the appellant during the relevant previous year on the ground that no actual expenditure has been incurred by the appellant and the amount claimed by the appellant represented notional cost only.

8.1. That the assessing officer erred on facts and in law in observing that the underlying ESOP options have been granted by the appellant to the top level management only who represent an insignificant percentage of total employees of the appellant.

8.2. That the Hon'ble DRP erred on facts and in law in upholding the proposed action of the learned AO of disallowance of ESOP expenses merely by observing that this issue is under litigation.

8.3. That the Hon'ble DRP erred on facts and in law in upholding the proposed disallowance by the learned AO on account of ESOP expenses ignoring the decision of the Hon'ble Special Bench of ITAT in the case of CIT v. Biocon Limited [2013] 155 TTJ 649 (Bang.)(SB).

8.4. That the Hon'ble DRP also erred on facts and in law in rejecting the additional ESOP claim of Rs. 6.04 Crores made by the appellant before the Hon'ble DRP by relying on the decision of the Hon'ble Special Bench of the ITAT in the case of Biocon (supra) representing the difference between the FMV of the underlying stock options as on the date of exercise and FMV as on the date of grant.

9. That the assessing officer erred on facts and in law in arbitrarily disallowing the expenditure incurred on payment of software license fee by drawing an adverse inference regarding the revenue nature of the software license fee.

9.1. That the assessing officer erred on facts and in law in holding that benefit of an enduring nature was obtained by the appellant as a result of the software license fee paid by the appellant not appreciating that such software license fee did not result in creation of any capital asset and was not in the capital field.

9.2. That the Hon'ble DRP erred on facts and in law in upholding the proposed action of the learned AO of treating the software licence fee as a capital expenditure.

10. That the assessing officer erred on facts and in law in disallowing an amount of Rs. 124.05 Crores in respect of pre-mature unwinding/cancellation of the forward covers taken by the appellant in the normal course of its business, purely as a part of its hedging strategy, by arbitrarily deeming it to be speculative in nature under the provisions of Section 43 (5) of the Act.

10.1. That the assessing officer erred on facts and in law in failing to discharge his statutory obligation of rebutting the decision of the Hon'ble apex court in the case of CIT v. Woodward Governor India Pvt. Limited [312 ITR 254 (SC)].

10.2. That the Hon'ble DRP erred on facts and in law in upholding the proposed action of the learned AO of disallowing the foreign exchange loss of Rs. 124.05 Crores in respect of pre-mature unwinding/cancellation of the forward covers taken by the appellant.

11. That the assessing officer erred on facts and in law in disallowing an amount of 133.68 Crores in respect of foreign exchange loss arising on account of Marked to Market ("MTM") restatement of the forward covers taken by the appellant in the normal course of its business by presuming it to be contingent and notional in nature.

11.1. That the Hon'ble DRP erred on facts and in law in upholding the proposed action of the learned AO of disallowing the foreign exchange loss of Rs. 133.68 Crores in respect of foreign exchange loss arising on account of Marked to Market ("MTM") restatement of the forward covers taken by the appellant in the normal course of its business.

12. That the assessing officer erred on facts and in law in making an addition of Rs. 56,62,056/- of Sundry Creditors' balances outstanding for past three years by arbitrarily holding that the same was in the nature of income arising on remission/cessation of trade liability in the terms of Section 41 of the Act.

12.1. That the Hon'ble DRP erred on facts and in law in upholding the addition of Rs. 56,62,056/- of Sundry Creditors' balances outstanding for past three years.

13. That the assessing officer erred on facts and in law in charging interest under Section 234B of the Act.

**AY 2010-11**

1. That in the facts & circumstances of the case the Ld. assessing officer erred in law in computing the taxable income of the appellant at Rs.557,15,99,837/- as against the returned income of Rs. 34,00,85,258/-.

2. That the learned TPO/AO erred on facts and in law in making a TP adjustment of Rs. 21,52,64,998/- on account of interest charged @ 9.50% p.a. from HCL Bermuda Limited on INR denominated loan by arbitrarily taking the arm's length interest rate to be 14.88% p.a..

2.1. That the learned TPO erred on facts and in law in failing to discharge his statutory obligation of rebutting the judicial pronouncements which the appellant had cited in the justification of an arm's length nature of interest rate of 9.50% p.a. charged by the appellant on INR denominated loan.

2.2. That the Hon'ble DRP erred on facts and in law in upholding the TP adjustment proposed by the TPO on account of interest charged by the appellant @ 9.50% p.a. from HCL Bermuda Limited on INR denominated loan.

3. That the learned TPO/AO erred on facts and in law in making a TP adjustment of Rs. 19,44,82,946/- on account of interest charged @ 5.00% p.a. from HCL Bermuda Limited on USD denominated loan by arbitrarily taking the arm's length interest rate to be 14.88% p.a. instead of taking LIBOR plus interest rate.

3.1. That the learned TPO erred on facts and in law in failing to discharge his statutory obligation of rebutting the judicial pronouncements which the appellant had cited in the justification of an arm's length nature of interest rate of 5.00% p.a. charged by the appellant on USD denominated loan.

3.2. That the Hon'ble DRP erred in omitting to adjudicate the objections filed by the appellant against the TP adjustment proposed by the TPO on account of interest charged by the appellant @ 5.00% p.a. from HCL Bermuda Limited on USD denominated loan.

4. That the learned TPO/AO erred on facts and in law in making a TP adjustment of Rs. 48,59,97,821/- by arbitrarily imputing a guarantee fee in respect of guarantees which the appellant had furnished in the normal course of its business on behalf of its AEs.

4.1. That without prejudice to the above Ground no. 4, in the facts & circumstances of the case the Id. TPO/AO erred in law in imputing the guarantee fee at an extremely high rate of 1.75% p.a. ignoring the comparable rates provided by the appellant.

4.2. That the learned TPO erred on facts and in law in failing to discharge his statutory obligation of rebutting the judicial pronouncements which the appellant had cited in justification of non charging of any guarantee fee from its AEs.

4.3. That the Hon'ble DRP erred on facts and in law in upholding the TP adjustment proposed by the TPO by arbitrarily imputing the guarantee fee in respect of guarantees which the appellant had furnished in the normal course of its business on behalf of its AEs.

5. That the learned TPO/AO erred on facts and in law in making a TP adjustment of Rs. 44.73 Crores by arbitrarily considering the profit margin of BPO segment of the appellant to be not satisfying arm's length principle, completely ignoring the economic analysis undertaken by the appellant in the contemporaneous documentation maintained.

5.1. That the Hon'ble DRP erred on facts and in law in upholding the TP adjustment proposed by the TPO on account of profit margin of BPO segment of the appellant.

6. That the assessing officer erred on facts and in law in denying proper deduction under Section 10A of the Income-tax Act, 1961 ("the Act") in respect of the profits derived from the various undertakings owned by the appellant in the complete disregard of actual facts and circumstances.

6.1. That the assessing officer erred on facts and in law in drawing an adverse inference regarding the eligibility of some of the undertakings owned by the appellant for the purpose of claiming deduction under Section 10A of the Act even without considering all the documentary evidence placed by the appellant on record in support of its claim.

6.2. That the assessing officer erred on facts and in law in denying deduction under Section 10A of the Act in respect of the profits derived from the various undertakings owned by the appellant alleging that (a) the original 32 undertakings were split into 61 undertakings by the appellant in the return of income, (b) no separate license was obtained by the appellant from STPI Authorities in respect of these undertakings and (c) that deduction in respect of these undertakings was deliberately not claimed by the appellant in the initial years.

6.3. That the assessing officer erred on facts and in law in drawing an adverse inference regarding the independent and separate nature of the undertakings owned by the appellant, not appreciating that each of such undertaking of the appellant is an independent viable unit registered with STPI Authorities and was eligible for deduction under section 10A of the Act.

6.4. That the assessing officer erred on facts and in law in arbitrarily concluding that the ratio of the decision of the Hon'ble apex court in the case of Textile Machinery Corporation Ltd. vs. CIT : 107 ITR 195 (SC) is not applicable in the case of the appellant without considering the actual facts and circumstances and also overlooking the necessary evidence filed by the appellant in the course of impugned assessment proceedings in support of new and independent nature of undertakings owned by the appellant.

6.5. That the assessing officer erred on facts and in law in not appreciating that Section 10A of the Act is a complete code in itself and only those conditions which are prescribed by Section 10A of the Act are liable to be fulfilled by an undertaking for being eligible for the purpose of deduction under Section 10A of the Act.

6.6. That the assessing officer erred on facts and in law in arbitrarily concluding that the different undertakings covered under a single STPI license represent a single undertaking with multiple locations in the complete disregard of the certificate issued by the Chennai STPI Authorities upon the request made by the appellant to the said authorities.

6.7. That the assessing officer erred on facts and in law in concluding that the undertakings owned by the appellant do not represent new undertakings despite the fact that these undertakings have separate identifiable work force and are set up as independent viable units.

6.8. That the assessing officer erred on facts and in law in concluding that the undertakings owned by the appellant do not represent new undertakings despite the fact that these undertakings were clearly engaged in newer and different technology areas.

6.9. That the assessing officer erred on facts and in law in drawing an adverse inference regarding the fulfillment of condition of setting up of each undertaking with substantial new investment without considering the details of capital investment made by each undertaking and the necessary evidence in support thereof filed by the appellant in the course of impugned assessment proceedings.

6.10. That the assessing officer erred on facts and in law in concluding that in a number of cases, the ultimate customer of the assessee is a group company in complete disregard of the contention of the appellant that the group company represents only the immediate customer of the appellant and the ultimate customer always is a third party independent customer.

6.11. That the assessing officer erred on facts and in law in drawing an adverse inference regarding the eligibility of the undertakings owned by the appellant for the purpose of claiming deduction under Section 10A of the Act on the ground that all the undertakings do not have their separate bank account, without appreciating the fact that no such condition has been prescribed under Section 10A of the Act.

6.12. That the assessing officer erred on facts and in law in concluding that it is not possible to verify whether the condition regarding the setting up of each undertaking with substantial fresh investment is satisfied in the first year or not despite the fact that all the necessary details and evidence in support of substantial new capital investment is very much available on record.

6.13. That the assessing officer erred on facts and in law in drawing an adverse inference regarding the eligibility of the different undertakings owned by the appellant without appreciating the fact that the basis of determining the profits derived by the appellant from each of the undertakings were duly explained by the appellant and the same were duly verified by the learned assessing officer in the course of impugned assessment.

6.14. That the assessing officer erred on facts and in law in concluding that the condition regarding the filing of a separate Form 56F by each undertaking has not been fulfilled in the earlier years without appreciating that the said condition was not applicable in the earlier years.

6.15. That the assessing officer erred on facts and in law in not discharging his statutory obligation to rebut all the judicial pronouncements relied upon in support of claiming of deduction under Section 10A of the Act.

6.16. That the Hon'ble Dispute Resolution Panel ("DRP") erred on facts and also in law in arbitrarily upholding the proposed action of the assessing officer of drawing adverse inference regarding the eligibility of some of the undertakings to separately claim deduction under Section 10A of the Act even without considering all the facts and evidence on record.

7. That the assessing officer erred on facts and in law in arbitrarily concluding that 60% of the aggregate amount of expenses incurred by the appellant in convertible foreign exchange during the year under consideration was incurred in connection with technical services rendered by the appellant and was required to be reduced from "export turnover", in view of the term "export turnover" as defined in the Explanation of Section 10A/10AA/10B of the Act.

7.1. That the assessing officer erred on facts and in law in making the reduction of expenses incurred by the appellant in convertible foreign exchange from "export turnover" following the assessment order for assessment year 2004-05, without appreciating that the said issue has already been decided by the Hon'ble ITAT in favor of the appellant for the Assessment Year 2004-05 and even the departmental appeal against the said order of the ITAT has been rejected by the Hon'ble Delhi High Court.

7.2. Without prejudice and in the alternative, the assessing officer erred in not excluding the expenses incurred by the appellant in the convertible foreign exchange from "total turnover" while reducing these from "export turnover" for calculation of deduction u/s 10A/10AA/10B of the Act leading to absurd results.

7.3. That the Hon'ble DRP erred on facts and in law in upholding the proposed action of the learned AO of reduction of expenses incurred by the appellant from "export turnover" and, without prejudice, in not excluding the same from "total turnover" as well for computing deduction under section 10A/10AA/10B of the Act by merely observing that the said issue is under litigation.

8. That the assessing officer erred on facts and in law in reducing link charges attributable to delivery of computer software outside India from "the export turnover" as defined in the Explanation of Section 10A/10AA/10B of the Act, without making a similar adjustment from "the total turnover" resulting into absurd and unintended results.

8.1. That the assessing officer erred on facts and in law in making the reduction of link charges incurred by the appellant from "export turnover" without making the corresponding adjustment from "total turnover" following the assessment order for assessment year 2004-05, without appreciating that the said issue has already been decided by the Hon'ble ITAT in favor of the appellant for the Assessment Year 2004-05 and even the departmental appeal against the said order of the ITAT has been rejected by the Hon'ble Delhi High Court.

8.2. That the Hon'ble DRP erred on facts and in law in upholding the proposed action of the learned AO of reduction of expenses incurred by the appellant from "export turnover" for computing deduction under section 10A/10AA/10B of the Act without making the corresponding adjustment from the "total turnover" by merely observing that the said issue is under litigation.

9. That the assessing officer erred on facts and in law in enhancing the expenditure disallowed under section 14A of the Act from an amount of Rs. 26,22,318/- (which the appellant had originally disallowed itself in the return of income) to Rs. 8,14,77,961/- by arbitrarily invoking the provisions of Rule 8D of the Income-tax Rules.

9.1. That the Hon'ble DRP erred on facts and in law in upholding the proposed action of the learned AO of disallowing further amount u/s 14A r/w Rule 8D.

10. That the assessing officer erred on facts and in law in making disallowance of ESOP expenditure of Rs. 40,46,20,341/- incurred by the appellant during the relevant previous year on the ground that no actual expenditure has been incurred by the appellant and the amount claimed by the appellant represented notional cost only.

10.1. That the assessing officer erred on facts and in law in observing that the ESOP options have been granted by the appellant to the top level management only who represent an insignificant percentage of total employees of the appellant.

10.2. That the assessing officer also erred on facts and in law in rejecting the additional ESOP claim of Rs. 54.64 Crores made by the appellant in the course of the impugned assessment proceedings which represented the difference between the FMV of the underlying stock options as on the date of exercise and FMV as on the date of grant, relying on the decision of the Hon'ble Special Bench of the ITAT in the case of CIT v. Biocon Limited [2013] 155 TTJ 649 (Bang.)(SB).

10.3. That the Hon'ble DRP erred on facts and in law in upholding the proposed action of the learned AO of disallowance of ESOP expenses merely by observing that this issue is under litigation.

10.4. That the Hon'ble DRP erred on facts and in law in upholding the proposed disallowance by the learned AO on account of ESOP expenses ignoring the decision of the Hon'ble Special Bench of ITAT in the case of CIT v. Biocon Limited [2013] 155 TTJ 649 (Bang.)(SB).

10.5. That the Hon'ble DRP also erred on facts and in law in upholding the action of the learned AO to reject the additional ESOP claim of Rs. 54.64 Crores made by the appellant before the learned AO in the course of the impugned assessment proceedings by relying on the decision of the Hon'ble Special Bench of the ITAT in the case of Biocon (supra) representing the difference between the FMV of the underlying stock options as on the date of exercise and FMV as on the date of grant.

11. That the assessing officer erred on facts and in law in arbitrarily disallowing the expenditure incurred on payment of software license fee by drawing an adverse inference regarding the revenue nature of the software license fee.

11.1. That the assessing officer erred on facts and in law in holding that benefit of an enduring nature was obtained by the appellant as a result of the software license fee paid by the appellant, not appreciating that such software license fee did not result in creation of any capital asset and was not in the capital field.

11.2. That the Hon'ble DRP erred on facts and in law in upholding the proposed action of the learned AO of treating the software licence fee as a capital expenditure.

12. That the assessing officer erred on facts and in law in disallowing the loss of Rs. 369.77 Crores suffered by the appellant on pre-mature unwinding/cancellation of the forward covers taken by the appellant in the normal course of its business, purely as a part of its hedging strategy.

12.1. That the assessing officer erred on facts and in law in failing to discharge his statutory obligation of rebutting the decision of the Hon'ble apex court in the case of CIT v. Woodward Governor India Pvt. Limited [312 ITR 254 (SC)] and other decisions cited before him while disallowing the forex loss.

12.2. That the Hon'ble DRP erred on facts and in law in upholding the proposed action of the learned AO of disallowing the foreign exchange loss of Rs. 369.77 Crores in respect of pre-mature unwinding/cancellation of the forward covers taken by the appellant.

13. That the assessing officer erred on facts and in law in making an addition of Rs. 28,82,449/- of Sundry Creditors' balances outstanding for past three years by arbitrarily holding that the same was in the nature of income arising on remission/cessation of trade liability in terms of Section 41 of the Act.

13.1. That the Hon'ble DRP erred on facts and in law in upholding the addition of Rs. 28,82,449/- of Sundry Creditors' balances outstanding for past three years.

14. That the assessing officer erred on facts and in law in charging interest under Section 234B of the Act."

**<u>AY 2011-12</u>**

1. That the assessing officer erred on facts and in law in completing assessment under section l 44C read with section 143(3) of the Income-tax Act, 1961 ('the Act') at an income ofRs.216,78,98,000 as against the income ofRs.58,17,76,077 returned by the appellant.

2.1 That the assessing officer erred on facts and in law in arbitrarily restricting the deduction claimed in the return of income under Section 10A of the Act allegedly holding that (i) the appellant had split the original 22 undertakings (including the undertakings owned by the erstwhile entities which were amalgamated with the appellant during the year under consideration) into 41 undertakings, (ii) appellant has obtained only 22 separate licenses and there are no separate licenses for the other 19 units.

2.2 That the assessing officer erred on facts and in law in further holding that (i) new project was not executed by each of the undertakings, (ii) in a number of cases, the ultimate customer of the appellant is a group company, (iii) all the undertakings do not have separate bank account, (iv) no record of profits has been shown by the appellant from the year of inception.

2.3 That the assessing officer erred on facts and in law in drawing an adverse inference regarding the eligibility of different undertakings owned by the appellant for the purpose of claiming deduction under Section 10A of the Act even without considering all the documentary evidence filed and placed by the appellant on record in support of its claim.

2.4 That the assessing officer erred on facts and in law in not appreciating that Section 10A of the Act is a complete code in itself and only those conditions which are prescribed by Section 10A of the Act are liable to be fulfilled by an undertaking for being eligible for the purpose of deduction under Section I OA of the Act.

2.5 That the assessing officer erred on facts and in law in concluding that the undertakings owned by the appellant do not represent new undertakings despite the fact that these undertakings have separate identifiable work force and were clearly engaged in newer and different technology areas.

2.6 That the assessing officer erred on facts and in law in arbitrarily concluding that different undertakings covered under a single STPI License represent a single undertaking with multiple locations in complete disregard of the certificate issued by the Chennai STPI Authorities upon request made by the appellant to the said authorities.

2.7 That the assessing officer erred on facts and in law in arbitrarily concluding that the time period for which the deduction under Section I OA of the Act in respect of undertakings owned by the appellant was available has been extended.

2.8 That the assessing officer erred on facts and in law in not appreciating that the Hon'ble Delhi High Court in appellant's own case has held that there is no estoppel in law and appellant was entitled to deduction under section I OA even at a belated stage.

2.9 That the assessing officer/ DRP erred on facts and in law in concluding that there has been no emergence of a fresh undertaking and no fresh investments have been made by the appellant without considering the details of capital investment made by each undertaking and the necessary evidence in support thereof filed by the appellant before the assessing officer and the DRP.

2.10 That the assessing officer erred on facts and in law in arbitrarily concluding that the ratio of the decision of the Hon'ble apex Court in the case of Textile Machinery Corporation Ltd vs CIT: 107 ITR 195 (SC) is not applicable in the case of the appellant, overlooking the necessary evidence filed by the appellant before the assessing officer and the DRP in support of new and independent nature of undertakings owned by the appellant.

2.11 That the assessing officer erred on facts and in law in drawing an adverse inference regarding the eligibility of the different undertakings owned by the appellant without appreciating the fact that books of account/ records maintained by the appellant in respect of different undertakings were duly produced before and verified by the assessing officer in the course of impugned assessment proceedings.

2.12 That the assessing officer erred on facts and in law in concluding that the condition regarding the filing of separate Form 56F by each undertaking has not been fulfilled in the earlier years, without appreciating that the said condition was not applicable in the earlier years.

2.13 Without prejudice, that the assessing officer/ DRP erred on facts and in law in not appreciating that 5 (five) undertakings set up by the appellant in assessment year 2006-07 onwards were always treated to be separate, distinct undertakings and claim of tax holiday benefit in respect of the said undertakings could not be rejected on the ground of estoppel and warranted adjudication on merits in accordance with the conditions enlisted in section 10A.

3.1 That the assessing officer/ DRP erred on facts and in law in holding that 60% of the aggregate amount of expenses incurred by the appellant in convertible foreign exchange during the year under consideration were incurred in connection with technical services rendered by the appellant and was required to be reduced from the export turnover in view of the term 'export turnover' as defined in Explanation to section 10A/10AA/10B of the Act, following the findings in the preceding years.

3.2 That the assessing officer erred on facts and in law in not appreciating that the said issue has already been decided in favour of the appellant by the Hon'ble ITAT and the Delhi High Court in appellant's own case for assessment year 2003-04, 2004-05 and 2005-06.

4.1 That the assessing officer erred on facts and in law in making disallowance of expenditure allegedly incurred for earning exempt income, invoking provisions of section 14A of the Act read with Rule 8D of the Income-tax Rules, 1962 ('Rules'), ofRs.10,86,82,860 as against Rs.34,20,620, suo motu disallowed by the appellant.

4.2 That the assessing officer erred on facts and in law in not appreciating that under section 14A of the Act, only expenses having direct/ proximate nexus with earning of the dividend income could be disallowed.

4.3 That the assessing officer erred on facts and in law in applying Rule 8D, without establishing/ specifying the nexus of such expenditure with earning of exempt income.

4.4 Without prejudice, that the assessing officer erred on facts and in law in applying sub-section (2) of section 14A without recording his satisfaction about the correctness of the claim of the appellant in respect of the expenditure incurred for earning the said income.

4.5 Without prejudice, that the assessing officer erred on facts and in law in erroneously computing Rs.7,18,53,826 as expenses disallowable under section 14A of the Act by applying sub-rule (2)(ii) of Rule 8D of the Rules as against Rs. Nil as expenses disallowable under sub-rule (2)(ii) of Rule 8D.

4.6 Without prejudice, that the assessing officer erred on facts and in law in not appreciating that no disallowance under section 14A of the Act read with rule 8D of the Rules was required to be made in respect of investment, on which no dividend income was earned during the year.

4.7 Without prejudice, that the assessing officer erred on facts and in law in not appreciating that the investment aggregating to Rs.34,48,60,965, on which no dividend income was earned, was not required to be taken into account for computing the disallowance applying formula provided under sub-rule (2)(ii) and (iii) of Rule 80 and accordingly, disallowance under section 14A of the Act, at best, would be restricted to Rs.3,51,04,463 as against Rs.10,86,82,860.

4.8 Without prejudice, the assessing officer erred on facts and in law in making the addition of Rs 10,52,62,240/- under section 14A of the Act, to the book profits of the assessee under section 115JB of the Act.

5.1 That the assessing officer/ DRP erred on facts and in law in making disallowance of ESOP ('Employee Stock Option Plan') expenditure of

Rs.230,70,78,305 (including enhanced claim of Rs.155.71 crores made during assessment proceedings) liability for which was incurred during the relevant previous year, allegedly holding that the appellant did not file complete details in this regard.

5.2 That the assessing officer/ DRP erred on facts and in law in disallowing additional claim of Rs.155.71 crores incurred by appellant on account of ESOP expenditure representing difference between Fair Market Value ('FMV') on the date of grant and FMV on the date of exercise by holding that such enhanced claim could have been made by appellant only in original return of income or in revised return of income and not thereafter in view of Supreme Court decision in the case of Goetze India Limited vs CIT: 284 ITR 323 (SC).

5.3 That the assessing officer erred on facts and in law in not appreciating that the aforesaid was merely re-computation of an existing claim and not a new claim and was allowable as per decision of the Delhi High Court in the case of Pr CIT vs E Funds International India Pvt Ltd: 379 !TR 292 (Del).

5.4 That the assessing officer erred on facts and in law in not appreciating that the enhanced claim of deduction made by the appellant in respect of ESOP expenditure was allowable on merits.

5.5 Without prejudice, the Hon'ble Tribunal, being an appellate authority, may kindly admit and allow the aforesaid claim of deduction in respect of ESOP expenditure by treating the same as fresh claim made during the proceedings in view of decision of the Supreme Court in the case of National Thermal Power Co. Ltd. vs CIT: 229 ITR 383 (SC).

6.1 That the assessing officer erred on facts and in law in arbitrarily disallowing expenditure on account of Software License Fee of Rs.76.89 crores holding that the same resulted in benefit of an enduring nature.

6.2 That the assessing officer erred on facts and in law in not considering the decision of the jurisdictional High Court, which the appellant has cited in favour of deductibility of the Software License Fee paid.

6.3 That the assessing officer/ DRP grossly erred on facts and in law in holding that software licenses were not filed by the appellant without considering software license agreements furnished by the appellant during the course of proceedings before the DRP.

6.4 That the DRP erred on facts and in law in incorrectly recording that details of software licenses were not filed by the appellant.

7.1 That the assessing officer erred on facts and in law in disallowing foreign exchange loss ofRs.82.44 crores in respect of cancellation/ premature unwinding of forward covers taken by the appellant holding the same to be in the nature of speculative loss within the meaning of section 43(5) of the Act.

7.2 That the assessing officer/ DRP erred on facts and in law in not appreciating that foreign exchange loss arising on cancellation/ premature unwinding of forward covers taken by the appellant was actual loss incurred in the course of carrying on of the business and the same cannot be termed as speculative loss in terms of section 43(5) of the Act, following its order for the preceding years, allegedly holding that appellant failed to furnish any evidence in support of the claim.

7.3 That the assessing officer/ DRP erred on facts and in law in holding that for almost all forward contracts, there was no underlying exposure either for the entire period or for limited period commencing from the date of the forward contract to the various dates of issue of export invoices.

7.4 That the assessing officer/ DRP erred on facts and in law in not appreciating that the forward contracts were taken by the appellant for hedging of receivables on account of export of software as per the guidelines issued in this regard by the Reserve Bank of India.

8.1 That the assessing officer erred on facts and in law in making an addition of Rs.64,27,974 being sundry credit balances outstanding from past three years, allegedly holding that the same was in the nature of income arising on remission/ cessation of underlying trade liability in terms of section 41 of the Act.

9.1 That on the facts and circumstances of the case and in law the assessing officer ought to have allowed Foreign Tax Credit ('FTC') ofRs.13,01,54,884 [including enhanced claim to the extent ofRs.12,59,945 made during the course of assessment proceedings and further to the extent of Rs.6,01,63,421 made following the law as clarified by the Hon'ble Karnataka High Court in the case of Wipro Ltd vs DCIT: 282 CTR 346 (Kar)], instead of restricting it to Rs.6,87,29,518 only.

9.2 That the assessing officer erred on facts and in law in concluding that the aggregate amount of FTC allowable to the appellant cannot exceed the total amount of FTC claimed in the original or revised return of income despite the fact that the assessing officer was otherwise duly satisfied with allowability of additional FTC on merits.

10.1 That the assessing officer erred on facts and in law in making an addition of Rs.1,58,33,629/- to the income of the assessee on account of TDS credit on deferred revenue, without appreciating that there was only timing difference and no loss to the Revenue arose on account of said approach followed by the appellant.

11.1 That the assessing officer/ DRP erred on facts and in law in making an addition of Rs.34,32,08,874 allegedly on the ground that no commission has been charged by the appellant for providing corporate guarantee to the lenders on behalf of its Associated Enterprises.

11.2 The assessing officer/ DRP erred on facts and in law in not appreciating that since the corporate guarantee issued by the appellant on behalf of its associated enterprise has no income or cost consequence, it cannot be considered as an international transaction in term of section 92B of the Act.

11.3 The assessing officer/ DRP erred on facts and in law in not appreciating that the corporate guarantee issued by the appellant on behalf of its associated enterprise is not an international transaction in term of section 92 of the Act.

11.4 That the assessing officer/ DRP erred on facts and in law in holding that corporate guarantee is a service provided by the appellant which has conferred a benefit to the associated enterprise.

11.5 Without prejudice, the assessing officer/ DRP erred in fact and in law in not appreciating that on facts and circumstances of the case, the corporate guarantee provided by the appellant was merely a substitute for equity infusion and therefore, was pursuant to a shareholder activity for which no compensation is warranted.

11.6 That the DRP erred on facts and in law in not appreciating that some of the corporate guarantees (being in the nature of performance guarantees) issued by the assessee was purely on the commercial consideration in anticipation of significant benefit in the form of profit income in the later years.

11.7 That the DRP erred on facts and in law in imputing commission on such corporate guarantee at the rate of 1.75% p.a., on the basis of rates prescribed under the safe harbor provisions.

11.8 Without prejudice, the DRP erred on facts and in law in not appreciating that the appellant has himself paid commission at the rate of0.40% p.a. on bank guarantee to State Bank of India, and accordingly, the adjustment made on this account shall be restricted to 0.40% p.a., applying CUP method with internal uncontrolled comparable price.

12. That assessing officer erred on facts and in law in levying interest under Section 234C and Section 234D of the Act."

4. The additional grounds raised by the assessee in all the three assessment years viz. 2009-10, 2010-11 and 2011-12 are reproduced below:-

**AY 2009-10**

"14.1 That on the facts and circumstances of the case and in law, the assessing officer ought to have allowed the foreign tax credit of Rs.10,56,85,829 (including enhanced claim to the extent of Rs.8,64,53,778in pursuance to law clarified by the Hon'ble Karnataka High Court in the case of *Wipro Ltd vs DCIT: [2015]382 ITR 179),* instead of restricting it to Rs.1,92,32,051 only."

"On the facts and circumstances of the case and in law, the assessing officer/ CIT(A) ought to have restricted the levy of dividend distribution tax on the dividend distributed/ paid to the non-resident shareholder(s), to the rate specified under Article 10 of the relevant Double Taxation Avoidance Agreements ("DTAA") between India and the country of residence of the non-resident shareholder(s) instead of 16.995% charged in terms of section 115-O of the Act."

"That on the facts and circumstances of the case and in law, the assessing officer/ CIT(A) ought to have held that income earned from systematic activity of investing funds generated by the eligible undertakings of the Appellant in fixed deposits with banks, mutual funds, inter-corporate deposits, etc., were part of 'profit of the business' of such undertakings and were eligible for deduction under section 10A/ 10AA/ 10Bof the Income-tax Act, 1961."

**<u>AY 2010-11</u>**

"On the facts and circumstances of the case and in law, the assessing officer/ CIT(A) ought to have restricted the levy of dividend distribution tax on the dividend distributed/ paid to the non-resident shareholder(s), to the rate specified under Article 10 of the relevant Double Taxation Avoidance Agreements ("DTAA") between India and the country of residence of the non-resident shareholder(s) instead of 16.995% charged in terms of section 115-O of the Act."

"That on the facts and circumstances of the case and in law, the assessing officer/ CIT(A) ought to have held that income earned from systematic activity of investing funds generated by the eligible undertakings of the Appellant in fixed deposits with banks, mutual funds, inter-corporate deposits, etc., were part of 'profit of the business' of such undertakings and were eligible for deduction under section 10A/ 10AA/ 10Bof the Income-tax Act, 1961."

"1. That on the facts and circumstances of the case and in law, the assessing officer ought to have allowed, in pursuance to law clarified by the Hon'ble Rajasthan High Court in the case of Chambal Fertilisers and Chemicals Ltd vs JCIT: D.B. ITA No.52/2018 and Hon'ble Bombay High Court in the case of Sesa Goa Ltd vs JCIT: 117 taxmann.com 96 (Bom HC), deduction ofRs.5,84,12,695, being education cesscomputed on returned income and dividend distribution tax, paid by the Appellant before the due date of filing return of income for the subject assessment year.

2. That on the facts and circumstances of the case and in law, pursuant to law clarified in the case of Chambal Fertilisers and Chemicals Ltd (supra) and Sesa Goa Ltd (supra), the assessing officer also ought to have allowed further deduction in respect of any additional amount paid by the Appellant towards education cess during the financial year relevant to the subject assessment year."

"15.1 That on the facts and circumstances of the case and in law, the assessing officer ought to have allowed the foreign tax credit of Rs.8,39,60,393(including enhanced claim to the extent of Rs.6,73,69,486in pursuance to law clarified by the Hon'ble Karnataka High Court in the case of *Wipro Ltd vs DCIT: [2015]382 ITR 179),* instead of restricting it to Rs.1,65,90,906 only."

**AY 2011-12**

"On the facts and circumstances of the case and in law, the assessing officer/ CIT(A) ought to have restricted the levy of dividend distribution tax on the dividend distributed/ paid to the non-resident shareholder(s), to the rate specified under Article 10 of the relevant Double Taxation Avoidance Agreements ("DTAA") between India and the country of residence of the non-resident shareholder(s) instead of 16.609% charged in terms of section 115-O of the Act."

"That on the facts and circumstances of the case and in law, the assessing officer/ CIT(A) ought to have held that income earned from systematic activity of investing funds generated by the eligible undertakings of the Appellant in fixed deposits with banks, mutual funds, inter-corporate deposits and from guarantee fee, etc., were part of 'profit of the business' of such undertakings and were eligible for deduction under section 10A of the Income-tax Act, 1961."

"1. That on the facts and circumstances of the case and in law, the assessing officer ought to have allowed, in pursuance to law clarified by the Hon'ble Rajasthan High Court in the case of Chambal Fertilisers and Chemicals Ltd vs JCIT: D.B. ITA No.52/2018 and Hon'ble Bombay High Court in the case of Sesa Goa Ltd vs JCIT: 117 taxmann.com 96 (Bom HC), deduction ofRs.6,01,08,155, being education cesscomputed on returned income and dividend distribution tax, paid by the Appellant before the due date of filing return of income for the subject assessment year.

2. That on the facts and circumstances of the case and in law, pursuant to law clarified in the case of Chambal Fertilisers and Chemicals Ltd (supra) and Sesa Goa Ltd (supra), the assessing officer also ought to have allowed further deduction in respect of any additional amount paid by the Appellant towards education cess during the financial year relevant to the subject assessment year."

5. Considered the rival submissions and material placed on record by both the parties. We observed that the issues raised by the assessee in additional grounds go to the root

of the matter challenging the jurisdictional issue. In the light of Hon'ble Supreme Court in the case of NTPC Limited vs. CIT (1998) 229 ITR 383 (SC), we are inclined to admit the additional grounds and take up the same for adjudication herein below.

6. Ground No.1 in all the three assessment years i.e. 2009-10 to 2011-12 is general in nature, hence the same are not adjudicated.

7. Grounds No.2 to 2.2, Grounds No.2 to 2.2 and 3 to 3.2 in the AYs 2009-10, 2010-11 respectively are with regard to TP adjustment made in relation to transaction of interest charged on loans issued to the AE.

8. At the time of hearing, ld.AR of the assessee brought to our notice the relevant facts relating to this issue and submitted that during the year, the assessee earned interest income of Rs.21,48,04,282 on loans of GBP 74 Million extended to its AE, HCL Bermuda Limited. The relevant extract of the agreement is reproduced as under :–

> The Lender agrees to make available and to lend to Borrower a sum up to but not exceeding the amount of One hundred Million GBP (GBP100,000,000) (hereinafter called the "Loan Amount") pursuant to the provisions of the following sections (the "Loan"). The Loan will be made in GBP and be recorded in the Lender's books as INR equivalent of the Loan Amount remitted to the Borrower. The applicable conversion rate on the date of remittance of the Loan Amount shall be the basis for determining the INR equivalent of the Loan Amount.

The Loan Amount shall be advanced by the Lender (to the account notified by the Borrower) in immediately available Sterling funds, within two business days (being a day other than a Saturday or a Sunday on which banks are open for general business in New Delhi and Bermuda) of a demand of the Borrower which demand may be made within the period of 180 days from the date of execution of this Agreement. The Lender and Borrower have agreed that the whole of or part of the Loan, may by agreement between the Lender and the Borrower, be converted into equity capital (i.e. a convertible loan) by allotment of equity shares in the Borrower to the Lender at par value. The Loan Amount shall be interest bearing at a rate (and at interest rate periods) to be agreed between Lender and Borrower prior to or at the time of disbursement of Loan.

9. The benchmarking undertaken by the assessee is as under:–

| | |
|---|---|
| Rate of interest charged by assessee from its AE | 9.50% p.a. |
| Rate of interest earned by assessee on deposit made in Indian Banks | 8.18% p.a. |

10. Ld. AR further submitted that since the interest charged by the assessee from its AEs is at 9.5% p.a. higher than the interest earned by it on fixed deposits at the rate of 8.18%, the international transaction of receipt of interest on loan was considered to be at arm's length.

11. The TPO disregarded the benchmarking analysis undertaken by the assessee and determined the arm's length rate of interest at 16%, as under:-

| | |
|---|---|
| Prime Lending Rate of Interest issued by SBI | 12.77% p.a. |
| Markup on account of security and single customer risk | 3.33% p.a. |
| **Total** | **16%** |

12. The Ld. TPO accordingly computed an adjustment of Rs. 14,69,71,351 in respect of international transactions of receipt of interest on loan advance to associated enterprise. The DRP summarily upheld the adjustment proposed by the TPO.

13. Ld. AR of the assessee submitted that the assessee, in order to benchmark the rate of interest charged from the associated enterprise at the rate of 9.5% p.a. has considered the interest received by it at the rate of 8.18% p.a. on investment made in fixed deposits of Indian Banks. The aforesaid transaction was benchmarked by applying Comparable Uncontrolled Price ('CUP') method considering rate of interest received

by the assessee on investment made in the fixed deposits of banks as a valid internal CUP.

14. It is submitted that internal comparable available in case of an assessee is to be preferred for the purpose of benchmarking of international transactions even in the case where any of the prescribed method is applied, instead of relying on external comparable, as provided in Paragraph 3.26 of the OECD Guidelines. The revised OECD Transfer Pricing Guidelines also provide for use of internal comparable data for benchmarking analysis in preference over the external benchmark.

15. He further submitted that generally, specific details regarding internal comparable are more readily available to the parties engaged in the controlled transaction than details regarding external comparable. In light of above, External CUP should be used with utmost caution, and if internal CUP is available, it is preferred over external CUP.

16. Reference in this regard, is made to the following decisions:

- Sony Ericsson Mobile Communications India Pvt. Ltd. vs. CIT 374 ITR 118
- Birlasoft India Limited vs. ACIT 136 TTJ 505 –Approved by Hon'ble High Court in ITA 44/ 2015
- Technimount ICB Pvt. Ltd. vs. ACIT:138 ITD 23, (Mum) (TM)
- Gharda Chemicals Limited Vs DCIT, 130 TTJ 556
- Destination of the World vs. ACIT 47 SOT 1 (URO)(Del)
- Honeywell Electrical Devices & Systems India Pvt. Ltd. vs. ACIT (ITA No. 2152/Mds/2011)
- Lummus Technology Heat Transfer BV vs. DCIT (ITA No. 6227/Del/2012)
- Cable & Wireless (India) Limited Vs. ADIT : 151 ITD 78
- Cybertech Systems & Software Limited Vs. ACIT :144 ITD 620
- Diageo India (P.) Limted Vs. DCIT : 59 SOT 150
- DCIT Vs. Destination of the world (Subcontinent) (P.) Limited : 34 ITR(T) 355
- Technip India Limited Vs. DCIT (ITA No. 883/Mds/2014)

17. Ld. AR submitted that in the present case, internal CUP is available in the form of interest received by the assessee on investment made in fixed deposit of Indian banks. Due to the availability of internal comparable, internal CUP method was considered as the most appropriate method.

18. He further submitted that the Chennai Bench of Tribunal in the case of V.V.F. Ltd. vs DCIT [ITA No. 673/Mum/06], in similar case of interest charged on loan advanced to AEs, held that [Page no. 3 of PPB – Caselaws- Transfer Pricing] -

> *"We have noted that as was also noted by the Transfer Pricing Officer himself at page 3 of his order the assessee has borrowed foreign currency loans in US Dollars and for the purposes of investing in subsidiaries abroad, from ICICI Bank at the rate of LIBOR + 3% The assessee has also filed a letter from Bank of India stating that "during March 2002, we had been charging spreads of 150 bps to 300 bps over LIBOR in respect of foreign currency loans based on financial position and credit rating of the borrower". As for the LIBOR rate, as per the information provided by assessee, it ranged from 1,85,000 (2 weeks) to 3.00250 (1 year). On the given facts, in our considered view, it would be appropriate to accept internal CUP, i.e. the rate at which the assessee has resorted to foreign exchange borrowings from the ICICI, as arm's length price under CUP method. The fact, as painstaking brought on record by the authorities below that this loan from ICICI bank was not used for the purposes of remittance to subsidiaries as interest free loans has no bearing for the purposes of computing ALP of interest free loan. <u>The financial position and credit rating of the subsidiaries will be broadly the same as the holding company, and, therefore, the precise rate at which the ICICI Bank has advanced the foreign currency loans to the assessee company can be adopted at arm's length price of interest free loans advanced by the assessee company to its foreign subsidiaries. The External CUP, as submitted by the assessee by way of letter from Bank of India, is relatively vague as the adjustments on account of 'spread of 150 to 300 points over LIBOR' is specified but there is no way to reasonably ascertain as on which end of this spectrum will the subsidiaries of assessee will fit in. In such a situation, and for the reasons we have discussed earlier, internal CUP is more reliable. Since we are able to find internal CUP based on the material produced before us, it is not really necessary to deal with other arguments of the assessee and the ALP of interest free loans worked out by the TPO himself in the later years."</u>*

19. Ld. AR further submitted that the ITAT in the case of *Bharti Airtel Ltd. (ITA No. 5636/Del/2011)*, too, following the principles laid down in the case of *VVF Ltd. (supra)*, upheld the contention of the assessee that internal benchmark available in the form of interest paid on borrowings in same or similar currency, ought to be taken into consideration for undertaking benchmarking of international transactions of loan extended to the AE in foreign /currency. [Page no. 54 of PPB- Caselaws (Transfer Pricing)]

20. He further placed reliance on the decision of the Pune Bench of the Tribunal in the case of Varroc Engineering Pvt. Ltd. vs ACIT (ITA No 2482/PN/2012) wherein the Tribunal held as under [Page no. 13 of PPB- Caselaws (Transfer Pricing)]:

> *"In the totality of the facts and circumstances where the assessee has the internal CUP of operating at international rates available and since the said loan raised by the assessee at international rates was advanced to its*

*associated enterprises, we find no merit in the order of the TPO in applying the domestic loan rates i.e. BPLR rates for benchmarking transaction of charging of interest on the loans advanced to the associated enterprises by the assessee."*

21. Further, he submitted that the TPO has himself held in the impugned order that since the assessee is the tested party, a valid comparable uncontrolled transaction would be the opportunity cost of the assessee had he invested the same fund in the Indian Banks, as under:

> *"5. ……..Thus, one needs to find a CUP rate based on cost of funds or opportunity cost of funds blocked in such intra-group loans. If any Indian entity had invested such sums in India with Banks, then the deposit rate would be that from India. If the same were invested in any other investment, e.g., stocks, mutual funds or real estate, the return would still be with reference to interest rates in India. If the Indian entity did not have sufficient surplus funds to lend, it may borrow such funds from banks or others, then cost of borrowings in India would also be relevant. Also if the surplus funds are invested in existing business or expansion of new businesses, the return also would be linked with domestic interest rates.*
>
> *5.2…………..The basic principle, to be followed, is that the currency in which the loan has originated must be considered along with the country of origin for e.g., if the Indian parent is lending to another party, important consideration would be the interest rate expected by the lender, which would be the interest prevalent in India or opportunity cost of such funds if they were invested either in the business, or other forms of investment."*

22. Accordingly, he submitted that since the interest charged by the assessee from its AEs at 9.5% p.a. is higher than the interest earned by the assessee on fixed deposits at the rate of 8.18% p.a., the international transaction of receipt of interest on loan was considered to be at arm's length.

23. It is further submitted that Prime Lending Rate as considered by the Ld. TPO for determining the arm's length price of interest, in any case, is not applicable in terms of following observation of Hon'ble Delhi High Court in the case of DCIT vs. Cotton Naturals (I) Pvt. Ltd. 276 CTR 445[Page no. 102 of PPB- Caselaws (Transfer pricing)]-

> ***42.*** *The first paragraph quoted above, rightly stipulates that inter-company loans would require examination of the loan agreement, comparison of the terms and conditions of loan agreements, the determination of credit rating of the lender and the borrower, identification of comparable third party loan*

*agreements and suitable adjustments should be made. In addition to the aforesaid factors, the comparability analysis should also take into account the business relationship and the functions performed by the subsidiary AE for the parent company. In the present case, we are not concerned with paragraph 10.4.10.3 of the United Nations Transfer Pricing Manual. However, we are unable to agree with the position set out and asserted in paragraph 10.4.10.2 of the Manual. The reasoning given therein is contrary to the accepted international tax jurisprudence and the rules adopted and applied. There is no justification or a cogent reason for applying PLR for outbound loan transactions where the Indian parent has advanced loan to an AE abroad. Chapter 10 of the United Nations Practical Manual on Transfer Pricing relates to country practices. The said Chapter sets out an individual country's view point and its experiences for the information of the readers. The said Chapter does not reflect the view of the Manual.*

**Re: <u>Arm's length rate of interest shall be determined on the basis of applicable Libor rate of interest</u>**

24. He submitted that it is pertinent to note that the present transaction of lending loan to the associated enterprise is in foreign currency, i.e. GBP and given to foreign associated enterprise, HCL Bermuda Limited. Accordingly, the comparable transaction, for the purpose of application of CUP, should be considered to be foreign currency lending by unrelated parties.

25. At the outset, it is submitted that in the assessee's own case for AY 2011-12, the DRP has directed the TPO to use the 6 month LIBOR plus 400 basis points on loan denominated in US$, in accordance with the decision of the Hon'ble High Court in the case of Cotton Naturals(supra). Relevant extract of DRP directions for AY 2011-12 is reproduced below:

(iv) Considering these facts and judicial decisions on the subject, 6 month LIBOR plus 400 basis points is the most appropriate CUP. As discussed in para (iii) above, a mark-up of 100 basis points is appropriate towards the currency risk arising from fluctuations in the foreign exchange rate, borne by the assessee. The LIBOR plus 300 basis points rate discussed in para (i) above compensates the remaining costs. The AO/TPO is directed to compute the adjustment using the rate 6 month LIBOR plus 400 basis points, on loan denominated in US $, in accordance with the decision in Cotton Naturals.

7. The AO/TPO shall compute the adjustment in accordance with the above directions. The Ground is accordingly partly allowed.

26. From the aforesaid, it is submitted that since the loan denominated to AE is in GBP, the arm's length rate of interest on loan given to the AE shall be the GBP Libor rate of interest. The average GBP Libor rate of interest for the period April 2008 to March 2009 works to 3.72%. Further, 400 basis points are added as per the directions of the DRP. Accordingly, since the interest charged by loan issued by the assessee to HCL Bermuda Limited at 9.5% p.a. is higher than the arm's length rate of interest at 7.72%, no adjustment in relation to interest on loan issued to the associated enterprise was warranted.

27. Further, he placed reliance on the recent decision of Hon'ble Delhi High Court in the case of DCIT vs. Cotton Naturals (I) Pvt. Ltd.:276 CTR 445, wherein, while upholding the finding of the Hon'ble Tribunal with respect to appropriate comparable rate of interest on foreign currency denominated loan, Hon'ble High court held [Page no. 99 of PPB- Caselaws (Transfer pricing)]:

> *"39. The question whether the interest rate prevailing in India should be applied, for the lender was an Indian company/assessee, or the lending rate prevalent in the United States should be applied, for the borrower was a resident and an assessee of the said country, in our considered opinion, must be answered by adopting and applying a commonsensical and pragmatic reasoning. We have no hesitation in holding that the interest rate should be the market determined interest rate applicable to the currency concerned in which the loan has to be repaid. Interest rates should not be computed on the basis of interest payable on the currency or legal tender of the place or the country of residence of either party. Interest rates applicable to loans and deposits in the national currency of the borrower or the lender would vary and are dependent upon the fiscal policy of the Central bank, mandate of the Government and several other parameters. Interest rates payable on currency specific loans/ deposits are significantly universal and globally applicable. The currency in which the loan is to be re-paid normally determines the rate of return on the money lent, i.e. the rate of interest.*

28. He further submitted that to the same effect is the decision of the Hon'ble Special Bench of the Tribunal in the case of Invesco (India) Private Limited v. DCIT, Circle 2(1) [ITA No.111/Hyd/2022 & 506/Hyd/2022] wherein the Hon'ble Special Bench held that *"the interest payment on the said CCDs is to be benchmarked with reference to the rate of interest applicable to the loans extended in currency concerned".*

29. The Mumbai Bench of Tribunal in the case of Everest Kanto Cylinder Limited vs ACIT [ITA No. 7073/Mum/2012; AY 2008-09] held as under [Page no. 641 of PPB-Caselaws (Transfer Pricing)]:

> *12. In light of the above decisions, the rate to be used for undertaking an adjustment should be LlBOR and not the average yield rates considered by the learned TPO. The LlBOR rate for March 2008 was 2.6798%. However the assessee has charged 7% from its AE as per the internal CUP available.* ***Thus, the assessee has charged interest to EKC Dubai and EKC China at the rate higher than existing LlBOR rates. Accordingly, the said transaction of providing loan to EKC Dubai and EKC China is at arm's length.*** *Additions made by the AO are accordingly set aside.*

30. The aforesaid decision of the Mumbai Tribunal was affirmed by the Hon'ble Mumbai High Court vide order in ITA No. 435/2015 as under :-

> *1. The learned counsel for the Assessee and the Respondent are at idem that three questions raised by the Assessee are covered in the Assessee's own case for the earlier Assessment year in Income Tax Appeal No.1165 of 2013 decided by this Court against the Revenue on 8th May 2015. As far as question No.4 as framed is concerned, the Tribunal has observed as under:*
>
> > *"In light of the above decisions, the rate to be used for undertaking an adjustment should be LIBOR and not the average yield rates considered by the learned TPO. The LIBOR rate for March 2008 was 2.6798%. However the assessee has charged 7% from its AE as per the internal CUP available.* ***Thus, the assessee has charged interest to EKC Dubai and EKC china at the rate higher than existing LIBOR rates. Accordingly, the said transaction of providing loan to EKC Dubai and EKC China is at arm's length. Additions made by the AO are accordingly set aside.****"*
>
> *2. The said reasoning does not appear to be perverse.*
>
> *3. In light of above, no substantial question of law arise. The Appeal as such is dismissed. No costs.*

31. He further placed reliance on the following decisions:

- CIT vs. Vaibhav Gems Ltd. [ITA No. 14/2015] [Raj. HC]
- CIT vs. Tata Autocomp Systems Limited [ITA No. 1320/2012] [Bom. HC]
- Dharampal Satyapal Limited vs. DCIT [ITA No. 3738, 3739/Del/2016]
- Amol Dicalite Ltd. vs. DCIT [ITA No. 991/Ahd/2018]
- Oriental Aromatics Limited vs. DCIT [ITA No. 1039/Mum/2015]
- Oriental Aromatics Limited vs. DCIT [ITA No. 96/Mum/2018]

- Bharti Airtel Limited vs. ACIT (ITA No. 5816/Del/2012)
- Siva Industries and Holdings Ltd. vs. ACIT [ITA No. 2148/Mds/2148]
- Tata Autocomp Systems Ltd. vs. ACIT [ITA No. 7354/Mum/2011],
- Four Soft Ltd. vs. DCIT: 142 TTJ 358, (Hyd.)
- DCIT vs. Tech Mahindra Ltd. : 46 SOT 141 (Mum)
- Tricom India Ltd. vs. ITO [ITA No. 322/Mum/2014]
- Parle Biscuits (P.) Ltd. Vs. DCIT (ITA No. 9010/Mum/2010)
- PMP Auto Components (P.) Ltd. Vs. DCIT : 66 SOT 42
- Hinduja Global Solutions Ltd. Vs. ACIT (ITA No. 254/Mum/2013)
- Bhansali & Co. vs. ACIT (ITA No. 825/Mu/2014)

32. It is further submitted that the Ld. TPO in the impugned order has added a mark-up of 333 bps. Without prejudice, even if such mark-up of 333 bps is added to the GBP Libor rate of interest at 3.72%, the effective arm's length rate of interest works out to 7.05%. Again, since the interest charged by loan issued by the assessee to HCL Bermuda Limited at 9.5% p.a. is higher than the arm's length rate of interest at 7.05%, no adjustment in relation to interest on loan issued to the associated enterprise was warranted.

**<u>Without prejudice, Interest rate applicable to assessee is available for "AAA" category companies</u>**

33. It is submitted that in the present case, the assessee is carrying a rating of AAA by Crisil, a leading credit rating agency in India and since the assessee is the parent company of the entire group, the subsidiaries too, shall be considered to be carrying the credit rating of AAA.

34. Further ld. AR placed reliance in this regard on the decision of the Hon'ble Delhi High Court in the case of Cotton Naturals (supra) wherein the Hon'ble High Court held that *"The financial position and credit rating of the subsidiaries will be broadly the same as the holding company"*

35. Reliance in this regard is also placed on the decision of Chennai Bench of Tribunal in the case of V.V.F. LTD vs. DCIT [ITA No. 673/Mum/06], wherein, in a similar case involving transaction of loan advanced to the associated enterprise and credit rating of borrower, the Hon'ble Tribunal held as under [Page no. 3 of PPB- Caselaws (Transfer Pricing)]:

> *"We have noted that as was also noted by the Transfer Pricing Officer himself at page 3 of his order the assessee has borrowed foreign currency loans in US*

*Dollars and for the purposes of investing in subsidiaries abroad, from ICICI Bank at the rate of LIBOR + 3% The assessee has also filed a letter from Bank of India stating that "during March 2002, we had been charging spreads of 150 bps to 300 bps over LIBOR in respect of foreign currency loans based on financial position and credit rating of the borrower". As for the LIBOR rate, as per the information provided by assessee, it ranged from 1.85000 (2 weeks) to 3.00250 (1 year). On the given facts, in our considered view, it would be appropriate to accept internal CUP, i.e. the rate at which the assessee has resorted to foreign exchange borrowings from the ICICI, as arm's length price under CUP method. The fact, as painstaking brought on record by the authorities below that this loan from ICICI bank was not used for the purposes of remittance to subsidiaries as interest free loans has no bearing for the purposes of computing ALP of interest free loan.* ***The financial position and credit rating of the subsidiaries will be broadly the same as the holding company, and, therefore, the precise rate at which the ICICI Bank has advanced the foreign currency loans to the assessee company can be adopted at arm's length price of interest free loans advanced by the assessee company to its foreign subsidiaries."***

36. He further submitted that it shall be noted that as per the information sought by the Ld. TPO from CRISIL*(reproduced in TPO's order)*the annual yield on 'AAA' rated bonds is 9.98% p.a. Accordingly, since the interest charged by the assessee from its AEs at 9.5% p.a. is within the range of +/-5% of the rate of interest available on bonds with similar credit rating that of the AEs, the international transaction of receipt of interest on loan was considered to be at arm's length.

**Without prejudice, Ad-hoc mark up of 333bps on prime lending rate of interest:**

37. Ld. AR submitted that the Ld. TPO in the impugned order has allegedly added an ad-hoc markup of 333 bps on the Prime Lending rate of Interest at 12.77% p.a. on account of credit risk/single customer risk.

38. He submitted that the Hon'ble Delhi High Court in the case of CIT vs. Cotton Naturals (I) Pvt. Ltd. (supra), while upholding application of Libor rate of interest on foreign denominated loans, at Para 31 and 32 of their order, rejected various mark-up added by the TPO on account of security and transaction cost, on the Libor rate of interest.

39. Reliance is also placed on the following decisions, wherein, for benchmarking the interest charged on loan advanced in foreign currency, i.e. USD, application of Libor rate is upheld without adding mark-up to such Libor rate:

- CIT vs. Vaibhav Gems Ltd. [ITA No. 14/2015] [Raj. HC]
- CIT vs. Everest Kanto Cylinder Ltd. [ITA No. 435/2015]
- CIT vs. Tata Autocomp Systems Limited [ITA No. 1320/2012] [Bom. HC]
- Dharampal Satyapal Limited vs. DCIT [ITA No. 3738, 3739/Del/2016]
- Amol Dicalite Ltd. vs. DCIT [ITA No. 991/Ahd/2018]
- Oriental Aromatics Limited vs. DCIT [ITA No. 1039/Mum/2015]
- Oriental Aromatics Limited vs. DCIT [ITA No. 96/Mum/2018]

40. Further, the Ld. TPO has also failed to provide any cogent basis or computation to arrive at a markup of 333 bps on account of security and single customer risk. In view of the aforesaid, a markup of 333 bps on account of risk adjustment is unwarranted and liable to be excluded.

41. On the other hand, ld. DR of the Revenue heavily relied on the findings of lower authorities.

42. Considered the rival submissions and material placed on record. We observed that the assessee had lent the loan to its AE, HCL Bermuda Limited in GBP currency and earned interest income. In order to bench mark the above transaction, the assessee bench marked on the basis of interest earned in India from Fixed Deposit and declared that the interest earned from its AE is within arm's length. However, TPO bench marked the above transaction by adopting PLR of SBI with the margin of 333 bps, with the total interest of 16% against the interest earned by the assessee @ 9.50%. After careful analysis of the facts on record and the various case laws relied upon, we observed that the issue is already settled by various courts that the bench marking must be done on the basis of the currency in which the loan was given. In this case, it is in GBP and relevant interest on the basis of LIBOR must be applied. Therefore, the relevant LIBOR plus bps would be, as applied by the Ld DRP in the assessee's own case in AY 2011-12 for the USD dominated loan and directed to apply 6 month LIBOR plus 400 basis points, for the sake convenience, even we adopt the same, in GBP dominated currency, the applicable rate would be, the rate prevailing for FY 2008-09 would be 3.72%, the applicable rate would be 7.72% (it is factual matter, the points are fluctuating currency wise depending upon the market conditions, it may not be 400 basis points for 6 months Libor, but for convenience, we agree with the Ld DRP for analysis). That being the case, the assessee had lent the loan @ 9.50%, which is higher than the prevailing market rate. Therefore, in our view, the interest charged

by the assessee is within arm's length price. Hence, the grounds raised by the assessee in this regard are allowed.

43. Grounds No.3 to 3.3 and Grounds No.4 to 4.3 in the AYs 2009-10 and 2010-11, Gr.Nos.11.1 to 11.8 in the AY 2011-12 respectively are with regard to TP adjustment made by imputing commission on various guarantees issued by the assessee.

44. At the time of hearing, ld. AR of the assessee brought to our notice relevant facts and submitted that HCL Technologies Limited ('the assessee') is a global IT and IT enabled service provider headquartered in India and the ultimate parent company of the HCL Group and directly or indirectly owns subsidiaries and branches in more than nineteen countries worldwide which gives the group global sales and project support and rollout capabilities in multiple countries. The assessee along with its associated enterprise provides the above services by leveraging its infrastructure in the form of Offshore Development Centers ("ODCs") in India. The HCL Group mainly provides services in the following categories:

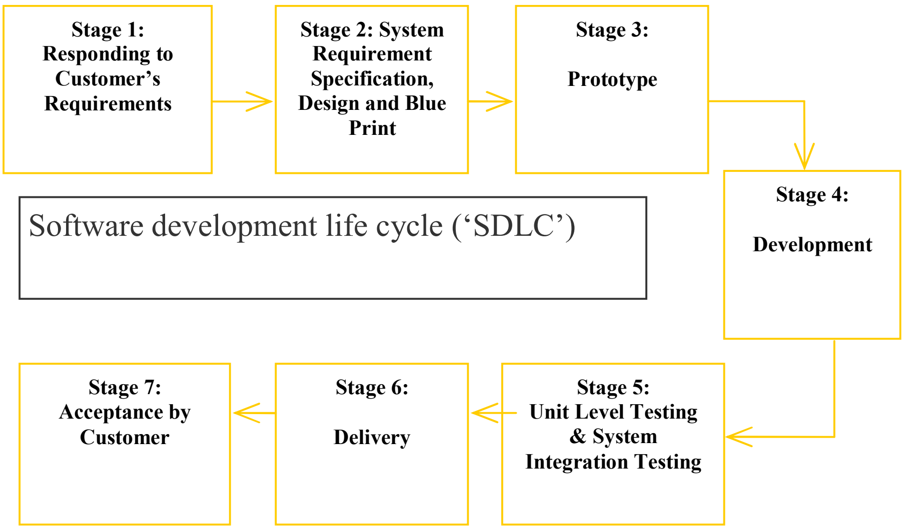
- **Software Services:** Information Technology ("IT") services such as custom application development and maintenance, Enterprise application services including ERP package implementation and support, product engineering etc.;

- **Infrastructure Services:** Infrastructure related IT enabled services such as Remote Infrastructure Management ("RIM"), data center operations, end user computing, network management, and security management; and

- **Business Process Outsourcing Services:** IT enabled services such as technical helpdesk, back office services, transaction processing, and call center services.

45. The breadth of services provided by HCL Group provides it with a competitive advantage over other software services providers with HCL acting as a one stop shop for all customer needs. The end to end value chain of software development service rendered by the assessee is as under:

**The stages commence with an understanding of the requirements of the customer, involve design and development of the software and end with delivery to and acceptance by the customer. The various stages are set out in a typical software development life cycle ("SDLC") illustrated below.**




46. The assessee undertakes the role of the software developer that conceptualizes and creates the software and then predefines user specifications, designs and protocols that are used by the customer.

47. HCL subsidiaries across the globe participate primarily in the System integration testing and delivery stages of the SDLC. HCL subsidiaries may also provide input to the assessee in relation to respective market conditions and/or customer requirements relevant for various phases of the SDLC.

48. In any typical software life cycle, almost 70% of the efforts are being given by the assessee and 30% of the efforts are being given by the subsidiary companies.

49. The assessee company has set-up its subsidiaries in different parts of the world for having its footprint across the globe and these subsidiary companies, being involved primarily as a provider of sales and marketing support and onsite routine software and IT services, acts as limited risk service providers. The assessee company, being the ultimate parent entity, acts as a full-fledged risk bearing entrepreneur, owns the keys assets and bears the significant risk and performs the offshore work.

50. The assessee, during the preceding years and the year under consideration has given undertakings in the form of corporate guarantee and performance guarantee to various

bankers/customers on behalf of its associated enterprises, as under:

| S. N. | Name of the Party to whom guarantee was furnished | For Subsidiary | Currency | Amount in FC | Date of issue of Guarantee | F. Ex. Rate | Amount in INR | Pg No of main PPB | Pg No of convenience PPB |
|---|---|---|---|---|---|---|---|---|---|
| 1 | Deutsche Bank | HCL America Inc. | USD | 6,750,000 | Nov-2002 | 46.84 | 316,203,075 | 412 | 241 |
| 2 | Duke Realty, Limited Partnership | HCL America Inc. | USD | 1,000,000 | 4-Feb-04 | 46.84 | 46,844,900 | 421 | 250 |
| 3 | Mamaroneck Avenue L.P. and Viviane Paris | HCL Jones | USD | 562,500 | 25-Jun-04 | 46.84 | 26,350,256 | 424 | 253 |
| 4 | Deutsche Bank | HCL GB | GBP | 6,700,000 | Dec-02 | 77.15 | 516,905,000 | 431 | 260 |
| 5 | Co-operative Group (CWS) Ltd | HCL GB | GBP | 1,000,000 | 7-Nov-05 | 77.15 | 77,149,400 | 438 / 439 | 267/268 |
| 6 | Invest Northern Ireland, | HCLT BPO (NI) | GBP | 5,125,000 | 11-May-05 | 77.15 | 395,390,675 | 447 | 276 |
| 7 | Invest Northern Ireland | HCLT BPO (NI) | GBP | 344,000 | 11-May-07 | 77.15 | 26,539,394 | 452 | 281 |
| 8 | Konica Minolta Holdings Inc | HCL Japan Limited | USD | 15,000,000 | 1-Jan-07 | 46.84 | 702,673,500 | 459 | 288 |
| 9 | Standard Chartered Bank | HCL EAS | USD | 585,000,000 | 23-Dec-08 | 46.84 | 27,404,266,500 | 403 | 232 |
| 10 | Ryder System Inc | HCL America Inc. | USD | 5,000,000 | 9-Feb-06 | 46.84 | 234,224,500 | 461 | 290 |

51. The assessee did not incurred any costs/expenses on account of issue of such guarantees and accordingly, they were treated as being closely linked to the transactions pertaining to provision of software development services and receipt of onsite services from associated enterprise and benchmarked applying TNM method.

52. In respect of the transaction of undertakings given by the assessee in the form of corporate guarantee provided to lenders on behalf of associated enterprise, the Ld. TPO imputed notional commission income at the rate of 2.71% plus a mark-up of 200 basis points on the basis of data obtained from State Bank of India u/s 133(6) of the Act, holding that such transactions are independent transactions and shall be benchmarked applying CUP method.

53. The TPO accordingly computed an adjustment of Rs. 47,13,88,814 in respect of international transaction of issue of corporate guarantee by the assessee on behalf of its associated enterprise. The DRP summarily upheld the addition made by the TPO.

54. It is submitted that the adjustment made by the TPO with regard to issue of corporate guarantee is unlawful and is not sustainable for the reasons submitted as under:

1. **<u>Corporate Guarantee given by the assessee company in favour of Deutsche Bank ("DB") in connection with the credit facilities taken by the AEs (represented by S.No. 1 & 4 in the table above)</u>**

55. The brief facts in the aforesaid corporate guarantee issued by the assessee are as under:

The assessee company, being the ultimate parent company, is the full-fledged service provider whereas the associated enterprises are limited risk service providers. HCLT India provides services to its associated enterprises at such prices which enable the associated enterprises to recover all their costs and to earn a reasonable profit margin on overall basis based on the functions performed, risks undertaken and assets employed.

Two of the associated enterprises of the assessee company, namely, HCL America Inc. and HCL GB, had taken the credit facilities from Deutche Bank during the financial year 2002-03 in connection with the business of procuring software development assignments from the end customers abroad and subcontracting the entire offshore work to the assessee company for executing the same from India.

The assessee company, being the ultimate parent entity of HCL Group, had furnished the following guarantees in favour of DB for the credit facilities taken by the associated enterprise:

| **Name of AE** | **Country** | **Party in whose favour guarantee was furnished** | **Maximum Amount of Credit Facility sanctioned by DB (in FC)** | **Maximum Amount of Credit Facility sanctioned by DB (in INR)** | **Actual amount of Credit Facility availed by AE during relevant FY (in FC)** | **Actual amount of Credit Facility availed by AE during relevant FY (in INR)** |
|---|---|---|---|---|---|---|
| HCL America Inc. | USA | Deutsche Bank | 1,987,159 | 93,078,518 | 325,799 | 15,260,447 |
| HCL GB | UK | Deutsche Bank | 1,677,185 | 129,394,787 | 683,609 | 52,740,407 |

56. Ld. AR submitted that HCL America Inc. and HCL GB, being two major associated enterprises of the assessee company, were requiring the funds for the expansion of its operations during the financial year 2002-03. Being the ultimate parent company, the assessee may had infused by way of investment in equity shares of its subsidiary companies. However, since generating cash for making investment in subsidiary company has huge interest cost and opportunity cost, the assessee, alternatively had organized loan for its subsidiaries, by way of issuing corporate guarantee to the lender banks of the associated enterprise.

57. Further ld. AR submitted that the issue of corporate guarantee to the lenders of associated enterprise is a shareholders' activity since the benefit of existence of its associated enterprise benefits directly to the assessee. It would be appreciated that in the guarantee agreement dated October 25, 2002entered into by the assessee with Deutsche Bank, it is specifically stated as under (Page 241 of Convenience PPB):

> *".... The Guarantor, as owner of all the outstanding shares of stock of the Company,* ***will derive substantial direct and indirect from any credit extensions made to the Company by the Bank****, should the Bank, in its sole discretion agree to make such credit extensions. It is a condition precedent to the making of any credit extensions of the Company by the Bank that the Guarantor shall have executed and delivered this Guaranty."*

58. Further, ld. AR submitted that the global presence of associated enterprises enables the assessee to be the contact point for its customers and also for working on the routine software development in huge quantum. Further, it is in the interest of the assessee, being a shareholder, to issue corporate guarantee to its associated enterprise so as to lower the interest cost/opportunity cost had they provided funds to its associated enterprises by way of share capital.

59. It is submitted that due to the corporate guarantee provided by the assessee, the assessee in return had earned huge business profits over the years, as under:

**<u>HCL America Inc.</u>**

(All figures in USD / Millions)

| Relevant Financial Year ended on | Total Revenue billed by HCL America Inc. on the end customers | Total Revenue passed on by HCL America Inc. to the assessee company |
|---|---|---|
| 30/06/2005 | 232.66 | 119.95 |
| 30/06/2006 | 331.03 | 163.00 |

| | | |
|---|---|---|
| 30/06/2007 | 461.71 | 197.92 |
| 30/06/2008 | 643.55 | 263.59 |
| 30/06/2009 | 789.72 | 347.89 |

**HCL GB**

(All figures in GBP/'000)

| Relevant Financial Year ended on | Total Revenue billed by HCL GB on the end customers | Total Revenue passed on by HCL GB to the assessee company |
|---|---|---|
| 30/06/2003 | 23,831 | 5,906 |
| 30/06/2004 | 34,766 | 12,277 |
| 30/06/2005 | 61,984 | 19,941 |
| 30/06/2006 | 109,718 | 34,227 |
| 30/06/2007 | 131,091 | 57,920 |
| 30/06/2008 | 102,246 | 70,651 |
| 30/06/2009 | 120,544 | 60,548 |

60. In other words the benefit of USD 1,092.35 Million and GBP 261,470 thousands by way of providing corporate guarantee without charging any commission is much higher than Rs.1,70,99,560 which would have been charged as a commission, as alleged by the Ld. TPO by considering the rate of commission at 4.71%.

2. **The performance guarantees furnished by the assessee company in favor of end customers, namely, Co-operative Group, UK (CWS), Konica Minolta Holdings Inc. Japan and Ryder System Inc. USA for HCL GB, HCL America Inc. and HCL Japan (represented by S.No. 5, 8 & 10 in the aforesaid table)**

61. During the financial years 2005-06 & 2006-07, the assessee company had furnished the following three performance guarantees for the below-mentioned end customers: -

| S. No | Name of the end customer to whom guarantee was furnished | Name of the AE | Amount of Guarantee (in FC) | Amount of Guarantee (in INR) |
|---|---|---|---|---|
| 1. | Co-operative Group, UK (CWS) | HCL GB | GBP 1,000,000 | 77,149,400 |
| 2. | Konica Minolta Holdings Inc., Japan | HCL Japan | USD 15,000,000 | 702,673,500 |
| 3. | Ryder System Inc., USA | HCL America Inc. | USD 5,000,000 | 234,224,500 |

62. He further submitted that having regard to the business model of the assessee group, the assessee company has its presence across the globe through its associated enterprises, being the wholly subsidiaries of the assessee, and the entire offshore work

is subcontracted by the associated enterprise to the assessee company. As a result, almost 70% of total software development work is performed by the assessee company from India.

63. Being in the nature of off-on projects (i.e. partly executed onsite and partly offshore from India), the contracts with all of underlying three end customers, namely, Konica Minolta, Ryder System & CWS, were also partly executed by the assessee company from India. As a result, the activity of furnishing of performance guarantees by the assessee company in favor of each of these three end customers had in fact benefited the assessee company also thereby satisfying an arm's length nature and leaving no scope for charging of any guarantee fee from the associated enterprise.

64. He submitted that the Hon'ble Mumbai Bench of Tribunal in the case of ACIT vs. KEC International Ltd.( ITA No. 5611/MUM/2015, has upheld the order passed by CIT(A) and deleted the adjustment made by TPO imputing commission on Performance Guarantee, holding as under [Page no. 527 of PPB Caselaws (Transfer Pricing)]:

> *5. We have heard the rival submissions. At the outset, we find that the assessee had only given performance guarantee in favour of Bahwan Engineering Company LLC on behalf of its AE nearly to indemnify the losses, claims, damages, if any, that may arise pursuant to non -performance of duties and obligations by the AE in execution of the contract allotted to them. Admittedly, the assessee has not charged any commission from its AE for issuance of this performance guarantee. We find that assessee had also parallelly entered into another agreement with its AE wherein in the event of AE failing in execution of the contract and the performance guarantee issued by the assessee gets invoked by Bahwan Engineering Company LLC,* ***then the contract which is awarded to the AE gets assigned in favour of the assessee, wherein the assessee would be obligated to execute the contract on its own by using its own infrastructure, which would in turn result in assessee deriving the entire contractual revenue and huge profits there from****. In these circumstances, there is absolutely no risk involved for the assessee in issuing the performance guarantee on behalf of its AE, warranting charging of any commission to mitigate that risk. Hence, we hold that assessee was fully justified in not charging any commission from its AE in the subject mentioned performance guarantee transaction. Hence, there is no need to make any adjustment to arm's length price thereof. In view of this decision in the peculiar facts and circumstances, the issue as to whether issuance of performance guarantee would fall within the ambit of an international transaction or not is left open and no decision is given herein. Hence, the various decisions quoted by the ld. Counsel for both the sides need not be gone into. Accordingly, the addition made in the sum of Rs. 69,45,342/- is*

*hereby directed to be deleted. Accordingly, the ground No. 1(a) raised by the revenue are partly allowed.*

65. In view of the aforesaid, at the outset it is submitted that such performance guarantee ought not to be treated at par with corporate guarantee and therefore, no adjustment ought to have been made in relation to such performance guarantee.

**3. <u>The guarantees furnished by the assessee company in favor of Invest Northern Ireland, Belfast (represented by S. No. 6 & 7 in the table above)</u>**

66. He submitted that during the financial year 2001-02, the assessee company had acquired an entity called HCL Technologies NI Limited ("HCL NI") in Northern Ireland. It was through this acquisition only that the assessee had marked the beginning of its foray into the growing and profitable BPO Segment. Being the largest employer in Northern Ireland, HCL NI had received grants from Northern Ireland authorities during the financial years 2004-05 & 2006-07. However, these grants were given to HCL NI subject to a condition that a minimum level of employment shall be maintained by HCL NI over a stipulated period of time, failing which the said grants shall be liable to be refunded. It was to this effect that the following two corporate guarantees were furnished by the assessee company, being the ultimate parent entity, in favor of Northern Ireland authorities:

| S. No. | Amount of Guarantee Given (in FC) | Amount of Guarantee Given (in INR) |
|---|---|---|
| 1. | GBP 5,125,000 | Rs. 395,390,675 |
| 2. | GBP 344,000 | Rs. 26,539,394 |
| **TOTAL** | **GBP 5,469,000** | **Rs. 421,930,069** |

67. He submitted that the assessee, in lieu thereof, has received following benefits:

**a. <u>Guaranteed Revenues from British Telecom</u>**

68. Ld. AR submitted that with the acquisition of HCL NI, British Telecom ("BT"), customer in Northern Ireland guaranteed revenue aggregating to USD 30.24 Million to the assessee. Relevant extract from Annual Report of the assessee company for the financial year ended on June 30, 2002 is placed on record before the TPO vide reply dated 09$^{th}$January, 2013. [Page no. 203 of Convenience PPB]

**b. Growth in the BPO Revenues of HCL Group after acquisition of HCL NI**

69. He further submitted that it was only after acquiring HCL BPO NI that the assessee company was in a position to demonstrate its strength and capabilities in the BPO Segment as is evident from the below mentioned growth in the BPO revenues of HCL BPO NI and erstwhile HCL Technologies BPOServices Limited (which now stands amalgamated with the assessee company) after the acquisition of HCL BPO NI:-

(All figures in INR/ Crores)

| Financial Year ended on | Revenues of HCL BPO NI [A] | Revenue of HCL Technologies BPO Services Ltd. (now stands amalgamated with assessee)[B] | Total BPO Revenues [A+B] |
|---|---|---|---|
| June, 2002 | 36.39 | 4.15 | 40.54 |
| June, 2003 | 104.46 | 37.58 | 142.04 |
| June, 2004 | 145.00 | 116.41 | 261.41 |
| June, 2005 | 221.70 | 222.78 | 444.48 |
| June, 2006 | 228.46 | 333.63 | 562.09 |
| June, 2007 | 245.02 | 527.78 | 772.80 |
| June, 2008 | 262.46 | 603.38 | 865.84 |
| June, 2009 | 195.21 | 531.26 | 726.47 |

70. In other words the benefit of Rs.1438.7 crores by way of providing corporate guarantee to the Northern Ireland authority without charging any commission is much higher than Rs. Rs. 1.98 crores which would have been charged as a commission, as alleged by the TPO by considering the rate of commission at 4.71%.

**4. Guarantees furnished by the assessee in favour of landlords for enabling its AEs to take the business premises on lease (as represented by S.No. 2 & 3 in the table above)**

71. Ld. AR submitted that the assessee company had furnished the following two corporate guarantees during the financial year 2003-04 & 2004-05 for enabling its associated enterprises to take their business premises on lease:

| S. No. | Name of the Party to whom guarantee was furnished | Name of the AE | Amount of Corporate Guarantee (in FC) | Amount of Corporate Guarantee (in INR) |
|---|---|---|---|---|
| 1. | Duke Realty Limited | HCL America | USD | 46,844,900 |

| | | | | |
|---|---|---|---|---|
| | Partnership, USA | Inc. | 1,000,000 | |
| 2. | Mamarineck Avenue L.P. and Viviane Paris, LLC | HCL Jones | USD 562,500 | 26,350,256 |

72. It is submitted that in the guarantee agreement entered into by the assessee with Duke Realty Ltd. it is specifically stated that the assessee benefits from the lease agreement entered into between Duke Realty and the associated enterprise of the assessee. The relevant extract is as under (Page no. 250 of Convenience PPB):

> *" WHEREAS, Guarantor is the parent company of Tenant and will be benefitted by the Lease;"*

73. He further submitted that since the major part of its total revenue is derived by the assessee company from its associated enterprise across the globe, having regard to the Transfer Pricing model which the assessee company follows, it is evident that business synergies do clearly flow to the assessee company as a result of setting up of its associated enterprises by the assessee company in different parts of the world.

74. Under these circumstances, there was no justification for charging of any guarantee fee by the assessee company from its associated enterprises in connection with the underlying corporate guarantees. Since both of these guarantees were furnished by the assessee company in favour of landlords for enabling the associated enterprise to take their business premises on lease without which the assessee company would not have been able to have it's footprint in USA, it had clearly benefited to the assessee company in form of getting the offshore work from USA and as such, no guarantee fee was liable to be charged by the assessee company from the associated enterprises.

**5. <u>Corporate Guarantee given by the assessee company in favour of Standard Chartered Bank in connection with loan taken by HCL EAS Limited for the purpose of AXON acquisition (as represented by S. No. 9 in the table above)</u>**

75. The brief facts in the aforesaid corporate guarantee issued by the assessee are as under:

76. The assessee company in order to bring to business synergy to its operations has acquired one company, namely AXON Limited. The sequence of events and the benefits derived by the assessee, in this regard, is as follows:

77. Global Economy was facing significant challenges in 2008 with Global IT spends showing deceleration. The growth opportunities in traditional IT business were drying up or limited with discretionary spending on the decline. Quarter on Quarter (QoQ) revenue growth of HCL group had slumped to historic low of mere 0.1% in quarter ended on 30$^{th}$September, 2008 with margin pressure increasing.

78. Realizing that the future growth engine had to be in, hitherto, untapped markets/segments, the assessee implemented a 'Blue Ocean Strategy' to identify and develop such untapped market/segment. The internal and external studies conducted by the assessee identified Enterprise Application Services (EAS) specially the SAP Package implementation segment to be the huge untapped market (e.g. offshore SAP Market) and particularly the weak spot of the company. The external study suggested that HCL is fast becoming irrelevant in SAP space with the least growth rate and market share among the top IT players. The study went on to point out that even with extraordinary organic growth, HCL would continue to remain irrelevant in this space. The study stated that lack of front ending capability is primarily responsible for stopping offshore vendors from going after this untapped potential in SAP space and suggested for an inorganic growth route.

79. In view of the above background, the assessee identified Axon Group headquartered in the UK, an ERP (SAP/Oracle) system integrator, as a target to give impetus to its blue ocean strategy. The acquisition was structured through a special purpose vehicle being incorporated in the form of a wholly owned step down subsidiary of the assessee namely HCL EAS Limited (a UK resident company). The acquisition was financed majorly (~70% of the acquisition cost) through a bridge loan taken from Standard Chartered Bank, UK Branch and remaining with the funds infused by the assessee. Certainly, HCL EAS Limited could not have supported such debt on its own strength and strength of Axon future cash flows; it became imperative that the assessee should give a corporate guarantee as collateral.

80. During a study conducted by an independent consultant on business case evaluation of Axon, it was stated that Axon would offer significant revenue synergies to both SAP and IT service business of HCL group, a substantial portion of which would come to the assessee as increased offshore business. The study identifies the following business synergises leading to increased revenue potential:

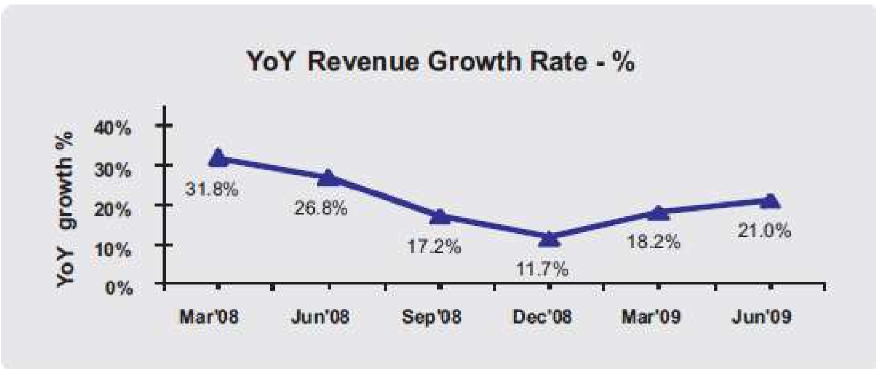
a) Axon enjoys a high quality, blue chip customer base with a strong position in the defensive UK public sector which is complementary to HCL Group customer base providing access to attractive new customers for HCL services through cross selling and up-selling;

b) Axon acquisition is likely to result in significant increase in HCL brand and service offering positioning with increase "surround" revenues and pull-through effect of capturing more deal opportunities through scale, particularly in applications management;

and

c) Axon provides a qualitative business synergy to HCL and opportunity to scale-up offshore capabilities in SAP space.

81. The success of business synergy strategy attained by HCL Group through AXON acquisition is apparent from the below mentioned charts showing a comparative **<u>Revenue Growth during pre-AXON acquisition period till December, 2008</u>** and **<u>during post-AXON acquisition period from January, 2009 onward</u>**:-

82. Following extract of the press release made on 24th November, 2008 (copy of the relevant press release was placed before the TPO vide letter dated 10.12.2012) [Page no. 362 of Convenience PPB] illustrates the above points amply:-

> *"This acquisition continues to make sound strategic sense for HCL especially in the current macro- economic situation.*
>
> *Axon has achieved a significant degree of success in creating a SAP implementation SAP business which **when combined with HCL's enterprise application services, offshore capabilities and complementary market presence** in North America, Europe and Asia will help drive the ongoing expansion of product and service capabilities in the global IT sector business.*
>
> *In addition this acquisition provides HCL **with scale, significant revenue synergies and exposure to Axon's considerable client base** where the majority of the revenues are generated from defensive sectors including UK public sector."*

83. The strategy and acquisition purpose was clearly reflected in the following extract of press note released by the assessee at the time of acquisition on 15th December, 2008 (copy of the relevant press release was placed before the TPO vide reply dated 10.12.2012) [Page no. 366 of convenience PPB]:

> *"A Blue Ocean thinking to create uncontested market spaces is an underpinning of the HCL Transformation story. **The merger of Axon and HCL SAP practice presents a great opportunity to bring new capabilities to the market with a truly global delivery model providing the full lifecycle suite of services - fitting into HCL's Blue Ocean strategy perfectly.***
>
> *HCL Axon has enormous potential given the complementary strengths of Axon and HCL SAP Practice. The current capability gap prevents vendors from addressing the full opportunity. **As HCL Axon will be combining Axon's strong business benefit led consulting and implementation capabilities with HCL's strong global delivery based application and infrastructure management capabilities.** We are confident to leapfrog competition in delivering unique value on an end to end basis for customers who have chosen SAP as their strategic technology platform and whose business challenge is transformation."*

84. Following extract from the assessee company's annual report for the financial year ended on June 30, 2009 further elaborates and supports the above contention of the assessee company (copy of relevant extract from the annual report was placed before the TPO vide reply dated 10.12.2012) [Page no 373 of convenience PPB]:

> *"Acquisitions to gain salience in growth segments – HCL completed Axon acquisition in Dec 08, the biggest acquisition in Indian IT Industry history, to create a dominant position in the SAP Applications Services market place.* ***As per an analysis of SAP Services Market, the Global SAP Services market size is around $26-28bn, of which $7-8bn has the potential for offshore. Currently, about $2bn has been captured by Indian players. So, there exists enough headroom for growth in this market segment****.*
>
> *Increase cross-sell and up-sell within acquired entities –HCL is focused on cross-sell and up-sell opportunities with Axon accounts for non-SAP service and HCL accounts for SAP services.* ***HCL had some quick wins during second half of FY09 on cross sell with Axon accounts. 3 of top 5 Axon customers have signed for non-Axon services."***

85. The success of the strategy is clearly reflected in the fact that in financial year 2010-11 and 2011-12, it is estimated that HCL won contracts for IT services worth ~$471 million and ~$695 million respectively with Axon influence a substantial part of which will accrue to India in term of increased offshore revenue. Axon influence was either in the form of existing customer relationship or IT services being bundled together with Axon proposal for SAP business.

86. In view of the aforesaid, it would be noted that the acquisition of Axon was not a standalone acquisition but was a strategic move of HCL to strengthen its market positioning and growth prospect on the strength of business synergies. It was expected that Axon acquisition will help the assessee to grow faster its own SAP and IT service business and will also help HCL to project itself as "one stop shop" for its customer and thereby improving its chances of getting business in other segments. It was also expected that 'offshore delivery model' getting introduced into acquired business will help HCL India to garner greater business and improving cost competitiveness.

87. Further, from an arm's length perspective, it is clear that the assessee would have only made the guarantee with an unrelated party as part of a larger integrated transaction where the assessee acquires complete indirect control and ownership of Axon by obtaining direct control and ownership of the unrelated party. For example, if HCL EAS had been an unrelated party, then in these circumstances, the taxpayer could have directly borrowed the money from a bank and then made a capital investment in HCL EAS obtaining complete control and ownership of HCL EAS and at the same time thereby funding its acquisition of Axon. Such a transaction represents the

substance of the entire transaction—the acquisition of Axon for the benefit of the assessee with the acquisition funding supported by the assessee capital and credit. However, if instead, the assessee directs its newly acquired subsidiary HCL EAS to borrow a portion of the purchase price with such loan supported by the assessee guarantee, then HCL EAS receives no added benefit from this alternative form of the transaction. In fact, HCL EAS is burdened with substantial debt obligations that it has little prospect of being able to pay (and adding guarantee fees to those obligations makes payment even less likely). The guarantee under this form of the transaction represents a capital investment made by the assessee in a subsidiary to extend its own investment and business decisions, and accordingly, no guarantee fees arise under those circumstances.

88. In view of the aforesaid facts, the various corporate guarantees provided by the assessee for the purpose of financial support, guarantee performance, undertaking premises and acquisition and merger with unrelated parties, was a strategic move of the assessee to strengthen its market positioning and growth prospect on the strength of business synergies. With the support extended by the assessee, it was expected that the assessee will grow faster on its SAP and IT service business, BPO business and customer procurement for other assignments. It also helped the assessee to project itself as “one stop shop” for its customer and thereby improving its chances of getting business in other segments. It was also expected that ‘offshore delivery model’ getting introduced into acquired business will help the assessee to garner greater business and improving cost competitiveness.

89. In the present case, it would be appreciated that the corporate guarantees / SBLC have been issued by the assesseeon behalf of its associated enterprise as a matter of commercial prudence primarily to protect the business interest of the group by fulfilling the shareholder's obligation and therefore, issue of corporate guarantee(s) do not warrant charging of consideration of a fee by the assessee.

90. Reference in this regard is made to the OECD Transfer Pricing Guidelines, wherein, the shareholder activity is defined as under [Page no. 106 of PPB Caselaws (Transfer pricing)]:

> "***Shareholder activity***
> *An assessee company activity which is performed by a member of an MNE group (usually the parent company or a regional holding company) solely because of its ownership interest in one or more other group members, i.e. in its capacity as shareholder."*

91. Further, para 7.10 of the OECD Transfer Pricing Guidelines further provides the following examples of shareholder activity:

> *"7.10 The following examples (which were described in the 1984 Report) will constitute shareholder activities, under the standard set forth in paragraph 7.6:*
>
> *a) Costs of activities relating to the juridical structure of the parent company itself, such as meetings of shareholders of the parent, issuing of shares in the parent company and costs of the supervisory board;*
>
> *b) Costs relating to reporting requirements of the parent company including the consolidation of reports;*
>
> *c)* ***Costs of raising funds for the acquisition of its participations."***

92. Ld. AR submitted that shareholder activity is an activity which is performed by an entity solely because of its ownership interest in other company i.e. <u>in the capacity of shareholder.</u> In the present case, the assessee itself was to benefit from the corporate guarantee extended to its associated enterprises by way of new stream of business and increase in market share for IT services.

93. The concept of share holders' function is a well-recognized principal under transfer pricing, as is evident from the following:

**American Bar Association**

94. Even where the guarantee is concededly appropriate and the fee is arm's length, certain courts, at the Service's urging, have denied a section 162 deduction on the theory that the shareholder, if necessary, would have provided the guarantee for free in order to protect his investment [*Olton Feed Yard, Inc. v. United States, 592 F.2d 272 ($5^{th}$ Cir. 1975)]*

**Decree Issued by State Secretary of Finance – Netherlands**

95. Lenders can receive a guarantee from associated companies for instance for the following reasons:

- The lender does not want to furnish a loan (or only a smaller one) without a guarantee;

- The lender does want to furnish a loan but provides less favourable conditions to the group company without a guarantee;

- The lender wants to avoid the group company to whom funds are lent, becoming insufficiently solvent due to acts by the parent company.

96. If the group company, independently, without the guarantee of associated companies, is unable to raise a loan in the capital market, the guarantee is usually provided in the shareholders sphere and there is no question of a group service for which a consideration must be charged.

**Regulations issued by Australian Tax Office**

97. To the extent that the debt funding performs the rule of an equity contribution it would seem appropriate, based on the reasoning in TR 92/11 and paragraph 1.37 of the OECD Guidelines, that for the purposes of applying sub section 136AD(4) that portion of the debt funding be regarded as quasi equity and that it be costed on an interest-free-basis, consistent with its purpose and effect. This is in line with the OECD view that the cost of funding a company's participation is a "shareholder activity" and that it would not justify a charge to the borrowing company.

98. Thus, where the need for the guarantee stems from decisions made by the parent company in relation to the capital structures it would use in its subsidiary companies, those structures provide benefits to the parent company in reducing the amount of equity and debt it needs to commit and by enhancing cash flow, it would not be expected that a company pay for the acquisition of the equity it needs for its formation and continued viability. This type of activity would not justify a charge to the recipient companies.

99. Ld. AR submitted that the Apex Court has in the landmark judgment of **Morgan Stanley and Co. Inc. : 292 ITR 416** recognized the concept of stewardship or shareholder services by drawing a distinction between services that benefit the service recipient and those which benefit the service provider itself. In the said case, the Court held that services rendered by the assessee to its India subsidiary in the nature of quality control, monitoring to ensure client confidentiality and supervision aimed in protecting the group interest as a whole, could not be considered as 'services' within

the meaning of Article 5(2)(1) of the India-US Tax Treaty. The relevant extract in this regard is re-produced below [Page no. 234 of PPB Caselaws- Transfer Pricing)]:

> ***"In such a case it cannot be said that MSCo has been rendering the services to MSAS. In our view MSCo is merely protecting its own interests in the competitive world by ensuring the quality and confidentiality of MSAS services. We do not agree with the ruling of the AAR that the stewardship activity would fall under Article 5(2)(1)."***

100. He further submitted that the Hon'ble Rajasthan High Court in the case of CIT vs. Vaibhav Gems Limited (ITA No. 14/2015) [Page no. 121/123 of PPB Caselaws (Transfer pricing)], referring the decision of Hon'ble Bombay High Court in the case of Hindalco Industries Limited vs. ACIT (359 ITR 46) upheld that non-charging of commission on corporate guarantee is at arm's length price considering shareholder activity undertaken by the issuer. The above decision of the Hon'ble High Court was affirmed by the Supreme Court in SLP Diary No. 30849/2018 vide order dated 01.10.2018.[Page no. 125 of PPB Caselaws (Transfer pricing)]

101. He submitted that the Hon'ble Rajasthan High Court in the case of Pr. CIT vs. Vaibhav Gems Limited (ITA No. 291/2017) followed their earlier order in ITA 14/2015 and upheld the order of ITAT deleting the transfer pricing adjustment made in relation to Corporate Guarantee [Page no. 128 of PPB Caselaws (Transfer Pricing)] . The Supreme Court again in SLP Diary No. 21846/2022 vide order dated 25.11.2022 dismissed the revenue's appeal challenging the order of Hon'ble High Court. Page no. 133 of PPB Caselaws (Transfer Pricing)]

102. He also placed reliance on the decision of Hon'ble Delhi Bench of Tribunal in the case of **Jindal Pipes Ltd. [ITA No.1886/Del/2012][Page no. 147 of PPB-Caselaw (Transfer pricing)],** wherein Tribunal upheld the deletion made by CIT (A) on account of commission charged on corporate guarantee as under:

> *"14. Hon'ble Supreme Court in the case of S.A. Builders Ltd. vs. CIT [288] ITR 1 [Refer Page 592-70 of CL-PB Vol.1], wherein it is held that where it is obvious that the holding company has deep interest in its subsidiary and the subsidiary has used the funds borrowed for its business, the loan can ordinarily be considered as given to subsidiary as a measure of commercial expediency and accordingly the interest expense on the funds lent should be allowed as a deductible expense to the company. The relevant findings of the Supreme Court read as under:*
>
> *"20 …….*

*In view of above material facts i.e. giving of Corporate Guarantee having been given without charging any commission, there could not be any addition to the income of the assessee to the assumed/notional interest in absence of any interest having been filed or received by the assessee."*

103. The Chennai Bench of the Tribunal in the case of Mascon Global Ltd. vs. ACIT (ITA No.2205/Mds/2010) has appreciated the concept of shareholder services holding that no interest payment on advances extended to a subsidiary was required where the advances made were to undertake an acquisition and hence arose out of commercial expediency. The relevant extracts from the Tribunal Ruling are set out below:

> *"The assessee-company had paid to its subsidiary MGL Americas Inc (formerly known as Mascon Global Technologies Inc) Rs.2,81,86,370/- as advance during the financial year. It also paid Rs.34,31,04,100 as advance to another subsidiary Mascon Global (Europe) Ltd.* ***but it has not charged any interest from both the transactions. The TPO sought explanation regarding this non charging of interest, in response to which the assessee replied vide letter dated 14.10.2009 stating that these advances were made as a part of long term working capital for acquiring new business.***
>
> *Global has raised long term funds in the form of fresh equity in the overseas market, and out of which the company had placed monies with its US subsidiaries as long term funds mainly for acquiring new business in US. It was explained that these long term funds were required to acquire new accounts for the company and this could be done only through the subsidiary companies in US.* ***This subsidiary was stated to be 100% owned by the assessee-company and further investments were made with a view to facilitate return of the money as and when not used by the subsidiary for the purpose for which they were advanced. Thus, according to the assessee-company, these advances had nothing to do with the business transactions for the subsidiary companies for the current year. Major resources out of which advances are made are interest free capital money raised with the assessee-company. It was explained that advances to Mascon Global (Europe) Ltd were made for developing markets in Europe for acquiring new business. Therefore, no interest was charged on these advances.*** *It was also stated that this Associate company, in turn, had also kept certain amount as interest free with the assessee-company and no profit is left out with the associate which ought to have been brought to India and therefore, this transaction is also at ALP. With the above submission, it was prayed that no interest need to be charged on these advances.*
>
> *...21.* ***After considering the rival stands, we hold that the Assessing Officer has jurisdiction to consider this issue, as per law and as per the majority view. But on merits, the Revenue has no case. These advances have been***

***made on account of commercial expediency only as has been claimed by the assessee-company.***

104. He submitted that issuance of corporate guarantee being a shareholder activity does not amount to a service to the associated enterprise and therefore has no bearing on the income of the assessee.

105. He submitted that it has also been the settled position that the commercial expediency is to be taken into consideration for determining the taxability or otherwise of a transaction. Reference in this regard is also made to the decision of Hon'ble Delhi High Court in the case of CIT vs. Cotton Naturals (I) Pvt. Ltd. in ITA No. 233/2014, Where the Delhi High Court held as under:

> *"17. In our opinion, the reasoning recorded therein suffers from a basic and fundamental fallacy. Transfer pricing determination is not primarily undertaken to re-write the character and nature of the transaction, though this is permissible under two exceptions. Chapter X and Transfer Pricing rules do not permit the Revenue authorities to step into the shoes of the assessee and decide whether or not a transaction should have been entered. It is for the assessed to take commercial decisions and decide how to conduct and carry on its business. Actual business transactions that are legitimate cannot be restructured.*
>
> *xxx xxx xxx*
>
> *22. The aforesaid Rules indicate factors that ought to be taken into account for selection of the comparables, which necessarily include the contractual terms of the transaction and how the risks, benefits and responsibilities are to be divided. The conditions prevailing in the market in which the respective parties to the transactions operate, including the geographical location and the size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition, are all material and relevant aspects. If we keep the aforesaid aspects in mind, it would be delusive not to accept and agree that as per the prevalent practice, subsidiary AEs are often incorporated to carry on distribution and marking function. This is not an unusual but common. Once this is accepted, then we cannot accept the reasoning given by the TPO that the transfer pricing adjustment could restructure the transaction to reflect maximum return that a party could have earned and this would be the yardstick or the benchmark for determining the interest payable by the subsidiary AE. This is not what Chapter X of the Act and Rules mandate and stipulate. The aforesaid provisions neither curtail the commercial freedom, nor do they bar or prohibit a legitimate transaction. They permit transfer pricing adjustment so as to bring to tax what would have been paid for the*

*transaction in the same or similar comparable circumstances by an independent third party.*

*xxx xxx xxx*

*26. The TPO has noticed the contractual terms and referred to the following facets: The advance given by the parent company i.e. the assessed to M/s JPC Equestrian Inc. was to meet the working capital requirements of the subsidiary AE. He noted that when independent enterprises transact with each other, their business relations are determined by the market forces operating, i.e. what is the amount of interest that would have been earned had such an advance been given to an unrelated party placed in a similar position as that of the subsidiary AE. The TPO had asked for the audited financial accounts of the subsidiary. Credit rating would be relevant. He accepted that there was a sense of commercial expediency and related benefits in the loan transaction but the assessed had not been able to demonstrate that the interest charged satisfied the arm's length standard. He observed that business prudence or necessity of advancing loan to the subsidiary was not relevant for computing arm's length price (i.e. rate of interest in this case) in unrelated party transactions. This aspect, he held, would not take precedence over the arm's length nature of interest.*

*27. Several aspects enunciated above, reflect the correct legal position.* ***We, however, express our inability to accept that commercial expediency and related benefits have no connection or relationship with the rate of interest. In terms of Clause (c) and (d) to Rule 10B (2), contractual relations or terms, and other material facts should be recognized.*** *Having said so, we do accept the force of the alternative argument advanced that this fact could be of marginal significance and effect. It would be for the assessed to show and prove that a transaction separately benchmarked, included consideration for the lower interest rate being paid.*

106. He further placed reliance on the decision of the Supreme Court in the case of **S.A. Builders Ltd. vs. CIT : 288 ITR 1**, wherein it is held that where it is obvious that the holding company has deep interest in its subsidiary and the subsidiary has used the funds borrowed for its business, the loan can ordinarily be considered as given to subsidiary as a measure of commercial expediency and accordingly the interest expense on the funds lent should be allowed as a deductible expense to the company. The relevant findings of the Supreme Court read as under:

***"20.*** *In Madhav Prasad Jatia v. CIT AIR 1979 SC 1291, this Court held that the expression "for the purpose of business" occurring under the provision is wider in scope than the expression "for the purpose of earning income, profits or gains", and this has been the consistent view of this Court.*

***21.*** *In our opinion, the High Court in the impugned judgment, as well as the Tribunal and the Income-tax authorities have approached the matter from an erroneous angle. In the present case, the assessee borrowed the fund from the bank and lent some of it to its sister concern (a subsidiary) on interest free loan. The test, in our opinion, in such a case is really whether this was done as a measure of commercial expediency.*

***22. In our opinion, the decisions relating to section 37 of the Act will also be applicable to section 36(1)(iii) because in section 37 also the expression used is "for the purpose of business". It has been consistently held in decisions relating to section 37 that the expression "for the purpose of business" includes expenditure voluntarily incurred for commercial expediency, and it is immaterial if a third party also benefits thereby.***

*23. Thus in Atherton v. British Insulated & Helsby Cables Ltd. [1925] 10 TC 155, it was held by the House of Lords that in order to claim a deduction, it is enough to show that the money is expended, not of necessity and with a view to direct and immediate benefit, but voluntarily and on grounds of commercial expediency and in order to indirectly to facilitate the carrying on the business. The above test in Atherton's case, (supra) has been approved by this Court in several decisions e.g.Eastern Investments Ltd. v. CIT [1951] 20 ITR 1, CIT v. Chandulal Keshavlal & Co. [1960] 38 ITR 601 etc.*

***24. In our opinion, the High Court as well as the Tribunal and other income-tax authorities should have approached the question of allowability of interest on the borrowed funds from the above angle. In other words, the High Court and other authorities should have enquired as to whether the interest free loan was given to the sister company (which is a subsidiary of the assessee) as a measure of commercial expediency, and if it was, it should have been allowed.***

***25. The expression "commercial expediency" is an expression of wide import and includes such expenditure as a prudent businessman incurs for the purpose of business. The expenditure may not have been incurred under any legal obligation, but yet it is allowable as a business expenditure, if it was incurred on grounds of commercial expediency.***

***26. No doubt as held in Madhav Prasad Jatia's case (supra), if the borrowed amount was donated for some sentimental or personal reasons and not on the ground of commercial expediency, the interest thereon could not have been allowed under section 36(1)(iii) of the Act. In Madhav Prasad Jatia's case (supra), the borrowed amount was donated to a college with a view to commemorate the memory of the assessee's deceased husband after whom the college was to be named. It was held by this Court that the interest***

> ***on the borrowed fund in such a case could not be allowed, as it could not be said that it was for commercial expediency.***
>
> *27. Thus, the ratio of Madhav Prasad Jatia's case (supra) is that the borrowed fund advanced to a third party should be for commercial expediency if it is sought to be allowed under section 36(1)(iii) of the Act.*
>
> *28. In the present case, neither the High Court nor the Tribunal nor other authorities have examined whether the amount advanced to the sister concern was by way of commercial expediency.*
>
> *29. It has been repeatedly held by this Court that the expression "for the purpose of business" is wider in scope than the expression "for the purpose of earning profits" vide CIT v. Malayalam Plantations Ltd. [1964] 53 ITR 140 , CIT v. Birla Cotton Spg. &Wvg. Mills Ltd. [1971] 82 ITR 166 etc.*
>
> ***30.** The High Court and the other authorities should have examined the purpose for which the assessee advanced the money to its sister concern, and what the sister concern did with this money, in order to decide whether it was for commercial expediency, but that has not been done."*

107. He submitted that recently, Mumbai Bench of Hon'ble Tribunal in the case of **The Bombay Dyeing & Mfg. Co. Limited vs. DCIT in ITA No. 1716/Mum/2017** dated 27.10.2017, reiterating the principle of Shareholder's function and relying on the decision of Hon'ble Supreme Court's in case of S.A. Builders Ltd. v. CIT (2007) 288 ITR 1 (SC). The Hon'ble Tribunal while deleting the transfer pricing adjustment made by the TPO on account of issue of corporate guarantee, upheld the contention of the assessee that ***reiterates the proposition of the assessee that when the guarantee has been given by the assessee results in a direct or indirect benefit to the assessee itself, then there arises no need to charge any commission on the same.*** The relevant findings of the Tribunal read as under [Page no. 292/293 of PPB-Caselaw (Transfer pricing)]:

> "*18.* ***Further, we are in agreement with the argument of the assessee that even if providing corporate guarantee falls within the definition of "international transaction", in our view, providing such corporate guarantee by a parent company to its wholly owned subsidiary without charging any commission/fees would still be regarded as being at arm's length price, if such corporate guarantee was provided by the parent company for the overall benefit of the business of the group and therefore,***

***ultimately benefiting the parent company itself. Having regard to the direct or indirect commercial interest of the Company, corporate guarantee is given with a view to safeguard and to further business interest. Hence, relying on the Hon'ble Supreme Court's decision in case of S.A. Builders Ltd. v. CIT (2007) 288 ITR 1 (SC), wherein it has been held that once it is established that there was nexus between the expenditure and the purpose of the business (which need not necessarily be the business of the assessee itself), the Revenue cannot justifiably claim to put itself in the arm-chair of the businessman or in the position of the board of directors and assume the role to decide how much is reasonable expenditure and having regard to the circumstances of the case.***

*19. Further we have also gone through the decision of the Mumbai Tribunal in the case of ACIT v. Nimbus Communications Ltd. [2013] 145 ITD 582 (Mum-Trib.), wherein it was held as under:*

> *"For the guarantee given to the bank against the financial assistance given to its AEs, no commission was charged by the assessee company on the ground that the said AEs were not benefited by the guarantee so given and it was the assessee who benefited as a result of commercial benefits secured for future. In support of this stand of the assessee, the assessee has contended that business strategy should be taken into consideration while making any TP adjustments in respect of such transactions and has relied on the OECD Transfer Pricing Guidelines issued in 2010. As stated in para 1.59 of the said guidelines, the business strategies should also be examined in determining comparability for transfer pricing purposes and certain illustrations of such business strategies are also given therein. As stated in para 1.60 of the said guidelines which has been relied upon by the assessee, business strategies also could include market penetration schemes and taxpayer seeking to penetrate a market or to increase its market share might temporarily charge a price for its product that is lower than the price charged for otherwise comparable products in the same market. As explained further, a taxpayer seeking to enter a new market or expand (or defend) its market share might temporarily incur higher costs and hence achieve lower profit levels than other taxpayers operating in the same market. The relevant facts of the present case do not indicate that there was any such business strategy adopted by the assessee in not charging commission in respect of guarantees issued for its AEs. As a matter of fact, there is nothing to suggest that any such business strategy was adopted by the assessee with specific intention or motive and the case has been sought to be made out merely on the basis of commercial expediency by claiming that the assessee was benefited as a result of giving the guarantees in the form of commercial benefits secured for future."*

***20. Thus, the above decision of the Mumbai Tribunal reiterates the proposition of the assessee that when the guarantee has been given by the***

> ***assessee results in a direct or indirect benefit to the assessee itself, then there arises no need to charge any commission on the same.*** *Thus, following the decisions of the co-ordinates benches of the Tribunal (supra), we, in the present case are of the view that the above transaction does not fall within the purview of international transaction as defined under section 92B of the Act and hence, the orders of the lower authorities are reversed. This issue of assessee's appeal is allowed."*

108. He placed reliance on the recent decision of the Hon'ble Rajkot bench of the Tribunal in the case of ***Jyoti CNC Automation Pvt. Ltd.***, wherein, while dealing with the entire legal position in this regard, the Hon'ble Tribunal held the corporate guarantee to be in the nature of shareholders' activity and, therefore, not give rise to any international transaction. The findings of the Hon'ble Tribunal in this regard are as under [Page no. 366/367 of PPB-Caselaw (Transfer pricing)]:

> *"36.* ***We have noticed that the 'OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations' specifically recognizes that an activity in the nature of shareholder activity, which is solely because of ownership interest in one or more of the group members, i.e. in the capacity as shareholder "would not justify a charge to the recipient companies". It is thus clear that a shareholder activity, in issuance of corporate guarantees, is taken out of ambit of the group services. Clearly, therefore, as long as a guarantee is on account of, what can be termed as 'shareholder's activities', even on the first principles, it is outside the ambit of transfer pricing adjustment in respect of arm's length price.*** *It is essential to appreciate, at this stage, the distinction in a service and a benefit. One may be benefited even when no services are rendered, and, therefore, in many a situation it's a 'benefit test' which is crucial for transfer pricing legislation, such as in US Regulations 1.482-9(1)(3)(i) which defines 'benefit', form a US Transfer Pricing perspective, as "an activity is considered to be provided a benefit to the recipient if the activity directly results in a reasonably identifiable increment of economic or commercial value that enhances the recipient's commercial position, or that may be reasonably anticipated to do so". The expression "activity", in turn is defined, as "including the performance of functions; the assumption of risks; the use by a rendered of tangible or intangible property or other resources capabilities or knowledge (including knowledge of and ability to take advantage of a particularly advantageous situation or circumstances); and making available to the recipient any property or other resources of the rendered" [Regulation 1.482-9(1)(2)]. The issuance of guarantees is not within the ambit of transfer pricing in United States because it is a service but because it is covered by the specific definition discussed above. As a matter of fact, David S Miller, in a paper titled 'Federal Income Tax Consequences of Guarantees; A Comprehensive Framework for Analysis' published in the 'The American Lawyer Vol. 48, No. 1 (Fall 1994), pp. 103-165 (http://www.jstor.org/stable/20771688), has stated*

*that a guarantee is not a service. The following observations, at pages 114, are important:*

*The position that guarantees are services has been discredited by the courts with good reason 38. Guarantee fees do not represent payments for services any more than payments with respect to other financial instruments constitute payment for services39. A guarantor does not arrange financing for the debtor, but merely executes a financial instrument in its favour. 38 See. e.g., Centel Communications Co. v. Commissioner, 92 T.C. 612, 632 (1989), aff d, 920 F2d 1335 (7th Cir. 1990); Bank of Am. v. United States, 680 F.2d 142, 150 (Cl. Ct. 1982). The Service's current position on the characterization of guarantee fees as payment for services under section 482 is inconsistent with its treatment of guarantee fees under other provisions. See P.L.R. 9410008 (Dec. 13, 1993). 39 But cf Federal Nat'l Mortgage Ass'n v. Commissioner, 100 T.C. 541, 579 (1993) (Fannie Mae provided services by buying mortgages).*

*37. We are in agreement with these views. There can thus be activities which benefit the group entities but these activities need not necessarily be 'provision for services'. The fact that the OECD considers such activities in the services segment does not alter the character of the activities. While the group entity is thus indeed benefited by the shareholder activities, these activities do not necessarily constitute services. .....*

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***39. The issuance of financial guarantee in favour of an entity, which does not have adequate strength of its own to meet such obligations, will rarely be done. The very comparison, between the consideration for which banks issue financial guarantees on behalf of its clients with the consideration for which the corporates issue guarantees for their subsidiaries, is ill-conceived because while banks seek to be compensated, even for the secured guarantees, for the financial risk of liquidating the underlying securities and meeting the financial commitments under the guarantee, the guarantees issued by the corporates for their subsidiaries are rarely, if at all, backed by any underlying security and the risk is entirely entrepreneurial in the sense that it seeks to maximize profitability through and by the subsidiaries. It is inherently impossible to decide arm's length price of a transaction which cannot take place in arm's length situation. The motivation or trigger for issuance of such guarantees is not the kind for consideration for which a banker, for example, issue the guarantees, but it is maximization of gains for the recipient entity and thus the MNE group as a whole. In general, thus, the consideration for issuance of corporate guarantees are of a different character altogether.***

109. He further submitted that the Kolkata Bench of Tribunal in the case of **Tega Industries Limited vs. DCIT in ITA No. 1912/Kol/2012**, held that corporate guarantee furnished by assessee to bank for extending loan to subsidiary company in

the Bahamas (SPV), for the purpose of acquiring 2 South African entities is a shareholder function not warranting any commission on issue of such corporate guarantee.

110. He submitted that the **Hon'ble Ahmadabad Bench of the Tribunal** in the case of **Micro Ink Ltd vs. Addl CIT:2013] 157 TTJ 289 (Ahmedabad - Trib.)** while relying on the OECD guidelines held that activity which is solely undertaken because of the ownership interest in the subsidiary would not justify a charge from the subsidiary. The Tribunal accordingly held that shareholder activity, in issuance of corporate guarantees, is taken out of the ambit of group services. The Hon'ble Tribunal further held that the occasion of benchmarking the transaction of issuance of corporate guarantee would arise only when the transaction falls within the definition of the term international transaction. The Tribunal further held that the transaction of corporate guarantee would fall in the definition of international transaction only when costs are incurred for the same or recoveries, as a matter of abundant caution, for this non chargeable activity.

111. Further, he placed reliance on the decision of the **Ahmedabad Bench of Tribunal** in the case of **Micro Inks Limited vs. ACIT (ITA No. 2873/Ahd/2010**for subsequent year, i.e. assessment year 2006-07, wherein it is extensively dealt with the issue of shareholder's activity with respect to transaction of issue of corporate guarantee and held that issuance of corporate guarantees in question was not in the nature of 'provision for services' and these corporate guarantees were required to be treated as shareholder participation in the subsidiaries.

112. He further placed reliance on the decision of **Delhi Bench of the Tribunal** in the case of **Bharti Airtel Limited vs. ACIT (ITA No. 5816/Del/2012)**, wherein, the Hon'ble Tribunal held that the guarantees having no impact on income, profits, losses or assets of the assessee cannot be construed as an international transaction.

113. He submitted that the Kolkata Bench of Tribunal in the case of **EIH Limited vs. DCIT (ITA No. 117/Kol/2017)** following their decision in the case of Tega Industries, further held that:

> *5. We have heard the contentions of both the parties and perused the materials available on records. At the outset we note that the impugned issue has already been decided in favour of assessee by this Tribunal in its own case in*

*ITA No. 110/Kol/2016 for the AY 2011-12 vide order dated 12.1.2018. The relevant extract of the order is reproduced below:*

> *"12.10. We note that M/s. EIH flight is a startup company, it required funds primarily for acquisition of capital assets for setting up its operation and guarantee facilities given by the assessee/assessee company to the lender bank is normal business practice and obligation towards a subsidiary. Since the AE was a startup company, the assessee extended corporate guarantee to the third party borrowers as a matter of commercial prudence to protect its interest by fulfilling the shareholders obligation. We agree with the contention of the ld AR that the corporate guarantee as provided by the assessee was a matter of commercial prudence to protect and by fulfilling the shareholder obligation, as any financial incapacitation of the subsidiary would jeopardize the investment of the assessee. For that we rely on the order of the Coordinate Bench of this Tribunal in the case of Tega Industries Ltd. Vs DCIT (ITA No.1912/Kol/2012 wherein it was held that the provision of corporate guarantee is in the nature of shareholder activity and hence, no TP adjustment on account of corporate guarantee is required. In the said case, this tribunal had held that "the assessee's expectation from provision of guarantee was not that of a guarantor i.e. to earn a guarantee fee, rather, the expectation was of a shareholder to protect its investment interest, to help it achieve the assessee's business objective". Thus, we agree with the contention of the assessee that the objective of the assessee for providing guarantee was not to earn guarantee fee but to earn returns in the form of appreciation in investment value and receive dividends and, therefore, no TP adjustment ought to have been made in the facts and circumstances of the case."*

114. H submitted that in the following cases too, relying on the decision of Bharti Airtel (supra) and Micro Inks (supra), it has been held that corporate guarantee issued by holding company is in the nature of shareholder transaction and hence cannot constitute an international transaction:

- DCIT vs. Spentex Industries Ltd. (ITA No. 4959/Del/2014, 6243 and 6244/ Del/2014) (Del Trib.)
- Videocon Industries Limited vs. ACIT (ITA No. 6145/mum/2012) (Mum Trib.)
- The Bombay Dyeing & Mfg. Co. Limited vs. DCIT in ITA No. 1716/Mum/2017 (Mum Trib.)
- Advanta India Limited vs. ACIT (ITA No. 1643/Ban/12) (Bang Trib.)
- Batronics India Limited vs. DCIT (2017) 86 taxmann.com 254 (Hyd Trib)

- Dr. Reddy's Laboratories Limited vs. ACIT (2017), 81 taxmann.com 398 (Hyd Trib.)
- DCIT vs. CCL Products (India) Pvt. Ltd. (ITA No. 191/Viz/2018)(Vizag Trib.)

115. He submitted that in view of the aforesaid, since the corporate guarantee has been given pursuant to an obligation of the assessee as the shareholder falls within the definition of shareholder activity, the adjustment made by the TPO by imputing commission on such issue of corporate guarantee, ought to be deleted.

116. He however pointed out that recently the Hon'ble Madras High court in the case of **Principal Commissioner of Income Tax 5 v. M/s. Redington (India) Limited (T.C.A. Nos. 590 & 591 of 2019),** reversed the decision of the Hon'ble Chennai Tribunal deleting the adjustment on account of corporate guarantee holding that it does not constitute an international transaction in terms of section 92B as "the guarantee provided by an assessee does not have any bearing on profits, income, loss or assets of the assessee."

117. He submitted that The Hon'ble high Court while relying upon the decision of the Tribunal in case of Prolifics Corporation Ltd. held that "there is a service provided to the Associate Enterprise in increasing its creditworthiness in obtaining loans in the market, be from financial institutions or from others. There may not be immediate charge on P & L account, but inherent risk cannot be ruled out in providing guarantees." The High Court accordingly upheld the adjustment made by the TPO.

118. He further submitted that however, the decision of the Hon'ble Madras High Court holding as aforesaid, did not consider the following contentions raised by the assessee in the present case:

**(a) <u>Whether notional income can be imputed under section 92</u>**

119. He submitted that in terms of section 4 of the Act, which is the charging section, the charge of tax is on the 'total income' of an assessee. The Supreme Court in the case of CIT vs. A. Raman And Co.: 67 ITR 11 laid down the proposition that –

> *"The law does not oblige a trader to make the maximum profit that he can out of his trading transactions. Income which accrues to a trader is taxable in his*

*hands; income which he could have, but has not earned, is not made taxable as income accrued to him. .... ..... ....”*

120. The dictum of law laid down in the aforesaid decision has been affirmed by the Supreme Court in the later decision in the case of UOI and Anr. Vs. Azadi Bachao Andolan and Anr. : 263 ITR 706.

121. He submitted that in respect of transactions where no income has been actually earned, no income can, it is respectfully submitted, be imputed under any provisions of the Act, since the law does not empower the Revenue authorities to bring to tax any notional / hypothetical income.

122. He further submitted that under the scheme of the Act, section 92 and the related provisions under Chapter - X of the Act contain machinery provisions for computation of income arising from international transaction(s) having regard to the arm’s length price. The Transfer Pricing Provisions, being in the nature of machinery provisions not intended to override the charging provisions of section 4 of the Act, cannot be invoked to bring to tax any fictional / assumed or hypothetical income where no income otherwise results. To put it differently, section 92 of the Act is not a charging provision and cannot enlarge the scope and ambit of the Act.

123. In other words, for application of section 92 of the Act, there has to be, first, income embedded in the international transaction. Accordingly, where an international transaction is entered gratis, that is, without consideration, section 92 of the Act not being in the nature of charging provision, cannot be applied to impute notional income.

124. To reiterate, where an international transaction between associated enterprises is without consideration, not resulting in any income liable to tax, applying transfer pricing provisions, addition cannot be made for any hypothetical / notional / assumed income. As a necessary corollary, where income results in an international transaction between associated enterprises, it is only income that has to be apportioned between the associated enterprises, such that the income producing international transaction can be said to have been undertaken at arm’s length.

125. He submitted that Hon’ble Delhi High Court in the case of Sony India (P) Ltd. vs. CBDT : 288 ITR 52, quoting the Budget speech of the Finance Minister for the year

2000-01 explaining the rationale behind the introduction of transfer pricing transactions, held as under :

> *".... .... It was acknowledged by the Finance Minister in the Budget Speech for the year 2001 that "the presence of multinational enterprises in India and their ability to allocate profits in different jurisdictions by controlling prices in intra-group transactions has made the issue of transfer pricing a matter of serious concern". The purpose of inserting these provisions is therefore to determine the arm's length price (ALP) of an international transaction involving an MNC and its local associate."*

126. He further placed reliance on the recent decision of Hon'ble Delhi High Court in case of Sony Ericsson Mobile Communications India Pvt.Ltd. vs. CIT III (374 ITR 118) where in it has been held that the arm's length seeks to correct distortion and shifting of profits of tax the actual income earned by a resident. The Hon'ble Delhi High Court held as under[ Page no. 552 of PPB- Caselaws (Transfer pricing)]:

> *"77.* ***As a concept and principle Chapter X does not artificially broaden, expand or deviate from the concept of "real income". "Real income", as held by the Supreme Court in Poona Electricity Supply Company Limited versus CIT, [1965] 57 ITR 521 (SC), means profits arrived at on commercial principles, subject to the provisions of the Act. Profits and gains should be true and correct profits and gains, neither under nor over stated. Arm's length price seeks to correct distortion and shifting of profits to tax the actual income earned by a resident/domestic AE. The profit which would have accrued had arm's length conditions prevailed is brought to tax. Misreporting, if any, on account of non-arm's length conditions resulting in lower profits, is corrected.***
>
> XXX
>
> *(xii) When segmentation or segregation of a bundled transaction is required, the question of set off and apportionment must be examined realistically and with a pragmatic approach.* ***Transfer pricing is an income allocating exercise to prevent artificial shifting of net incomes of controlled taxpayers and to place them on parity with uncontrolled, unrelated taxpayers. The exercise undertaken should not result in over or double taxation.*** *Thus, the Assessing Officer/TPO can segregate AMP expenses as an independent international transaction, but only after elucidating grounds and reasons for not accepting the bunching adopted by the assessed, and examining and giving benefit of set off. Section 92(3) does not bar or prohibit set off."*

127. He further submitted that the Hon'ble Delhi High Court recently in case of Ramp Green Solutions Pvt. Ltd vs CIT (ITA 102/2015) reaffirmed the finding of Sony

Ericssion*(supra)* and held that ***"The object of Chapter X of the Act is not to tax any notional income but to ensure that the real income is brought to tax under the Act".***[Page no. 856 of PPB – Caselaws (Transfer pricing)]

128. In respect of transactions where no income has been actually earned, no income can, it is respectfully submitted, be imputed under any provisions of the Act, since the law does not empower the Revenue authorities to bring to tax any notional / hypothetical income.

129. It is submitted that under the scheme of the Act, section 92 and the related provisions under Chapter - X of the Act contain machinery provisions for computation of income arising from international transaction(s) having regard to the arm's length price. The Transfer Pricing Provisions, being in the nature of machinery provisions not intended to override the charging provisions of section 4 of the Act, cannot be invoked to bring to tax any fictional / assumed or hypothetical income where no income otherwise results. To put it differently, section 92 of the Act is not a charging provision and cannot enlarge the scope and ambit of the Act.

130. In other words, for application of section 92 of the Act, there has to be, first, income embedded in the international transaction. Accordingly, where an international transaction is entered gratis, that is, without consideration, section 92 of the Act not being in the nature of charging provision, cannot be applied to impute notional income.

131. He further placed reliance on the decision of the **Hon'ble Bombay High Court** in the case of **Vodafone India Services Pvt Ltd vs UOI: 368 ITR 1 (Bom)** wherein negating the similar contention raised by the department that under transfer pricing as contained in Chapter 10 of the Income-tax Act can also be brought to tax, the Hon'ble High Court held as under [Page no. 623 of PPB- Caselaws (Transfer pricing)]:

> *"31. Similarly, the reliance by the revenue upon the definition of International Taxation in the sub clause (c) and (e) of Explanation (i) to Section 92B of the Act to conclude that Income has to be given a broader meaning to include notional income, as otherwise Chapter X of the Act would be rendered otiose is far fetched. The issue of shares at a premium does not exhaust the universe of applicability of Chapter X of the Act. There are transactions which would otherwise qualify to be covered by the definition of International Transaction. The transaction on capital account or on account*

*of restructuring would become taxable to the extent it impacts income i.e. under reporting of interest or over reporting of interest paid or claiming of depreciation etc. It is that income which is to be adjusted to the ALP price. It is not a tax on the capital receipts. This aspect appears to have been completely lost sight of in the impugned order.*

xx xx xx xx

***40** It was contended by the Revenue that in view of Chapter X of the Act, the notional income is to be brought to tax and real income will have no place. The entire exercise of determining the ALP is only to arrive at the real income earned i.e. the correct price of the transaction, shorn of the price arrived at between the parties on account of their relationship viz. AEs. In this case, the revenue seems to be confusing the measure to a charge and calling the measure a notional income. We find that there is absence of any charge in the Act to subject issue of shares at a premium to tax."*

132. **He submitted that the aforesaid decision of the Hon'ble Bombay High Court has also been accepted by the Government/ Central Board of Direct Taxes in the press release dated 28.01.2015.**[Page no. 627 of PPB- Caselaws (Transfer pricing)]

133. In the case of the assessee, it has been submitted that the issue of corporate guarantee to the lenders of associated enterprise is a shareholders' activity since the benefit of existence of its associated enterprise benefits directly to the assessee. The global presence of associated enterprises enables the assessee to be the contact point for its customers and for working on the routine software development in huge quantum. Further, it has been submitted that it is in the interest of the shareholders of the assessee to issue corporate guarantee to its associated enterprise so as to lower the interest cost/opportunity cost had they provided funds to its associated enterprises by way of share capital. It is also submitted that due to the corporate guarantee provided by the assessee, the assessee in return had earned huge business profits over the years. In fact , the benefit of USD 1,092.35 Million and GBP 261,470 thousand by way of providing corporate guarantee without charging any commission is much higher than Rs. 1,70,99,560 which would have been charged as a commission, as alleged by the Ld. TPO by considering the rate of commission at 4.71%.

134. The Hon'ble Madras high court, it is respectfully submitted, did not appreciate that the corporate guarantee given in the present case would result in a liability or loss only in the event of a default and hence does not have a bearing on profit or loss at this stage, and any transfer pricing adjustment in this regard is only seeking to bring to

tax a notional income.

**(b) <u>Whether the corporate Guarantee in the present case is in the nature of shareholder activity</u>**

135. He submitted that however, while holding as aforesaid, the High Court did not deal with the submissions of the assessee that the guarantee is in the nature of shareholder activity. In case where the guarantee is provided by the assessee in the capacity of a shareholder i.e. in order to funds its own business or to fulfil the obligation as a shareholder or to protect the interest of its investments in the subsidiary company, the said issuance of guarantee cannot be regarded as a service to the subsidiary or as having been issued for the benefit of the subsidiary. Since, the guarantee in such as a case is issued by the assessee to protect its own interest, no commission can be imputed as consideration for issuance of such guarantee.

136. He submitted that the Hon'ble Supreme Court in the case of **Morgan Stanley & Co. Inc., (2007) 292 ITR 416 (SC)** held that stewardship activities carried on by the assessee for protecting its own interests cannot be regarded as provision of service. Accordingly, issuance of guarantee by the assessee for protecting or promoting its own interest cannot be regarded as provision of service or benefit to the associated enterprise so as to warrant any compensation.

137. He submitted that it may be argued that since the guarantee has been issued by the assessee at its own volition and for its own benefit or to fulfil its obligations as a shareholder, without there being any request from the associated enterprise, it is a unilateral act on the part of the assessee not resulting in a transaction.

138. He further submitted that the Hon'ble Madras High Court in the case of Redington while upholding the retrospectivity of the amendment to section 92B and that the corporate guarantee to be an international transaction, did not deal with the issue of corporate guarantee given as shareholders activity. It is submitted that the Corporate Guarantee is given by the assessee, may be covered under clause (c) of Explanation 1 to Section 92B, only if it as a "bearing on the profit, income, losses or assets of such enterprises". It may be argued that the language used in the Explanation makes it clear that in so far as the transactions that fall within the main part of Section 92B are

concerned, such transactions must have a bearing on profit, income, losses or assets of an assessee.

139. In the assessee's case, the Corporate Guarantees represent shareholder's function and have no bearing on the profits, income or losses of the assessee and Corporate Guarantee cannot be covered within the definition of international transaction.

140. He submitted that the decision of the Hon'ble Madras High Court, did not consider the contentions raised by the assessee in the present case, and is therefore distinguishable and the aforesaid position of law as laid down by the Hon'ble Jurisdictional high court is ought to be followed by this Hon'ble Tribunal in the present case. Accordingly, the transfer pricing adjustment proposed made by the TPO, on this account calls for being deleted.

141. Without prejudice to the above, it is further submitted that even if a contrary view as contended by the Department Representative may at heart be said to be a possible view, it is a settled law that where a taxing provision is susceptible to two possible interpretations, the interpretation which is beneficial to the assessee is to be followed. Your Honour's kind attention in this regard is further invited to the judgement of the apex court in the matter of CIT v. Vegetable Products Ltd.: 88 ITR 192 wherein it was held as under:

> *"There is no doubt that the acceptance of one or the other interpretation sought to be placed on section 271(1)(a)(i) by the parties wilful lead to some inconvenient result, but the duty of the court is to read the section, understand its language and give effect to the same. If the language is plain, the fact that the consequence of giving effect to it may lead to some absurd result is not a factor to be taken into account in interpreting a provision. It is for the legislature to step in and remove the absurdity. On the other hand, if two reasonable constructions of a taxing provision are possible, that construction which favours the assessee must be adopted. This is a well-accepted rule of construction recognized by this court in several of its decisions. Hence, all that we have to see is, what is the true effect of the language employed in section 271(1)(a)(i). If we find that language to be ambiguous or capable of more meanings than one, then we have to adopt that interpretation which favours the assessee, more particularly so because the provision relates to imposition of penalty" (emphasis supplied)*

142. Reliance is also placed in this regard on the following decisions:

- CIT vs. J.K.Hosiery Factory : 159 ITR 85 (SC)
- ACIT v. Thanthi Trust: 247 ITR 785 (SC)
- UOI v. Onkar Kanwar : 258 ITR 761 (SC)

- Vijay Omprakash Bansal v. CIT : 257 ITR 649 (Bom)
- CIT v. L.G Balakrishnan: 255 ITR 339 (Mad)
- CIT v. Quantas Airlines Ltd.: 256 ITR 84 (Del)
- Southern Roadways Ltd. v. CWT: 251 ITR 213 (Mad)

143. In addition to the above, he submitted that since the guarantee has been issued by the assessee at its own volition and for its own benefit or to fulfil its obligations as a shareholder, without there being any request from the associated enterprise, it is a unilateral act on the part of the assessee not resulting in a transaction.

**Re: Guarantee fee being incidental to 'business of the assessee' and extended in pursuance of its own business interest should be aggregated with the other international business transactions and is already captured in Transaction Net Margin Method adopted by the assessee for the purpose of benchmarking:**

144. It is submitted that the assessee is a global IT and IT enabled service provider headquartered in India and the ultimate parent company of the HCL Group and directly or indirectly owns subsidiaries and branches in more than nineteen countries worldwide which gives the group global sales and project support and rollout capabilities in multiple countries. The assessee along with its associated enterprise provides the above services by leveraging its infrastructure in the form of Offshore Development Centers ("ODCs") in India.

145. Further, while providing the software development services, the assessee has earned an operating profit to cost margin of 22.18% in software development services and 28.20% in IT enabled services as against the average operating profit margin of comparable companies at 7.49% and 5.49% in respective segment. The assessee in his transfer pricing report has treated the issue of corporate guarantee as part of its functions undertaken for software development services and BPO services, as under:

> ***4.02. Software development services***
>
> *4.02.02. Functions performed*
>
> *Formulation of group strategy*
>
> *HCLT India is responsible for formulation of the overall group strategy. HCLT India assists its associated enterprises in their business operations. The market research team of HCLT India performs research relating to the current industry trends, requirements and thus provides the basic information on the industries to focus on and the nature of services that can be offered. HCLT India being the entrepreneurial entity of the group takes the strategic decision of the industry / verticals to focus on, service offerings.*

*The associated enterprises track the requirements of the market and communicate their service offerings and value propositions to the prospective clients. HCLT India assists its associated enterprises in preparing client presentations and preparation of solutions frame work. Given the proximity to the client, it is the responsibility of the associated enterprises to liaison with and maintain a healthy relationship with the customer.*

*Project Management*

*Project teams are drawn keeping in mind the project delivery. HCLT India assumes the role of project manager for all contracts entered into by any of its associated enterprise. However, for onsite contracts, the associated enterprises share the responsibility of project management and project execution with HCLT India. The associated enterprise liaises with customers, provides co-ordination and management for the projects, in their designated regions.*

***4.03. Provision of BPO services***

*4.03.2. Functions performed*

*Strategic functions*

*No strategic functions are performed by HCLT India's associated enterprises. HCLT India's associated enterprises perform certain limited operational functions relating to marketing services and internal management. HCLT India provides the overall strategic direction to its associated enterprises with respect to services rendered.*

146. In this regard, he submitted that it would be appreciated that the assessee has issued corporate guarantee and performance guarantee on behalf of the associated enterprises without incurring any expenses and the assessee in lieu of it is receiving a wide scope of services and support from its associated enterprises. The all such services as rendered by the associated enterprises is necessary for the business of assessee for managing and maintaining its software development services business.

147. The OECD guidelines provide that in order to arrive at the most precise approximation of fair market value, the arm's length principle should, ideally be applied on a transaction-by-transaction basis. However, there are often situations where separate transactions are so closely linked or continuous that they cannot be evaluated adequately on a separate basis. Attention is invited to paragraph 1.42 & 1.43 of the OECD guidelines which provide for evaluation of combined transactions where such transactions are closely linked or continuous and cannot be evaluated separately.

148. As per the OECD guidelines combining more than one transactions becomes necessary where there exists an intentional set-off - one associated enterprise provides a benefit to another associated enterprise which is balanced to some extent by different benefits received from that enterprise in return. In such situation the enterprises may claim that the benefit received by the respective enterprises should be set-off against the benefit each enterprise has provided as full or part payment of those benefits and only net gain or loss of the transaction need to be considered.

149. Rule 10A(d) too provides that closely linked transaction can be considered together. It is respectfully submitted, that the provisions contained in rule have equal force in law as the provisions contained in the Act.

150. He submitted that, on an analysis of OECD guidelines, transfer pricing regulations/practices in other jurisdiction as outlined hereinabove, and considering the mandate of the provisions of Rule 10A(d) of the Rules, the following position emerges:

(i) It is possible to conduct combined evaluation of interlinked transaction.

(ii) It is possible for the associated enterprise involved in the controlled transaction to undertake/ provide benefit in one controlled transaction to compensate for the benefit received in the other controlled transaction. In such situation the benefit received should be set off against the benefit provided i.e., such transactions are required to be evaluated together.

(iii) The combined effect of two or more separate transactions may be considered if such transactions taken as a whole are so interrelated that consideration of multiple transactions is the most reliable means for determining the arm's length consideration.

(iv) In case of a package deal transaction it would be appropriate to group all the transactions.

151. The assessee being the holding company and undertaking all entrepreneurial functions and risk, it can be nobody's case that the issue of corporate guarantee and provision of software development services and BPO services are not interlinked. The TPO, it is

respectfully submitted, on the basis of assumption and surmises, held that international transaction of issue of corporate guarantee on behalf of associated enterprises are not interlinked. In view of the aforesaid, in the absence of any evidence to contrary, the transaction of issue of corporate guarantee cannot be said to have any relevance on the business of the assessee of development of software products.

152. In this regard, he placed reliance on the decision of the Hon'ble Delhi High Court in the case of Sony Ericsson Mobile Communications Limited vs. CIT 374 ITR 118, wherein, the Hon'ble Court held that Clubbing of closely linked (including continuous transactions) is permissible in appropriate cases. The Hon'ble Court further held that once the Revenue accepts the TNMM as the most appropriate method, then it would be inappropriate for the Revenue to treat a particular expenditure as a separate international transaction. Such an exercise, the Hon'ble Court held, would lead to unusual and absurd results. The relevant findings of the Hon'ble Court are as under:

> *"82. There is considerable tax literature and text that CUP Method, i.e. Comparable Uncontrolled Price Method, RP Method, i.e. Resale Price Method and CP Method, i.e. Cost Plus Method can be applied to a transaction or closely linked, or continuous transactions. Profits Split Method and TNM Method grouped as ‗transactional profit methods', can be equally effective and reliable when applied to closely linked or continuous transactions. Thus, it would be inappropriate to proceed with the arm‗s length computation methods, with a pre-conceived suppositions on singularity as a statutory mandate. Clubbing of closely linked, which would include continuous transactions, may be permissible and not ostracized. Aggregation of closely linked transactions or segregation by the assessed should be tested by the Assessing Officer/TPO on the benchmark and the exemplar; whether such aggregation/ segregation by the assessed should be interfered in terms of the four clauses stipulated in Section 92C(3) of the Act, read with the Rules. It would, among other aspects, refer to the method adopted and whether reliability and authenticity of the arm‗s length determination is affected or corrupted.*
>
> *XXX*
>
> *91. In case the tested party is engaged in single line of business, there is no bar or prohibition from applying the TNM Method on entity level basis. The focus of this method is on net profit amount in proportion to the appropriate base or the PLI. In fact, when transactions are inter-connected, combined consideration may be the most reliable means of determining the arm‗s length price. There are often situations where closely linked and connected transactions cannot be evaluated adequately on separate basis. Segmentation*

*may be mandated when controlled bundled transactions cannot be adequately compared on an aggregate basis. Thus, taxpayer can aggregate the controlled transactions if the transactions meet the specified common portfolio or package parameters. For complex entities or where one of the entities is not ‗plain vanilla distributor', it should be applied when necessary and applicable comparables on functional analysis, with or without adjustments are available. Otherwise, the TNM Method should not be adopted or applied on account of being an inappropriate method.*

*XXX*

*101. However, once the Assessing Officer/TPO accepts and adopts TNM Method, but then chooses to treat a particular expenditure like AMP as a separate international transaction without bifurcation/segregation, it would as noticed above, lead to unusual and incongruous results as AMP expenses is the cost or expense and is not diverse. It is factored in the net profit of the inter-linked transaction. This would be also in consonance with Rule 10B(1)(e), which mandates only arriving at the net profit margin by comparing the profits and loss account of the tested party with the comparable. The TNM Method proceeds on the assumption that functions, assets and risk being broadly similar and once suitable adjustments have been made, all things get taken into account and stand reconciled when computing the net profit margin. Once the comparables pass the functional analysis test and adjustments have been made, then the profit margin as declared when matches with the comparables would result in affirmation of the transfer price as the arm's length price. Then to make a comparison of a horizontal item without segregation would be impermissible."*

153. He further placed reliance on the decision of the Hon'ble Delhi High Court in the case of Magneti Marelli Powertrain India Pvt. Ltd. for AY 2009-10 (ITA No 350/2014) wherein the Hon'ble High Court held that having accepted the TNMM as the most appropriate in respect of all the international transactions, it was not open to the TPO to subject only one element, i.e. payment of technical assistance fee, to an entirely different (CUP) method. The SLP filed by the Revenue against the aforesaid order of the Hon'ble Delhi High Court was dismissed by the Hon'ble Supreme Court vide order dated 03.11.2017.

154. Further, he submitted that the Hon'ble Bombay High Court in the case of Cummins India Ltd vs ACIT 153 Taxmann.com 223 (Bombay) relying upon the decision in the case of Magneti Marelli (supra) held that "the TPO having accepted that TNMM method applied by Assessee was the most appropriate method in respect of all the international transactions including payment of royalty cannot dispute application of

TNMM method as the most appropriate method for the payment of royalty only for which CUP method was sought to be applied."

155. He also placed reliance on the following decisions, wherein it was held that transactions which are critical and linked to core business operations of the assessee have to be benchmarked by applying TNMM on an aggregate basis:

- Avery Dennison India Pvt Ltd vs ACIT (ITA No 4868/Del/2014)
- B.G Exploration & Production India Ltd vs DCIT (ITA 1170/Del/2015)
- Demag Cranes & Components (India) Pvt. Ltd. vs. DCIT
- McCann Erickson India Pvt Ltd vsAddl CIT (ITA No 5871/Del/2011)
- Atul Ltd vs ACIT (ITA No 3118/Ahd/2010)
- Thyssen Krupp Industries India Pvt Ltd vs ACIT (ITA No 7032/Mum/2011)
- Cummins India Ltd vs. Addl. CIT (ITA No 1616/PN/2011)

156. He placed reliance on the following decisions, wherein it was held that no transfer pricing adjustment is warranted once the TPO accepts the TNMM method applied by the assessee in respect of all the international transactions:

- CIT vs Lumax Industries Ltd (ITA No 102/2014) (DHC)
- Magneti Marelli Powertrain India Pvt. Ltd. for AY 2009-10 (ITA No 350/2014) (DHC)
- Corning SAS-India Office vs DDIT (ITA No 548/Del./2015, 816/Del./2017 and 817/Del./2016)
- Cadbury India Limited vs. ACIT – (ITA No. 7408/Mum/2010)
- Toyota Kirloskar Auto Parts vs. DCIT (ITA No 1356/ Bang/2011)

157. It is submitted that while providing the software development services, the assessee has earned an operating profit to cost margin of 22.18% in software development services and 28.20% in IT enabled services as against the average operating profit margin of comparable companies at 7.49% and 5.49% in respective segment. Therefore, applying TNMM, on an entity wide basis, the above international transaction of issue of corporate guarantee would be regarded as being at arm's length applying TNMM.

**Re: <u>Without Prejudice, SBI, while issuing bank guarantee to the assessee has charged 0.40% on such guarantee amount</u>**

158. He submitted that without prejudice to the argument that no guarantee fee is chargeable on an arms' length basis, it is respectfully submitted that the rate of commission considered by the Ld. TPO on the basis of quotes furnished by certain

banks in pursuance of notice u/s 133(6) of the Act, without taking cognizance of the 'comparability criterion' as mentioned in Rule 10B (1)(a) of the Income tax rules, 1962, is not in accordance with law and therefore, cannot be considered.

159. It is submitted that in the case of the assessee itself, it has paid bank guarantee fees at a much lower rate that the rate than considered by the Ld. TPO in the impugned order. The rates available to the assessee are as follows:

| **Date of sanction letter** | **Bank Guarantee rate** |
|---|---|
| 09/04/2009 | 0.4% p.a. |
| 16/10/2010 | 0.4% p.a. |
| 10.01.2012 | 0.4% p.a. |

160. He submitted that the Hon'ble Bombay High Court in the case of DCIT vs. Everest Kanto Cylinder ltd. vs. DCIT (ITA No. 1165 of 2013), while dismissing the appeal filed by the revenue against the order of the Mumbai Bench of Tribunal in ITA No. 542/Mum/2012, upheld the internal rate of commission paid by the assessee to its banks, at the rate of 0.6%, holding as under [Page no. 646 of PPB- Caselaws (Transfer pricing)] :

> *"In the matter of guarantee commission, the adjustment made by the TPO were based on instances restricted to the commercial banks providing guarantees and did not contemplate the issue of a Corporate Guarantee. No doubt these are contracts of guarantee, however, when they are Commercial banks that issue bank guarantees which are treated as the blood of commerce being easily encashable in the event of default, and if the bank guarantee had to be obtained from Commercial Banks, the higher commission could have been justified. In the present case, it is assessee company that is issuing Corporate Guarantee to the effect that if the subsidiary AE does not repay loan availed of it from ICICI, then in such event, the assessee would make good the amount and repay the loan. The considerations which applied for issuance of a corporate guarantee are distinct and separate from that of bank guarantee and accordingly we are of the view that commission charged cannot be called in question, in the manner TPO has done. In our view the comparison is not as between like transactions but the comparisons are between guarantees issued by the commercial banks as against a Corporate Guarantee issued by holding company for the benefit of its AE, a subsidiary company. In view of the above discussion we are of the view that the appeal does not raise any substantial question of law and it is dismissed."*

161. He submitted that in view of the above, without prejudice, commission on corporate guarantee ought to be restricted to 0.40% being an appropriate internal CUP data.

162. It is further submitted that the various benches of the Tribunal has upheld the following rate of commission on corporate guarantee paid by the assessee in their respective cases, which ought to be considered as appropriate comparable cases:

| S. No. | Name of the case | Bench of Tribunal | Rate of commission |
|---|---|---|---|
| 1. | Manugraph India Ltd. vs. DCIT | Mumbai Bench | 0.50% |
| 2. | Everest Kento Cylinders Ltd. vs. DCIT | Mumbai Bench | 0.50% |
| 3. | Aditya Birla Minacs Worldwide Ltd. vs. DCIT | Mumbai Bench | 0.50% |
| 4. | Hindalco Industries Ltd. Vs. ACIT | Mumbai Bench | 0.50% |
| 5. | Mylan Laboratories Ltd vs. ACIT | Hyderabad Bench | 0.53% |
| 6. | Prolifics Corporation Ltd. Vs. DCIT | Hyderabad Bench | 0.53% |
| 7. | ACIT v. Reliance Industries Ltd. | Hyderabad Bench | 0.38% |
| 8. | Asian Paints Ltd. vs. ACIT | Mumbai Bench | 0.20% |
| 9. | ACIT v. M/s. Nimbus Communication Ltd | Mumbai Bench | 0.50% |
| 10. | Glenmark Pharmaceuticals Ltd vs. ACIT | Mumbai Bench | 0.53% |
| 11. | Nimbus Communication Ltd. vs. ACIT | Mumbai Bench | 0.50% |
| 12. | Everest Kanto Cylinder Ltd. vs. DCIT | Mumbai Bench | 0.50% |
| 13. | Grindwell Norton Ltd. VS ACIT | Mumbai Bench | 1% |
| 14. | Kohinoor Foods Ltd. VS ACIT | Delhi Bench | 1% |
| | **Average** | | **0.5%** |

163. It is submitted that Benches of Tribunal in the following cases has relied upon the uncontrolled rate of commission approved by other co-ordinate benches in respective cases, as a valid CUP for determining arm's length rate of commission -

- **Manugraph India Ltd vs The DCIT [ITA No. 4761/Mum/2013] -**

  *"19. Having considered the rival submissions as well as relevant material on record, we agree with the alternative please of the Ld. AR that* ***the arm's length guarantee commission charges can be considered at the rate of 0.5%*** *as held by this Tribunal in a series of decisions referred above."*

- **Western Refrigeration Pvt. Ltd. vs DCIT (ITA No. 6796/Mum/2014) –**

  *"6. The learned Departmental Representative relied upon the observations of learned Commissioner (Appeals) and the Transfer Pricing Officer. Having considered rival submissions, it is noticed that the Hon'ble Jurisdictional High Court in* ***Everest Kento Cylinders Ltd****. (supra), has held that the guarantee commission should be charged @0.5%. The*

> ***aforesaid decision of the Hon'ble Jurisdictional High Court has been followed in various decisions of the Tribunal including the decision in case of DCIT v/s RoltaIndia Ltd., ITA no.882/Mum./2017, dated 7th September 2018. In view of the aforesaid, we direct the Assessing Officer to re–compute the arm's length price of the corporate guarantee fee by applying the rate of 0.5%. Grounds are partly allowed.***"

164. Further, he submitted that in the following cases, the Hon'ble Tribunal has held that in absence of internal rate of commission, the arm's length rate of commission shall be 0.5% being the rate of commission approved by the Hon'ble Bombay High Court in the case of Everest Kanto-

- Havells India Ltd. vs. ACIT (ITA No. 6509/Del/2018)
- Rain Commodities vs. ACIT (ITA No. 157/Hyd/2014
- Thomas Cook (India) Ltd. vs. ACIT (ITA No. 768/Mum/2014)

165. He submitted that in view of the aforesaid, without prejudice, the commission on guarantee issued by the assessee, at best, ought to be restricted to 0.5% of the guarantee amount.

Re: **<u>Without prejudice, Ad-hoc adjustment of risk upon rate of commission on corporate guarantee:</u>**

166. He further submitted that the TPO in the impugned order has allegedly added an ad-hoc markup of 200 bps on the average rate of commission of 2.71% p.a. charged by various banks as per information sought under section 133(6).

167. In this regard, at the outset it is submitted that the TPO has already considered the highest rate of commission charged by various banks on corporate guarantee being the naked rates. It is common understanding that the rate of commission increases depending on the credit rating of the borrower. Since the TPO has considered the highest rate of commission that would have been charged by the bank from a company having BBB or unrated rating, the credit risk has already been factored in such rates. Further, no cogent basis and reason is provided in the show cause notice for charging a markup of 200 bps on account of security and single customer risk.

168. Accordingly, he submitted that since the Ld. TPO has considered the highest rate of commission charged by the banks without taking into account the credit worthiness and market reputation of the assessee, a markup on account of risk adjustment is

unwarranted and liable to be reduced from the arm's length rate of interest so determined.

**Re: Applicability of decision of Tax Court of Canada in the case of General Electric Capital Canada v the Queen (2009 TCC 563)**

169. The Ld. TPO, in the impugned order while imputing notional commission income on transaction of issue of corporate guarantee by the assessee on behalf of its associated enterprise has relied on the decision of Tax Court of Canada in the case of General Electric Capital Canada v the Queen (2009 TCC 563).

170. In this regard, it is submitted that in the case of General Electric Capital Canada Inc. (GE Canada), the Court relying on the 'interest saving approach' held that since the interest cost savings to the taxpayer based on the differential between BBB-/BB+ and AAA was determined to be approximately 1.83% (based on one of the expert reports), the guarantee fee charged by the taxpayer at the rate of 1% is below an arm's length price.

171. He further submitted that without prejudice to our aforesaid arguments, the assessee vide letter dated 11.01.2013, placed on record a quote furnished by M/s JPM Chase, being one of the leading international bankers, wherein it was stated that the bank would have charged 75 bps higher if the loan taken by HCL America was not backed by guarantee of the assessee, as under;

> *"non furnishing of corporate guarantee by the assessee company in connection with the overdraft facility availed of by HCL America Inc. would translate into a pricing difference of 75 basis points in so far as HCL America Inc. in so far as interest rate chargeable on the overdraft facility availed of by HCL America Inc. is concerned."*

172. In view of the aforesaid, he submitted that even if notional commission is to be charged on corporate guarantee furnished by the assessee in connection with the working capital loan availed by HCL America Inc. and HCL GB, the commission, at best, shall be restricted to 0.75% p.a. of the guarantee amount being the interest rate differential earned by the AE.

173. On the other hand, ld. DR of the Revenue submitted that he heavily relied on detailed findings of lower authorities.

174. Considered the rival submissions and material placed on record. It is a factual matter. We observed that the assessee had provided various corporate guarantees for the

purposes of financial support, guarantee for performance of the step-down subsidiaries, for undertaking premises for rent by the subsidiaries and acquisition/merger with the unrelated parties. For the above purposes, the TPO had determined the ALP by adopting notional rate of guarantee from the respective banks and added further basis points to mitigate the guarantees. Before us, the assessee had made detailed submissions on the above issue with the submissions that the above activities are not falling under the services, it is shareholders functions, there is no cost or transaction costs or benefit involved, it is the assessee who is the ultimate beneficiary by extending the guarantees on behalf of its step down subsidiaries. Further, it was submitted that if at all, it is to be treated as International Transaction, the commission should not be more than 0.50% as held in the case of Everest Kento Cylinders Ltd. (supra) and other similar decisions of various courts. Further it was submitted that there is no cost to the assessee in extending above said guarantees.

175. After considering the above detailed submissions, in our view, first of all, extending such guarantees falls within the definition of international transaction u/s 92B of the Act, it is a kind of long term finance extended by the assessee to its various step down subsidiaries. That being the case, all the above transactions will fall under the above category and there is no doubt it needs to be benchmarked. With regard to shareholders activities, it was submitted that Corporate Guarantee is issued by the assessee on behalf of the step-down subsidiaries as a matter of commercial prudence primarily to protect the business interest / shareholders interest of holding company, hence, issue of Corporate Guarantees do not warrant charging of fees by the assessee. After careful consideration, in our view, it is a business decision of the companies who are intended to expand the business ventures outside the territories/global level, it is for the risk mitigation, they choose to incorporate separate step-down subsidiaries instead of opening its own branches, it gives them flexibility in case the results of ventures goes south wise, they may close down the venture, even though they take lot of business risk by taking liabilities from different stake holders. This is the reason most of the lender’s demand for guarantees from the existing shareholders or corporate guarantees from the holding companies in order to mitigate their lending risks. This is similar to the bank guarantees; the bank will give guarantee to the relevant transaction considering the risk factors and premium is depends upon the

standing of the relevant corporation. Just because the bank has given guarantee, the risk of the transaction remains till the same is concluded. There is absolutely no participation by the bank in the transaction on which the bank has given guarantee. Similarly, the holding company gives guarantees on behalf of step-down subsidiary, there is no involvement of the holding company in any of the transactions on which relevant guarantee was demanded by the relevant lenders or implementer of the relevant contract. The risk remains on the transaction till the same is not concluded. Since the bankers who give the bank guarantee is the third party, who take the risk of default, they charge premium, whereas in the case of corporate guarantees, it is given for comfort of the third parties. In certain cases, the holding company charges certain premiums to its subsidiaries for extending such corporate guarantees. In such cases, there is involvement of direct international transaction, there is no question and the issue is settled by various courts. However, the issue comes when the holding company chooses not to charge or claim any corporate guarantee fees from its step-down subsidiaries. It is fact on record that the holding company has indulged in such transaction even though it falls into the definition of providing long-term financing for its step-down subsidiaries. It is not necessary that the long-term financing should be direct, it can also be indirect financing to its subsidiaries. Extending corporate guarantee is nothing but indirect financing. Therefore, in our view, the deeming provision applies in this case and as held in the case of Everest Kento Cylinders Ltd and other cases where the courts have held that corporate guarantee should be levied 0.50% on the outstanding corporate guarantees. In this case, the TPO had levied on the basis of notional commission plus markup of 200 basis points, in our view, which is not proper. Therefore, we are inclined to direct AO to sustain disallowance to the extent of 0.50% of the total outstanding guarantee at the end of each year under consideration, accordingly, partly allow relevant grounds on the basis of above observations.

176. Grounds No.5 to 5.1 in the AY 2010-11 are with regard to TP adjustment made in relation to international transaction of provision of ITES/BPO services.

177. At the time of hearing, with regard to above grounds, ld. AR brought to our notice the relevant facts and his submissions are as under:-

"The assessee is the principal entity of HCL Group, incorporated on 12th November, 1991. The assessee has segregated its business operations in three different segments viz.:

- Software development segment;
- IT infrastructure segment; and
- Business Process Outsourcing ('BPO') segment

**TP Study:**

During the financial year 2009-10, the assessee undertook international transaction of provision of BPO services with its associated enterprises, namely, HCL Great Britain Limited ('**HCL GB**') and HCL America Inc. ('**HCL America**') amounting to Rs. 423.22 crores. In the transfer pricing study, the said international transaction of provision of **BPO services was benchmarked applying** TNMM, considering **HCL GB** and **HCL America** as the tested parties and Net Profit Margin (**NPM**) as PLI, as under:

| Particulars | NPM |
|---|---|
| **NPM earned by HCL GB** | -3.22% |
| Average NPM of comparable companies operating in EMEA region | 2.30% |
| | |
| **NPM earned by HCL America** | -5.64% |
| Average NPM of comparable companies operating in North America region | 4.10% |

Accordingly, it was concluded that since the net profit margin earned by AEs, HCL GB and HCL America, in undertaking transactions with the assessee is lower than the average margin earned by comparable companies operating in same geography and under similar economic circumstances, the international transaction of provision of BPO services undertaken by the assessee with its AEs is at arm's length price.

**TPO's Order:**
The Ld. TPO, however, rejected the economic analysis undertaken by the assessee considering AEs as the tested party, holding that:

> *"A tested party should be least complex entity. In this case, the entire details of foreign AEs are not available in the records. Moreover, here Indian transactions are benchmarked. One has to operate in the same economic circumstances in order to be taken as tested party. In this case, there are certain economic benefits like Location saving advantages (LSA). One cannot foresee that American and Great Britain AE is operating in similar economic circumstances. These two are developing countries whereas India is developing country.*

*The Indian assessee is less complex than its AEs. As far as AEs are concerned, it has 02 AEs, EMEA region and other in North America. The assessee's main international transactions have been undertaken with these AEs. It can be seen that these two AEs are working in the different economic scenarios and it is difficult to ascertain which one is having more advantage than other. As the less complex entity should be taken in the absence of information otherwise, TPO is proposed to take Indian taxpayer as tested party."*

The Ld. TPO undertook a search of comparable companies considering Assessee as the tested enterprise and arrived at a set of following 9 companies with operating profit to cost ratio of 35.19%, as under:

| S. No. | Company Name | OP/OC % |
|---|---|---|
| 1 | Accentia Technologies Ltd. | 42.52 |
| 2 | Cosmic Global Ltd. | 18.28 |
| 3 | E4e Healthcare | 31.03 |
| 4 | Fortune Infotech Ltd. | 22.80 |
| 5 | Infosys BPO Ltd. | 31.44 |
| 6 | TCS E-Serve International Ltd. | 54.03 |
| 7 | TCS E-Serve Limited | 63.42 |
| 8 | I Gate Global Solutions Limited | 24.54 |
| 9 | ICRA Techno Analytics Limited | 28.66 |
| **Average** | | **35.19** |

Accordingly, the TPO computed an adjustment of Rs. 143.49 crores in the arm's length price of international transaction of provision of BPO services, as under:

| Particulars | | Amount in Cr. |
|---|---|---|
| Operating cost incurred by assessee in provision of services | A | 420.16 |
| Arm's Length Price over cost at a margin of 35.19% | B=A*135.19% | 568.01 |
| Actual price received by assessee | C | 424.52 |
| 105% of the price received | | 445.75 |
| Proposed adjustment u/s 92CA | B-C | 143.49 |

However, since the amount retained by AEs in undertaking transactions with the assessee was only Rs. 44.73 crore, the TPO relying upon the decision of the Supreme Court in case of Global Vantedge Pvt. Ltd. restricted the adjustment to **Rs. 44.73 crores**. The DRP upheld the adjustment of Rs. 44.73 crores proposed by the TPO.

The adjustment made by the TPO in the arm's length price of BPO services is not sustainable and liable to be deleted for the reasons submitted hereunder:

**Re: <u>Rejection of AEs as the tested party</u>**

It is submitted that the assessee and the TPO, both have selected TNMM as the most appropriate method to benchmark the transaction.

At the outset, it is submitted that for the AY 2011-12, the TPO has accepted the overseas AE as tested party as selected by the assessee in the transfer pricing documentation and no adjustment has been made with respect to international transaction of provision of BPO services. In view thereof, it is submitted that applying the Principle of Consistency, the overseas AEs considered by the assessee as tested party in the year under consideration may be accepted for the purpose of benchmarking analysis.

It is further submitted that Rule 10B(1)(e) of the Rules, which provides for application of TNMM states –

> *"e) transactional net margin method, by which,—*
>
> *(i) the net profit margin realised by the enterprise from an international transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;*
>
> *(ii) the net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;"*

From a perusal of Rule 10B(1)(e) of the Rules, it would be appreciated that the Rule does not give priority to the selection of either the assessee or the associated enterprise as the tested party. The OECD guidelines on transfer pricing provides that the entity with simpler functional profile and for which most reliable comparables can be found should be selected as the tested party for the purpose of benchmarking analysis.

> *"3.18 When applying a cost plus, resale price or transactional net margin method as described in Chapter II, it is necessary to choose the party to the transaction for which a financial indicator (mark-up on costs, gross margin, or net profit indicator) is tested. The choice of the tested party should be consistent with the functional analysis of the transaction. As a general rule, the tested party is the one to which a transfer pricing method can be applied in the most reliable manner and for which the most reliable comparables can be found, i.e. it will most often be the one that has the less complex functional analysis."*

The above view is also endorsed by the UN guidelines on transfer pricing. Para 5.3.3.1 of the guidelines states as under:

> *"5.3.3.1. When applying a cost plus, resale price or transactional net margin method it is necessary to choose the party to the transaction for which a financial indicator (mark-up on costs, gross margin, or net profit indicator) is tested. The choice of the tested party should be consistent with the functional analysis of the controlled transaction. Attributes of controlled transaction(s) will influence the selection of the tested party (where needed). The tested party normally should be the less complex party to the controlled transaction and should be the party in respect of which the most reliable data for comparability is available. It may be the local or the foreign party."*

Further, the US TP regulations also provides for selection of the least complex entity as the tested party requiring fewest adjustments

> *"(i) In general. For purposes of this section, the tested party will be the participant in the controlled transaction whose operating profit attributable to the controlled transactions can be verified using the most reliable data and requiring the fewest and most reliable adjustments, and for which reliable data regarding uncontrolled comparables can be located.* ***Consequently, in most cases the tested party will be the least complex of the controlled taxpayers and will not own valuable intangible property or unique assets that distinguish it from potential uncontrolled comparables.****"*

It is submitted that Section 92B of the Act defines an international transaction to include a transaction between two non-resident entities. It is submitted that if Rule 10B is interpreted to mean that a non-resident entity cannot be selected as a tested party, the provisions of section 92B of the Act to the extent they deal with transactions between two non-residents would become redundant and otiose. It is a settled legal position that a statute cannot be interpreted in such a manner so as to make a provision redundant, as is reflected in the legal maxim *utres magis valeat quam pereat.* Reliance in this regard is placed on the following decisions wherein it has been held that statute cannot be interpreted in a manner which renders a provision otiose:

- Sankhla Polymers Pvt. Ltd. vs. ITO (ITA 1100/2006) (SLP filed by Revenue dismissed)
- Hyosung Corporation vs. Authority for Advance Rulings (WP No. 5818/2013)
- CIT vs. Crescent Export Syndicate (ITA 20/2013)
- BP Singapore Pte. Ltd. vs. ITO (ITA 409/Rjt/2016)

Reliance is also placed on the decision of Hon'ble Delhi High Court in the case of GE Money Financial Services Private Ltd. (earlier known as M/s. G.E. Money Financial Services Ltd.) vs. Pr. CIT [ITA 662/2016], where the

Hon'ble High Court has reversed the finding of the Tribunal rejecting foreign AE as the tested party, held as under:

> *"The assessee has approached this court against the observations and findings of the ITAT – in paras 10 to para 18 to the effect that the Foreign AE cannot be considered as a tested party. Reliance is placed upon Section 92B to contend that there is nothing in the provision inhibiting such consideration*
>
> *This court notices that for re-consideration and determination of the appropriate method as well as appropriate comparables and the tested party, it would be convenient and appropriate for the TPO to consider the question which the assessee urges in the present case. The TPO is therefore directed to overlook and not feel bound by the observations of the tribunal and render findings on the merit of the issue."*

Accordingly, there is no prohibition in selection of AEs as the tested party. It is further submitted that the tested party is the participant in the controlled transaction whose profit attributable to the controlled transaction can be verified using most reliable data and requiring the fewest and most reliable adjustments.

The Hon'ble Madras High Court in the case of Virtusa Consulting Services Private Limited (T.C.A. No. 996 of 2018) overturned the order of the Tribunal rejecting foreign AE as the tested party, holding as under –

> *"22.The Tribunal had distinguished the decision in Ranbaxy Laboratories Limited on the ground that the Delhi Bench of the Tribunal has proceeded on the basis of the OECD guidelines.* ***However, we find in paragraph 25 of the judgment of the Tribunal the principles that emerge in selection of tested party has been culled out wherein it has been held that the tested party normally should be the least complex party to the controlled transaction and that there is no bar for selection of tested party either local or foreign party and neither the Act nor the guidelines on transfer pricing provides so and the selection of tested party is to further the object of comparability analysis by making it less complex and requiring fewer adjustment. Therefore, we do not agree with the reasons given by the Tribunal for not considering the decision in Ranbaxy Laboratories Limited.***
>
> **************
>
> *25.In Yamaha Motor Private Limited, the question arose as to whether the word 'Associated Enterprise' can be given a restrictive meaning to mean the other party to whom the assessee has sold or purchased goods. It was held that under the Act and the Rules, the words 'Enterprise' and 'Associated Enterprise' have been used interchangeably and the arguments that the Enterprise will mean the assessee and the Associated Enterprise will mean the other party to whom the assessee has sold or purchased goods is incorrect. As could*

> *be seen from the definition of Enterprise given in section 92F(iii) and Associated Enterprise as defined in Section 92A of the Act, it is evidently clear that the statute does not indicate that 'Enterprise' shall mean the assessee and the 'Associated Enterprise' will mean the other party. As pointed out earlier, the words 'Enterprise' and 'Associated Enterprise' have been used interchangeably. Therefore, the conclusion of the Tribunal in this regard is not sustainable.*
>
> *26.The Tribunal was largely guided by the decision in Aurionpro Solutions Limited. The learned senior counsel for the assessee has referred to various decisions of the Tribunal which were rendered subsequently, more particularly, the decision of the Ahemdabad Tribunal in the case of General Motors India Private Limited, which had taken note of the decision of the Mumbai Tribunal in Aurionpro Solutions Limited and noted the facts of the said case and held that the said decision cannot be applied as the main issue in Aurionpro Solutions Limited was the percentage of interest to be calculated on the loan advanced by the assessee to its AE. Thus, on facts the decision in Aurionpro Solutions Limited could not have been applied to the facts of the assessee's case before us. As already pointed out, it is not a case where there were no material produced by the assessee to establish the functional risk assumed by the foreign AEs. The material was available before the TPO but the TPO non-suited the assessee on the ground that such contention by referring to the foreign AEs as tested party was not part of TP documentation. This finding is incorrect. Interestingly in the case of in the case on hand the TPO rejected the data placed by the assessee in their TP documentation and undertook a fresh search for external comparables and arrived at a final list of 12 comparables. Therefore, when the TPO himself has not attached any sanctity to the TP documentation as submitted by the assessee, could not have foreclosed the assessee from canvassing the issue that the subsidiaries are least complex entities which should be taken note of.*

The Hon'ble Calcutta High Court in the case of Pr. CIT vs. Almatis Alumina Pvt. Ltd [ITAT/35/2020] vide order dated 18.02.2022 held that -

> *"After noting several decisions, it was held that the Indian Transfer Pricing guidelines issued by the Institute of Chartered Accountants of India vide guidance note on report under Section 92E by ICAI and transfer pricing guidelines issued by OECD does not prohibit AE to be a tested party. The Tribunal accepted the stand taken by the assessee that the AE can be selected as a tested party."*

Reliance in this regard is also placed on the decision of the Kolkata Bench of Hon'ble Tribunal in the case of Development Consultants (P) Ltd. vs DCIT, ITAT (Calcutta) (115 TTJ 577), wherein the Hon'ble Tribunal has held as under:

> *"We agree with the view that in order to determine the most appropriate method for determining the arm's length price, it is first necessary to select the 'tested party' and the tested party will be the least complex of the controlled taxpayer and will not own valuable intangible property or unique assets that distinguish it from potential uncontrolled comparables.*
>
> *xxx xxx xxx*
>
> *11. After due consideration of all the facts, we agree with the view that gross margins of DCIL need to be compared with gross margins of comparable uncontrolled transactions or unrelated enterprises entering into such transactions……"*

It was held similarly by the Hon'ble Kolkata Bench of the Tribunal in the case of Landis+Gyr Limited vs. DCIT (ITA No. 37/Kol/2012)

The Delhi Bench of Hon'ble the Tribunal in the case of Ranbaxy Laboratories Ltd. vs Addl. CIT (ITAT Delhi) 110 ITD 428, too, held that tested party should be the one which is least complex in the international transactional transaction, as under:

> *"58. We have also given careful thought to the other submissions of Shri Vohra. The tested party normally should be the party in respect of which reliable data for comparison is easily and readily available and fewest adjustments in computations are needed. It may be local or foreign entity, i.e., one party to the transaction. The object of transfer pricing exercise is to gather reliable data, which can be considered without difficulty by both the parties, i.e., taxpayer and the revenue. It is also true that generally least of the complex controlled taxpayer should be taken as a tested party. But where comparable or almost comparable, controlled and uncontrolled transactions or entities are available, it may not be right to eliminate them from consideration because they look to be complex….."*

The Hon'ble Delhi Bench of the Tribunal in the case of Ranbaxy Laboratories Ltd. vs. ACIT (ITA No. 196/Del/2013), vide order dated 25.04.2016, passed for the assessment year 2008-09, reiterated the law, as under:

> *"25. From the above guidance certain principles emerges in selection of tested party*
>
> *(a) The choice available of tested party for comparability only in CUP method, TNMM and "Other method', in other methods such as RPM and CPM choice of selecting a tested party is not available. In any case, it is not required in Profit split method.*

*(b) The tested party normally should be the least complex party to the controlled transactions.*

*(c) Availability of Most reliable data of tested party and requirement of minimum adjustments is also one of the most important aspects in selection of tested party.*

*(d) There is no bar against the selection of Tested party either Local party or Foreign party. Neither Income Tax Act and nor any guidelines on Transfer pricing provides so. Therefore selection of tested party is to further the object of comparability analysis by making it less complex and requiring fewer adjustments.*

*(e) There may be many circumstances where the data related to one party to the controlled transaction may be available easily, readily and in abundance. However the first step is to look at the FAR study of that party and if found to be complex than other party, then such party should be rejected as tested party and preference may be given to another entity which is least complex and is having reasonably reliable data for comparability. Therefore, the driving force in selection of tested party should be the least complex FAR of the party than the volume of comparable data."*

The above order passed for AY 2008-09 was followed by the Tribunal in the order passed for 2009-10 and 2010-11 bearing ITA No. 1782/Del/2014 and 781/Del/2015 respectively.

The Mumbai bench of Tribunal in the case of Tata Motors European Technical Centre, Plc. vs. ADIT (ITA No. 4630/Mum/2012), upheld the selection of foreign entity as the tested party for benchmarking the transactions of its PE in India, applying TNMM, holding that:

*"11. Here in this case, there can no dispute with regard to the fact that the tested party is TMETC, whose operating profit is to be bench marked by carrying out functional analysis of its controlled transactions for which reliable data for its comparability is available in the country where it is located, then such comparables has to be taken into account for carrying out the comparability analysis for the purpose of Transfer Pricing and bench marking the Arm's Length Price. The TMETC for the purpose of rendering services in India is incurring all its cost in UK like direct costs, employee costs, legal and professional fees, rent and other operating expenses, then for the purpose of computation of PLI, these costs have to be taken into consideration for determining the profit margin. Since all the main costs attributable to the PE are based on cost incurred in UK, then it can be very well said that PE is influenced by the economic and financial conditions of UK, as against the Indian economic factors. The Indian economic factors are not at all influencing the cost or*

> *margin of the assessee, hence it cannot be held that Indian comparables can be used to bench mark the TMETC transaction and the price with Tata Motors. For this reason, the finding of the TPO as well as DRP that PE is an Indian enterprise, working in India and therefore, its margin is to be bench marked with Indian comparables is not accepted. The PE in India is a service PE, having no establishment in India, nor incurring any costs, deployed any assets, therefore, cannot be held that it is an independent Indian enterprise. Nothing has been brought on record that assessee's PLI is influenced by the economic factors in India, viz, attribution of costs, assets or other factors relevant for determination of profits are based in India. Thus, in our opinion, the Transfer Pricing Officer and DRP were not correct in holding that UK comparables cannot be taken into consideration for the purposes of comparative analysis and bench marking the assessee's margin. Accordingly, we hold that under the facts and circumstances of the case, the foreign comparables i.e. UK comparables can be taken into account for carrying out FAR analysis and bench marking the Arm's Length margin of the assessee's transactions with its AE and the selection of the Indian comparables by the TPO is not accepted. Since the .T.A.No.7630 and 1698/Mum/2012 18 TPO has not carried out any comparability analysis or FAR analysis in respect of UK comparables chosen by the assessee, therefore, he is directed to carry out such analysis and benchmark the assessee's margin. If such comparables do not stand the test of comparability then, TPO may search other comparable after confronting to the assessee. In that case, for the search of comparability assessee will provide necessary assistance to the TPO. With this direction, the matter of transfer pricing adjustment is restored back to the file of the TPO/AO. The Ground No.1 as raised by the assessee is thus treated as partly allowed for statistical purposes."*

The Hon'ble Mumbai Bench of Tribunal in another case of ITO vs. WNS Global Services P. Ltd. in ITA No. 2318/Mum/2009, upheld the order of the CIT(A) accepting foreign associated enterprise as the tested party, holding that:

> *15. While deleting the addition made by TPO disregarding the benchmarking approach, CIT(A) observed as under:*
>
> *i. The assessee has changed the business model to increase its turnover which require the risk free environment to its marketing companies i.e. its AEs as risks and rewards from customers are passed on to the Assessee under the new business model.*
>
> *ii. The two business models of the Assessee are entirely different in functional analysis:*

(a) *In Business Model 1, the risks and rewards is with the Assessee. The AEs which are remunerated on a cost plus fees are insulated from the risks which is borne by the Assessee as entrepreneur. The AEs render only marketing and management services and are least complex party in the transaction.*

(b) *In Business Model 2, the major risks are borne by WNS UK. It functions as the entrepreneur, it bears the risks and the assessee is only a captive service provider bearing limited risks.*

iii. ***In Business*** *Model 1, the AEs were lease complex parties and they were rightly used as tested party for the marketing and management fees paid to the AEs on cost plus basis, unlike in Business Model 2.*

iv. *Each international transaction has to be benchmarked separately and the Assessee has different functional profiles for the two business models, one as an entrepreneur and the other as a captive service provider.*

v. *Such different transactions cannot be clubbed together as laid down in:*

(a) *Aztec Software and Technical Services Ltd. vs. ACIT (107 ITD 141)*
(b) *Star India Private Limited vs. ACIT (ITA No. 3585/Mum/2006).*

*16. In view of the above findings of CIT(A), we accept assessee's contention that the foreign AE should be considered as the tested party, accordingly all other grounds of appeal in the Department's appeal with respect to transfer pricing related issues become academic in nature.*

The Hon'ble Mumbai Bench of the Tribunal in the case of Nivea India Private Limited vs. DCIT (ITA No. 121/Mum/2013), admitted the additional ground of the assessee to consider the associated enterprise as the tested party, being the least complex entity.

The Hon'ble Bangalore Bench of the Tribunal in case of Unilog Content Solutions Private Limited vs. ACIT in ITA No.852/Bang/2022 dated 13.03.2023, upheld selection of foreign associated enterprise as the tested party being the least complex entity.

Further, the Hon'ble Bangalore Bench of the Tribunal in the case of Atmecs Technologies (P.) Ltd. vs. ITO in ITA No. 187/Bang/2021 dated 20.12.2021, too upheld selection of foreign associated enterprise as the tested party, holding as under:

> *"34. The facts of the Assessee's case is similar to the case decided by the Hon'ble Madras High Court in as much as the Assessee had in its Transfer Pricing Study chosen the foreign AE as a tested party and the TPO refused to examine the said claim. The decision of the Hon'ble Madras High Court being the only decision available on the issue of a High Court, judicial discipline requires us to follow the same in preference to the decisions of Tribunal to the contrary. Following the aforesaid decision of the Hon'ble Madras High Court, we remand the issue with regard to foreign AE being chosen as a tested party to the TPO for fresh consideration. The relevant ground of appeal of the assessee in this regard is treated as allowed for statistical purposes."*

The Hon'ble Delhi Bench of Tribunal in the case of Moser Baer India Limited vs. DCIT in ITA No. 883 & 894/Del/2008 (AY 2003-04) and ITA No 988, 1139 4484/Del/2013 (AY 2005-06 & 06-07), upheld selection of foreign associated enterprise as tested party, holding that:

> *"Ld. TPO is directed to accept assessee's contention for foreign AE to be a tested party in the event assessee is able to provide complete financials of GDM Dubai along with complete financials of relevant comparables required to benchmark the international transaction. Ld. TPO shall then consider the foreign AE to be tested party"*

The aforesaid decision was followed by the Hon'ble ITAT in appeal for assessment year 2008-09, 2009-10 and 2010-11 in ITA No. 6042/Del/2012, 2395 & 1200/Del/2014 and 1617/Del/2015 respectively.

The Hon'ble Delhi Bench of Tribunal in the case of Global Vantage Pvt. Ltd. vs. ACIT in ITA No. 2093/Del/2014, considering the identical business model as that of the assessee, upheld selection of foreign associated enterprise as the tested party, holding:

> *5. The plea of the assessee is indeed well taken. The law is by and large well settled on this issue. There is no dispute that, in principle, the least complex party is to be taken as the tested party but the trouble usually arises on account of lack of data with respect to the foreign tested party and it is for this reason that the foreign enterprise is, more often than not, not really taken as a tested party. That does not mean however that the use of a foreign enterprise as a tested party can be rejected summarily without assigning any reason- as has been done by the TPO and approved by the CIT(A). Learned CIT(A) has also not discussed the matter on merits and summarily dismissed the plea of the assessee. That course of action cannot be approved. We have also noted that on the peculiar facts of this case and looking to the nature of*

> *functional relationship between the assessee and GV Inc, there can indeed be little dispute that least complex of the party is GV Inc. While the core business function is performed by the assessee company, and entire infrastructure and operating assets are owned by the assessee company, the foreign AE, i.e. GV Inc, is primarily responsible for procuring the work and owns relatively much less assets, employees and operating assets. On these facts, therefore, the claim of the assessee that the foreign AE was the least complex entity could hardly be summarily rejected. Of course, the next question is the availability of data and the onus to furnish the same is on the assessee, but the authorities below have not at all addressed themselves to this aspect of the matter. In view of these discussions, as also bearing in mind entirety of the case- particularly peculiar business model and functional relationship between the assessee and GV Inc, its foreign AE, we deem it fit and proper to remit the matter, with respect to determination of ALP on the basis of adopting the foreign AE as the tested party, for fresh determination at the assessment stage. The matter will be decided afresh by the TPO/AO after giving a fair and reasonable opportunity of hearing to the assessee, in accordance with the law and by way of a speaking order dealing with contentions of the parties. Ordered, accordingly.*

The Ld. TPO in the impugned order has relied on the following decisions to held that the said decisions prohibit the use of foreign comparables –

- Global Vantedge Pvt. Ltd. 2010-TIOL-24-ITAT-DEL
- Ranbaxy Laboratories Limited (Delhi High Court) ITA 504 of 2008 dated 18.11.2011

In this regard, it is submitted that as per the finding of Tribunal in Para 5 of order passed (as reproduced above) in the case of Global Vantage Pvt. Ltd. (supra), the Tribunal has, in fact, upheld selection of foreign associated enterprise as the tested party.

Further, in the case of Ranbaxy, the Hon'ble High Court has passed their order only on the following two questions raised before them and not on the selection of foreign AE as the tested party –

> *"1. Whether on the facts and circumstances of the case, the Tribunal erred in law in holding that CIT had validly assumed jurisdiction under Section 263 of the Act?*
>
> *2. Whether on facts and circumstances of the case, the Tribunal erred in not holding that in terms of Section 92C (3) read with Section 92CA (1) of the Act, the Assessing Officer was fully competent to determine the arm's length price of international transactions even if the aggregate value thereof exceeded Rs. 5 crores, without making reference to TPO?"*

Accordingly, the above decisions relied upon by the Ld. TPO in his order nowhere prohibits considering foreign AE as the tested party and rather, supports the case of the assessee.

Accordingly, while selecting the tested party for the purpose of applying the TNMM, the functional profile of the transacting entities is required to be taken into consideration and the entity having simpler functional profile, i.e., the entity not assuming significant risks and employing non-routine intangibles should be selected as the tested party.

It is submitted that in terms of Master Service Agreements ('MSAs') entered by the assessee with its AEs, the AEs acts as limited risk service providers whereas the assessee acts as a full-fledged entrepreneur, being the holding company of the entire whole HCL group.

The Function, Assets and Risk analysis 'FAR analysis', as drawn in the Transfer Pricing Study states -

**i) <u>Functions Performed</u>**
The functions performed by the respective entities in the transaction of provision of BPO services to end customers is summarized as under –

| Type of Functions | HCLT (Assessee) | AEs |
|---|---|---|
| Marketing | Yes (marketing & contract negotiations) | Limited Role (marketing Support) |
| Strategic Functions | Yes | No |
| Project Management & execution | Yes | Yes (if some onsite work is also required to be performed) |
| Quality Control | Yes | No |
| Billing & collection | Yes | Limited Role |
| Research & Development | Yes | No |

It is evident from the aforesaid that all the functions are primarily performed by the assessee company and the role of the AEs are primarily in the nature of front ending with end customers because of their proximity with them. In nutshell, from functions' perspective, it is an undisputed fact that the assessee company is a more complex entity whereas the AEs are least complex entities.

**ii) <u>Risks Assumed</u>**
The risk assumed by the respective entities in the transaction of provision of BPO services to end customers is summarized as under

| Type of Risks | HCLT | AEs |
|---|---|---|

| | **(Assessee)** | |
|---|---|---|
| Market Risk | Yes | Limited |
| Capacity Utilization Risk | Yes | No |
| Service Liability Risk | Yes | No |
| Credit & Collection Risk | Yes | No |
| Foreign Exchange Risk | Yes | No |

In view of the aforesaid risk profile, it is submitted that the assessee company is a full-fledged risk bearing entrepreneur whereas the AEs are only a limited risk service provider thereby making the assessee company a much more complex entity as compared to its AEs.

Further, the assessee has developed its technological capabilities and technical know-how and other intangibles over a significant period of time. Such intangibles in the nature of trade secrets, patents, proprietary know-how, trademarks, brand and distribution networks are owned by the assessee being the key entrepreneurial entity of entire HCL group. On the other hand, the AEs of the assessee do not own significant intangibles and performs only marketing support services and routine onsite IT support services.

In view of the aforesaid factual position, it is emphatically submitted that it is only the assessee company, being an entrepreneur, can be characterized as the most complex entity and the AEs, being limited risk services provider, are the least complex. Accordingly, the assessee in its Transfer Pricing Report, for the purpose of benchmarking of BPO Segment, has rightly considered its AEs, namely, HCL America Inc. and HCL GB Limited as the "Tested Parties"**(Refer Page 226 of Paper Book – Convenience Compilation – Transfer Pricing)**.

Further, for the purpose of benchmarking the transaction of provision of BPO services applying TNMM, the net operating margin earned by the AEs in their BPO segment was compared with comparable companies operating in same geography and under similar economic circumstances. The detailed economic analysis, in this regard, is explained as under:

**a)** **<u>Steps involved in selecting comparable companies</u>**

The following steps were undertaken by the assessee in undertaking selection of comparable companies –

| **Step** | **HCL GB** | **HCL America Inc.** |
|---|---|---|
| I | Using Geographical selection tool, an EMEA (predominately European) search has been conducted by selecting 6 European Countries in which HCL Group has presence, namely, Belgium, Germany, Italy, Netherlands, Sweden | SIC Code Selection for North America Region by reviewing U.S. SIC codes. Each SIC code contains a brief description of industry including the types of companies in the classification |

| | | |
|---|---|---|
| | and United Kingdom | |
| II | Industrial Classification Code Selection (i.e. choosing companies which operate in the same or similar industries) | Quantitative Screening (including elimination of inactive companies) |
| III | Independent Screening (i.e. Filter applied to eliminate companies that were shown in the database as subsidiaries of another company, the companies which were holding companies that do not prepare consolidated accounts and the companies which had more than 10 Subsidiaries) | Qualitative Screening |
| IV | Active/Inactive Company Screening to eliminate the inactive companies | Review of Short Business Descriptions |
| V | Quantitative Screening | Review of 10-K Filings to find the most comparable companies |
| VI | Qualitative Screening | Use of Multiple Year data |
| VII | Use of Multiple Year data | Arm's Length Range by taking arithmetic mean of Comparable Companies |
| VIII | Arm's Length Range by taking arithmetic mean of Comparable Companies | Conclusion |
| IX | Conclusion | - |

b) **Conclusion drawn**

As per the TP Report, both the AEs had earned negative margins for the financial year ending on June 30, 2010, as under:-

| Particulars | HCL GB (Pg. 102 of TPR) | HCL America Inc. (Pg. 107 of TPR) |
|---|---|---|
| Number of companies taken for the purpose of benchmarking | 9 | 13 |
| Arithmetic Mean of Comparable Companies | 2.30% | 4.10% |
| Maximum | 6.80% | 11.80% |
| Minimum | -0.60% | -1.80% |
| Net Operating Margin of AE (at the entity level) | 5.39% | 2.58% |
| **Net Operating Margin of AE (in** | **-3.22%** | **-5.64%** |

| | | |
|---|---|---|
| **respect of BPO Segment)** | **(Refer Page 233 of Paper Book – Convenience Compilation – Transfer Pricing).** | **(Refer Page 238 of Paper Book – Convenience Compilation – Transfer Pricing).** |

Accordingly, since the net profit margin earned by AEs, HCL GB and HCL America, in undertaking transactions with the assessee is lower than the average margin earned by comparable companies operating in same geography and under similar economic circumstances, the international transaction of provision of BPO services undertaken by the assessee with its AEs is at arm's length price.

It is additionally submitted that in respect of provision of BPO services, the relevant financial data for computing profitability of the AEs in BPO Segment along with copy of Master Services Agreements were duly provided to the Ld. TPO. The margin earned by AEs and the comparable companies identified by the assessee were not disputed by the ld. TPO/ DRP.

In view of the aforesaid, it would be noted that the assessee has rightly selected its AEs as the tested party and also undertaken benchmarking analysis considering companies operating in same geography and under similar economic circumstances.

**II. <u>Comparability adjustment on account of exceptional year of performance warranting normalization of operating profits of BPO segment</u>**

It is submitted that the profitability of BPO segment of the assessee company was adversely affected during the relevant financial year 2009-10 due to various commercial and economic factors as under:-

- Reduction in Billing Rates;
- Extraordinary Service Credits;
- Incurrence of High Personnel Cost; and
- Incurrence of Certain Extra Ordinary Higher Costs.

The aforesaid fact was also demonstrated by way of profitability trend of the BPO segment of the assessee for the preceding and succeeding year, as under:

| **Particulars** | **Financial Year** | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **2008-09** | | **2009-10** | | **2010-11** | | **2011-12** | |
| **Income** | | | | | | | | |
| Revenues | 567.18 | | 424.50 | | 378.43 | | 537.53 | |
| Other Operating Income | 0.21 | | 0.02 | | 1.54 | | 11.12 | |
| **Total Operating Revenue ('OR')** | **567.39** | | **424.52** | | **379.97** | | **548.65** | |
| | | | | | | | | |
| **Expenditure** | | | | | | | | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Cost of Services | 284.77 | 50% | 250.70 | 59% | 272.59 | 72% | 277.10 | 51% |
| Administration & General Expenses | 121.52 | 21% | 138.93 | 33% | 130.69 | 34% | 124.51 | 23% |
| Finance Charges | 0.08 | 0% | 0.22 | 0% | 0.25 | 0% | 0.16 | 0% |
| Depreciation | 36.23 | 6% | 30.53 | 7% | 23.25 | 6% | 21.24 | 4% |
| **Total Operating Cost ('OC')** | **442.60** | | **420.37** | | **426.78** | | **423.01** | |
| **Operating Profit ('OP')** | 124.79 | | 4.15 | | (46.81) | | 125.64 | |
| **OP/OC** | 28% | | 1% | | -11% | | 30% | |
| **OP/OR** | 22% | | 1% | | -12% | | 23% | |

From perusal of the above profitability trend and also having regard to the fact that the terms and conditions of all the international transactions between the assessee company and its associated enterprise had remained unchanged in all the aforesaid financial years, it would be appreciated that lower profitability earned by the assessee in its BPO segment is only due to the uncontrolled poor economic and commercial conditions prevailing in the market. Further, the fact the assessee was facing poor economic and commercial conditions in the market was also reported by many news channels and newspaper, reproduced as under:

**Economic Times dated September 05, 2010**

*"HCL Tech is the fourth-largest among IT companies that are listed on the Indian stock exchanges. Its main business segments include custom applications, engineering and R&D, enterprise applications, infrastructure services and BPO.*
*XXXXXX*

*Its BPO segment has been a laggard so far. Three years ago, the division operated at a 15% margin and accounted for 16% of its revenue. Today, this proportion has shrunk to just over 8% with an operating loss……………….."*

**Economic Times dated November 15, 2010**

*"The BPO unit of HCL Technologies was running in losses as the company is trying to rejig the business model and move away from voice-based services.*

*However, HCL expects to turn the HCL BPO unit profitable in next five to six quarters.*

*The company had earlier said the BPO business will continue to make losses every quarter for the next five quarters.*

*The BPO had shown sequential revenue growth for the first time in the last three quarters during the July-September quarter. The company had a 5.7 per cent dollar term revenue growth (quarter-on-quarter).*

*However, HCL will continue to invest in re-jigging and investing in its BPO business."*

In view of the aforesaid, it is respectfully submitted that for the purpose of benchmarking the international transactions, it is imperative that the effect of such underutilization of capacity/excess fixed costs is eliminated, while computing the operating margins of the assessee.

It is submitted that the cardinal principle of the transfer pricing regulations is to compare like with like and to eliminate differences, if any, by suitable adjustment. Rule 10B(3) of the Rules also provides for appropriate comparability adjustments to made in the PLI of the tested party and comparable companies while computing the arm's length price.

Rule 10B(3) of the Rules provides that an appropriate adjustment is required to be made to account for the differences between the controlled and uncontrolled transactions:

> "*An uncontrolled transaction <u>shall be comparable to an international transaction if</u>—*
>
> *(i) none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market; or*
>
> *(ii) <u>reasonably accurate adjustments can be made to eliminate the material effects of such differences.</u>"*

Reliance in this regard is also placed on the recent decision of the Delhi High Court in the case of Sony Ericsson Mobile Communications India Pvt. Ltd. vs. CIT III (374 ITR 118), wherein, the Hon'ble Delhi High Court that reasonable accurate adjustments should be made in profits and margins to eliminate material differences. The Hon'ble Delhi High Court held as follows:

> *"68………..The comparables can be internal i.e. when one of the AEs enters into a similar uncontrolled transaction with an independent enterprise; or external i.e. involving an independent enterprise in the same market or industry. It is obvious that an internal comparable could in several cases be more dependable and reliable, than an external comparable. A comparable is acceptable, if based upon comparison of conditions a controlled transaction is similar with the conditions in the transactions between independent enterprises. The comparison must be with reference to the comparability analysis as elucidated in paragraph 5.1.1 of the United Nations Practical Manual on Transfer Pricing. In other words, t<u>he economically relevant characteristics of the two transactions being compared must be sufficiently comparable.</u> **<u>This entails and implies that difference, if</u>***

> ***any, between controlled and uncontrolled transaction, should not materially affect the conditions being examined given the methodology being adopted for determining the price or the margin. When this is not possible, it should be ascertained whether reasonably accurate adjustments can be made to eliminate the effect of such differences on the price or margin.*** *Thus, identification of the potential comparables is the key to the transfer pricing analysis. As a sequitur, it follows that the choice of the most appropriate method would be dependent upon availability of potential comparable keeping in mind the comparability analysis including befitting adjustments which may be required. As the degree of the comparability increases, extent of potential differences which would render the analysis inaccurate necessarily decreases."*

Para 1.22 of the OECD guidelines also points out the need to adjust comparables and the requirement for accuracy and reliability, as under:

> *"....To be comparable means that none of the differences (if any) between the situations being compared could materially affect the condition being examined in the methodology (e.g. price or margin), or that* ***reasonably accurate adjustments*** *can be made to eliminate the effect of any such differences." (Emphasis added)*

Para 2.74 of the revised OECD Guidelines in the context of the transactional net margin method indicates:

> *"………where differences in the characteristics of the enterprises being compared have a material effect on the net margins being used,* ***it would not be appropriate to apply the transactional net margin method without making adjustments for such differences****. The extent and reliability [emphasis added] of those adjustments will affect the relative reliability of the analysis under the transactional net margin method."*

The Hon'ble Delhi Bench of the Tribunal in the case of CRM services India Pvt. Ltd. vs. ITO (AY 2004-05 & 2006-07), has also upheld the claim towards adjustment of idle capacity under similar circumstances. The Hon'ble Tribunal held that:

> *"8.1 This bring us to the alternative argument that the assessee is entitled to get adjustment in respect of capacity under-utilization. No objection has been raised by the ld. CIT, DR in this matter. As a matter of fact, he has fairly accepted the proposition that adjustment in this regard is required to be made*
>
> *XXXXX*
>
> *At the same time, it is also held that suitable adjustment has to be made to such PLI in respect of idle capacity."*

The decision of the Hon'ble ITAT was affirmed by the Hon'ble Delhi High Court in ITA No. 618/2012 and 619/2012

Hon'ble ITAT, in the same case of CRM Services *(supra)*, in the appeal for assessment year 2008-09 in ITA No. 5930/Del/2012, following the decision of coordinate bench for the AY 2004-05 &2006-07 in ITA Nos. 4068/Del/2009 and 4796/Del/2010 respectively, upheld the adjustment on account unutilized capacity.

Further, the Hon'ble Delhi Bench of the Tribunal in the case of Transwitch India Pvt. Ltd. vs. ACIT (I.T.A. No. 6083/Del/2010) held as under:

> *"4.11 Another TPO's contention is that claim of the assessee that the sealing drive reduced its revenue is unsubstantiated. <u>In this regard, assessee has submitted that the assessee had placed on record its quarterly capacity utilization statement demonstrating the fall in its capacity utilization during the quarter January to March, 2006. The capacity utilization of the assessee during the quarter January to March, 2006 fell to 72% as against the normal capacity utilization of 87% to 94% during the financial year ending December, 31, 2005. Further, the fact that the assessee had to shift its office premises at a very short notice, sufficiently substantiates the low capacity utilization of the assessee during the last quarter of financial year 2005-06. We find our ourselves in agreement with the assessee's submission in this regard."</u>*

The Hon'ble Delhi High Court, in the appeal preferred by the revenue in the case of Transwitch India *(supra),* vide order dated 17.07.2013, upheld the adjustment claimed by the assessee on account of capacity utilization. Relevant extract of the decision of the Hon'ble High Court is as under:

> *"6. In response to the submission that operations could have been shifted on a weekend, without disruption, tribunal has recorded:-*
>
> *4.9 Another TPO's contention is the nature of assessee's business is such that shifting of business from one premises to another can be effected over a weekend, without causing disruption to the business of the assesses, in this regard we agree with the contention of the assessee that before the operations of the assessee could be shifted from one premises to another, the necessary equipments and devices computers systems, servers, storage devices, power backup devices etc. had to be dismantled from the existing premises and re-installed at the new premises. The dismantling and re-installation of such equipments requires considerable time and technical skills. As such, we do not agree with the TPO's contention that the shifting could have been done over a weekend time.*

> *4.10 Another TPO contention is that the assessee had already paid additional rent for two months for its new premises. This fact defeats the assessee's argument that its work suffered due to the sealing drive. In this regard, assessee has submitted that even though the assessee had leased the new premises and paid rent for the months of February and March, it could not have commenced its commercial operations from such premises, till the time necessary infrastructure in the form of fixtures, power supply etc. was established. Further, before the operations of the assessee could be shifted from one premises to another, the necessary equipments and devices had to be installed at the new premises. The entire process and activity require considerable time and the assessee therefore, had to pay rent for the period during which the aforesaid infrastructure was established at the new premises. Hence, we find ourselves in agreement with the assessee's contention in this regard.*
>
> *7. It is not disputed that if the figure of Rs.1,11,73,078/- is duly accounted for and taken into consideration, then the operating margin of the respondent/assessee come to 17.80%, which is higher than the comparable operating margin of 17.09%, taken as a benchmark by the TPO. Submission on behalf of the assessee that the parent company should have shared the burden or a part thereof is not legally tenable. The said expenditure was incurred by the Indian company because of peculiar problems faced by them as a result of which they had to shift the place from where they were operating. The abnormality and difficulty resulting in extra expenditure was not created or caused by the associated enterprise. They were not responsible or liable for the said payments/expenditure. The associated enterprise did not have legal or contractual obligation to make extra or additional payment beyond the true and correct value of the transaction.*
>
> *8. In view of the factual findings recorded by the Tribunal, we do not find any substantial question of law arises in this appeal and the same is, accordingly, dismissed."*

The principle laid down by the Hon'ble Delhi High Court in the case of Transwitch *(supra)*, has been followed in the following cases:
- Smart Cube India Pvt. Ltd. vs. ACIT (6274/Del/2012)
- Claas India Pvt. Ltd, (ITA No 1783/Del/2011)
- DCIT vs Terex India Pvt Ltd (ITA No. 6775/Del/2015)
- IKA India Pvt Ltd vs DCIT 98 Taxmann.com 312\
- HCL Technologies BPO Services Ltd. vs. ACIT (ITA No. 3547 & 5071 (Delhi) of 2010)
- Honeywell Automation India Pvt. Ltd. vs. DCIT (ITA No. 4/PN/08),
- Egain Communication Pvt. Ltd. vs. ITO : 118 ITD 243 (Pune)
- Radhashir Jewellery Co. Pvt. Ltd. vs. ACIT (ITA No. 7066/Mum/2013)

- Calsonic Kansel Motherson Products Ltd vs. DCIT (ITA No. 667/Del/2015)
- ACIT vs. Fiat India Pvt Ltd (ITA no 1848/Mum/2009)
- Brintons Carpets Asia Pvt. Ltd. vs. ACIT (ITA No. 1296/PN/10)
- E.I. Dupont India Pvt Ltd vs. DCIT (ITA No 5336/D/2010)
- DCIT vs. Panasonic AVC Networks India Co. Ltd. (ITA No. 4620/Del/2011)
- Genisys Integrating Systems (India) Pvt Ltd vs. DCIT (ITA No 1231/Bang/2010)
- Mando India Steering Systems (P.) Ltd. vs. ACIT (ITA No. 2092/Mds/2012)
- Amdocs Business Services (P.) Ltd. v. Dy. CIT: [2012] 54 SOT 46
- Tasty Bite Eatables Ltd. vs. ACIT (ITA No. 1682/PN/2011)
- Toyota Kirloskar Motors Pvt. Ltd. v. ACIT, Bangalore (ITA No. 828/Bang/2010)
- Demag Cranes & Components (India) Pvt. Ltd. v. DCIT, Pune in ITA No.120/PN/2011

Further, the Hon'ble Mumbai Bench of the Tribunal in the case of Pangea3 & Legal Database Systems Pvt. Ltd. vs. ITO (ITA No 2128/Mum/2014) held that there is no prohibition in law in making comparability adjustment in the margins of the tested party. The finding of the Hon'ble Tribunal in this regard are as under:

> *"21. From the harmonious reading of sub-clause (iii) of clause (e) of Rule 10B and sub-rule (3) of 10B, it is quite ostensible that under a comparability analysis of an international transaction with the uncontrolled transaction, reasonable and accurate adjustment is permitted to weed out any difference which materially affects the price or costs or the profit arising therefrom such transaction in the open market. <u>Nowhere the rule suggests that the adjustment which materially affects the price or cost or profit should be made only to the uncontrolled transaction, that is, comparables and not to the 'tested party' whose transactions is being compared. This is apparently clear from the reading of sub clause (i) and (ii) which envisages that the net profit margin is to be computed and compared to in relation to or having regard to the same base, that is, of the 'tested party' or the comparables; and sub-rule (iii) provides that adjustment of net profit margin arising in comparable uncontrolled transaction, i.e., vis-à-vis the independent comparables is adjusted taking into account the difference both between the comparables or between the enterprises (related parties) entering into such international transaction. The adjustment can be made either in the case of the 'tested party', (i.e. controlled transaction) or the comparables (i.e. uncontrolled transactions) so that the difference which could materially affect the amount of net profit margin is removed.</u> Further clause (iv) provides that the net profit realized by the enterprise as referred to in sub-*

*clause (i) i.e., the 'tested party' or the enterprise entering into controlled international transaction is to be established at the same net profit margin which is determined under sub-clause (iii), that is, under the comparability analysis. Lastly, sub-clause (v) provides that the net profit arrived should be at ALP.*

*22. In view of our understanding and analysis of Rule 10B as above, we are unable to appreciate the contention raised by the Ld. CIT DR that any adjustment if required to weed out the difference materially affecting the price or cost or profit can be made only in the case of the comparables while determining the profit margin and not in the case of the tested party. More so, in practical situations there may be absence of reliable data in the case of the uncontrolled transactions (comparables) for which such material difference is to be analysed or examined. Under the public domain at times in depth information of the financials or data of comparables are not available which renders the comparability analysis improper/impractical and so is the adjustments. The entire substratum of transfer pricing and determination of ALP is, thorough comparability analysis of controlled transactions with the comparable uncontrolled transactions which is needed to ensure that any adjustment if required to be made should achieve the results that would be realized by an independent enterprise in comparable circumstances. Without adequate comparability analysis, the third party data which is used to find out the transfer price or ALP of the international transaction might not represent true market price because of the difference in the circumstances of third party in relation to the assessee whose transaction is being benchmarked. In certain cases there may arise some difficulty when the reliable data for particular cost or profit may not be available, therefore, a reasonable accurate adjustment in the hands of the tested party may throw fruitful result. If we accept the proposition that no adjustment can be made either on the cost base or profit of the 'tested party' then there may arise a problem, that in case of the comparables such factors materially affecting the cost or profit may not be accurately available so that proper adjustment can be made in respect of all the comparables. Here in this case, it has been pointed out that in case of as many as ten comparables it was not possible to identify the correct amount of forex loss/gain from the financials/data available in the public domain. In such situations, it would be very difficult to fathom a proposition that adjustment should be made only in the case of comparables and not in the case of the tested party. Making adjustment of comparable margins with partial information would at times result into absurdity or unscientific analysis of the profit margin which can never be the intention of the law as contained in Rule 10B(1)."*

Reliance is also placed on the decision of the Hon'ble Delhi Bench of the Tribunal in the case of DCIT vs Terex India Pvt. Ltd. (ITA No. 6775/Del/2015) wherein the Hon'ble Tribunal while allowing adjustment for underutilization of capacity to an entity in the second year of operation held as under:

> *"The TP rules are to be interpreted in a fair and equitable manner both for the tax payer and the Revenue and they cannot be used to in a way so as to be disadvantageous to the tax payer. The whole purpose of determining arm's length price is to find out the value which is independent of all influences, may it be, related party or any other circumstance which is affecting such price. Thus, we hold that the TPO was not correct in denying the benefit of adjustment on account of capacity utilization."*

The Hon'ble Kolkata Bench of the Tribunal too, in the case of Witzenmann India Pvt Ltd vs DCIT (ITA No. 222/Kol/2021) too, relying upon the provisions of Rule 10B(3), allowed comparability adjustment on account of under-utilization of capacity.

It was similarly held by the Hon'ble Pune bench of the Tribunal in the case of Ariston Thermo India Ltd vs DCIT (ITA No 1455/PN/2010).

> *"At the same time, it is also held that suitable adjustment has to be made to such PLI in respect of idle capacity."*

The Hon'ble Delhi Bench of Tribunal in the case of HCL Technologies BPO Services Ltd., Vs. ACIT, CC-2, (Now stands amalgamated with the assessee) in ITA No. 5071/Del/2010, following the decision of Delhi High Court in case of Transwitch (supra), upheld comparability adjustment on account of unutilized capacity -

> *39. We have heard rival submissions and perused the material placed on record. We find that there is force in the argument of Ld. Counsel for the assessee that while calculating operating cost, the abnormal cost incurred on account of start-up should be excluded. Following the same parity of reasoning in the cases cited by him and keeping in view that the judgement of ITAT co-ordinate Bench in the case of Transwitch India (supra) affirmed by Hon'ble Delhi High Court. Therefore, respectfully following the decision of Hon'ble High Court, we direct TPO / A.O. to adjust operating cost by excluding abnormal cost incurred on account of start-up company like salary, rent and depreciation. This matter is restored to the file of TPO/A.O. to re-determine the operating cost on the above lines to arrive at operating profit.*

In view of the aforesaid, it is respectfully submitted that the assessee is eligible for an appropriate adjustment to account for the underutilization of capacity and extraordinary cost.

The Ld. TPO, however, rejected the aforesaid claim of adjustment allegedly holding that the assessee has made self-serving statements without providing any independent corroborative records.

In order to rebut the allegation of the Ld. TPO, the assessee vide reply dated 21.01.2014 has duly placed on record relevant documentary evidence in support of normalization of extraordinary expenses, reproduced as under:

| **S. No.** | **Nature of Normalization** | **Impact in the form of normalization** | **Relevant Documentary Evidence** |
|---|---|---|---|
| 1. | Revenues to be normalized on account of abnormal reduction in the charged out rates given to some of the customers | Revenues to be increased by Rs. 17.55 Crores | Agreement with customer and sample copies of invoices for following customer were provided in support of abnormal reduction in charged out rates -<br><br>a) **British Telecom ("BT")** - There was a reduction of 15% in the charged out rate of BT with effect from 1st day of July, 2009<br><br>and<br><br>b) **Office Depot ("OD")** - There was a reduction of 30% in the charged out rate of OD with effect from 1st day of January, 2010<br><br>**[Refer Page 687-724 of PB- Convenience Compilation – Transfer Pricing (agreements)]** |
| 2. | Revenues to be normalized on account of certain abnormal penalties imposed by some of the customers | Revenues to be increased by Rs. 4.16 Crores | Documents in support of abnormal penalties amounting to Rs. 2.75 Crores imposed by BT during the relevant financial year<br><br>**[Refer Page 725 of PB- Convenience Compilation – Transfer Pricing (Penalty letter along with invoices)]** |
| 3. | Normalization of incurrence of higher salary cost | Salary Costs to be reduced by Rs. 26.82 Crores | Salary Cost normally accounts for 50% of the revenues. However, in the relevant financial year, even after the normalization of revenues, it was 56% of the normalized revenues. It has been finally normalized @ 50% of the normalized revenue. Reason for this |

| | | | |
|---|---|---|---|
| | | | was underutilization of billable resources. |
| 4. | Normalization of certain abnormal costs incurred during the relevant financial year | Operating Costs to be reduced by Rs. 6.30 Crores | Rental expense in the financial year under consideration had increased by almost 10% because of imposition of service tax @ 10% on the rent and certain other abnormal expenses were also incurred as explained in the calculation sheet. |

Accordingly, after the normalization of the operating profits of the BPO Segment on account of various abnormal factors, the net operating margin works out to 15.23% over cost **(Refer Page 685 of Paper Book – Convenience Compilation – Transfer Pricing)**.

In view of the aforesaid, since the assessee has earned an adjusted net operating margin of 15.23%, no adjustment can further be made to the arm's length price of international transaction of provision of BPO services, particularly having regard to the fact that the associated enterprises of the assessee had made losses in their BPO segment.

It is submitted that in the transfer pricing study maintained for the succeeding year, i.e. 2011-12, the assessee has benchmarked the transaction of provision of BPO services considering AE as the tested party. The Ld. TPO during the course of assessment proceedings, issued show cause notice proposing adjustment of Rs. 308.81 Crores by considering the assessee as the tested party and computing its margin at 1.33% as against margin of comparable companies at 27.19%.

The assessee in its reply dated 14.01.2015, inter alia, submitted its adjusted operating profit margin after claiming above adjustments on account of underutilization of capacity and extra–ordinary expenses. The Ld. TPO, after duly considering the reply of the assessee and related evidences, accepted the claim of the assessee and also accepted the transaction of provision of ITES/ BPO services to be at arm's length price.

Accordingly, following the Rule of consistency, the net profit margin of the assessee shall be considered at 15.23% over cost, after normalizing the operating profits of the BPO Segment on account of various abnormal factors.

**V. <u>Incorrect selection of companies by the TPO</u>**

The Ld. TPO during the assessment proceedings undertook a fresh search of comparable companies for benchmarking the international transaction of provision of BPO services considering assessee as the tested party and arrived at a set of following 9 comparable companies with an average operating profit to cost ratio of 35.19% -

| S. No. | Company Name | OP/OC |
|---|---|---|
| 1 | Accentia Technology Ltd | 42.52% |
| 2 | Cosmic Global Ltd | 18.28% |
| 3 | e4e Healthcare Ltd | 31.03% |
| 4 | Fortune Infotech Limited | 22.80% |
| 5 | Infosys BPO Ltd | 31.44% |
| 6 | T C S E-Serve International Ltd | 54.03% |
| 7 | T C S E-Serve Ltd | 63.42% |
| 8 | ICRA Techno Analytics Limited | 28.66% |
| 9 | Igate Global Solutions Limited | 24.54% |
| **AVERAGE** | | **35.19%** |

It is respectfully submitted that the aforesaid companies considered by the Ld. TPO in the final set of comparable companies does not satisfy the comparability criteria enumerated under Rule 10B(2) and accordingly, cannot be considered as comparable to the assessee. Detailed reason for exclusion of such companies is provided in **Annexure 1**.

Summary of exclusion of the aforesaid companies is given below:

| S. No. | Name of the company | Reason for rejection |
|---|---|---|
| 1. | Accentia Technologies Ltd. | • Amalgamated with Asscent Infoserve Pvt. Ltd.**(Refer Page 79 of Paper Book – Annual Report of comparables)**<br>• Owns significant intangible assets in the form of Goodwill**(Refer Page 91 of Paper Book – Annual Report of comparables)**<br>• Engaged in the provision of Knowledge Process Outsourcing Services (“KPO”), provides services to healthcare industry in the nature of medical transcription, medical coding, billing and receivable management etc.**(Refer Page 4, 5 & 43 of Paper Book – Annual Report of comparables)**<br>• Earns 98.59% of its revenue from Medical coding, medical billing and receivables management**(Refer Page 77 of Paper Book – Annual Report of comparables)**<br>• Healthcare Receivables Cycle Management services rendered on a SaaS model being the first company to render said services using such model, which brings out the niche technology adopted by it**(Refer Page 39 to 41 of Paper Book – Annual Report of comparables)**<br>• Owns proprietary software products such as |

| | | |
|---|---|---|
| | | instacare, instascribe, instaweb etc<br>• Segmental profitability in respect of ITES segment not available**(Refer Page 81 of Paper Book – Annual Report of comparables)** |
| 2. | Cosmic Global Ltd. | • Engaged in Medical transcription and consultancy services, which includes medical, legal, business and audio and media services; Translation, localization, voiceovers, e-learning and Accounts BPO services**(Refer Page 33-34 of Annexure 1 to broad proposition)** |
| 3. | E4e Healthcare | • Annual report of the company for the financial year 2009-10 was not available in public domain<br>• Providing Healthcare outsourcing services**(Refer Page 153 of Paper Book – Annual Report of comparables)**<br>• Having software development centers in India which are registered as 100% Export Oriented unit under the STPI Guidelines issued by the Government of India**(Refer Page 164 of Paper Book – Annual Report of comparables)** |
| 4. | Fortune Infotech Ltd. | • Engaged in the provision of BPO and Knowledge Process Outsourcing Services (“KPO”). |
| 5. | Infosys BPO Ltd. | • Infosys BPO operates on a large scale of business operations having a turnover of INR 1,126.63 crores, as against a turnover of INR 208.01 crores in the relevant segment for the assessee**(Refer Page 238 & 259 of Paper Book – Annual Report of comparables)**<br>• Provides high-end integrated services by assisting its clients in improving their competitive positioning by managing their business processes in addition to providing increased value.<br>• Due to a wide array of services and significant functions performed and risks assumed, Infosys BPO charge a premium pricing for its services, which in turn results in exceptionally higher profit margins.<br>• Major business segments include customers in financial services, telecom, retail, manufacturing and other industries**(Refer Page 259 of Paper Book – Annual Report of comparables)**<br>• Acquired by Infosys Limited during the year under consideration |
| 6. | TCS E-Serve Limited | • Changes in the method of revenue recognition |

| | | |
|---|---|---|
| | | leading to increase in the operating profit margin of the company by Rs. 9,596 thousands**(Refer Page 486 of Paper Book – Annual Report of comparables)**<br>• Errors reported by the auditors of the company itself**(Refer Page 465 of Paper Book – Annual Report of comparables)**<br>• Not shown transactions undertaken with its related parties, namely, Citibank group companies. **(Refer Page 477 of Paper Book – Annual Report of comparables)**<br>• Operates on a large scale of business operations having a turnover of INR 1,359.41crores, as against a turnover of INR 208.01 croresin the relevant segment for the assessee**(Refer Page 452 of Paper Book – Annual Report of comparables)** |
| 7. | TCS E-Serve International Ltd. and TCS E-Serve Limited | • Before the acquisition of TCS E-serve Ltd. and TCS E-Serve International Ltd. by Tata Group in 2009, the company were known by the name of Citi Group Global Services Limited, providing core banking services only to Citibank group**(Refer Page 379 of Paper Book – Annual Report of comparables)**<br>• Providing core banking services to Citibank Group companies in terms of prior agreement with terms and condition decided between Citigroup and Tata Group and accordingly, cannot be considered to be an uncontrolled comparable third party.<br>• TCS E-Serve International Ltd. shown increase in sales of 173% over the preceding year and operating profit of 53.80% as compared to huge loss of -27.27% incurred during the immediate preceding year**(Refer Page 381 of Paper Book – Annual Report of comparables)** and TCS E-Serve Limited having an abnormal growth in the operating profit of 226% as compared to the previous year due to the synergy effect of the business restructuring**(Refer Page 379 of Paper Book – Annual Report of comparables)** |
| 8. | I Gate Global Solutions Limited | • Undertaken restructuring activities during the year and acquired iGATE Global Solutions Sdn. Bhd**(Refer Page 536 of Paper Book – Annual Report of comparables)**<br>• Engaged in providing IT as well as IT enabled services, however, segmental results are not |

| | | |
|---|---|---|
| | | available**(Refer Page 556 & 561 of Paper Book – Annual Report of comparables)** |
| 9. | ICRA Techno Analytics Limited | • Engaged in rendering software development services and engineering design services**(Refer Page 516 of Paper Book – Annual Report of comparables)**<br>• An entrepreneurial enterprise and not purely a BPO service provider.<br>• Non availability of segmental data pertaining to ITeS activities**(Refer Page 518 of Paper Book – Annual Report of comparables)** |

**III. Adjustment in the arm's length price cannot exceed the amount retained by associated enterprise**

It is respectfully submitted that the arrangement between the assessee and its AEs, namely HCL GB and HCL America is of revenue sharing. Under the arrangement, the revenue is shared between the assessee and the associated enterprises. It is respectfully submitted that the associated enterprises perform the significant function of marketing and client acquisition and assessee is responsible for execution of the contracts. For performance of such functions, the associated enterprises retain a share of revenue as explained above.

It is respectfully submitted that the revenue received by the AEs represents the arm's length price of the services provided by the assessee and the marketing function performed by the AEs. Accordingly, the adjustment computed by the TPO cannot exceed the amount of revenue received by the AEs from third party customers. Further, the AEs are also eligible for compensation in respect of the marketing functions performed by them.

Reliance is placed in this regard on the decision of the Hon'ble Delhi High Court in the case of *Sony India P. Ltd. vs. CBDT (Delhi); 288 ITR 52* has at pages 61-62, observed as under:

> *"The concept of transfer pricing leading to tax avoidance has been acknowledged in the Act only recently. It is a concomitant of the operations of multinational corporations (MNCs) that set up base by incorporating a local subsidiary in a country where they seek to operate. It is often seen that the MNC transfers goods and services to its local subsidiary at a price not reflective of the market price (or arm's length price as it is referred to in the present context) and in turn the subsidiary is able to avoid, partly or wholly, payment of the local tax. Although the expression "transfer price" has not been defined in the Act, it is understood to mean "that price which is arrived at when two associated or related enterprises deal with each other". It was acknowledged by the Finance Minister in the Budget Speech for the year 2001 that "the presence of multinational enterprises in India* <u>*and*</u>

> *their ability to allocate profits in different jurisdictions by controlling prices in intra-group transactions has made the issue of transfer pricing a matter of serious concern." The purpose of inserting these provisions is therefore to determine the arm's length price (ALP) of an international transaction involving an MNC and its local associate."*

Reliance in this regard is placed on the recent decision of Delhi High Court in case of Sony Ericsson Mobile Communications India Pvt. Ltd. vs. CIT III (ITA No. 16/ 2014) wherein, it has been held that the arm's length seeks to correct distortion and shifting of profits to tax the actual income earned by a resident. The Hon'ble Delhi High Court held as under:

> *"77.* ***As a concept and principle Chapter X does not artificially broaden, expand or deviate from the concept of "real income". "Real income", as held by the Supreme Court in Poona Electricity Supply Company Limited versus CIT, [1965] 57 ITR 521 (SC), means profits arrived at on commercial principles, subject to the provisions of the Act. Profits and gains should be true and correct profits and gains, neither under nor over stated. Arm's length price seeks to correct distortion and shifting of profits to tax the actual income earned by a resident/domestic AE. The profit which would have accrued had arm's length conditions prevailed is brought to tax. Misreporting, if any, on account of non-arm's length conditions resulting in lower profits, is corrected.***
>
> XXX
>
> *(xii) When segmentation or segregation of a bundled transaction is required, the question of set off and apportionment must be examined realistically and with a pragmatic approach.* ***Transfer pricing is an income allocating exercise to prevent artificial shifting of net incomes of controlled taxpayers and to place them on parity with uncontrolled, unrelated taxpayers. The exercise undertaken should not result in over or double taxation.*** *Thus, the Assessing Officer/TPO can segregate AMP expenses as an independent international transaction, but only after elucidating grounds and reasons for not accepting the bunching adopted by the assessed, and examining and giving benefit of set off. Section 92(3) does not bar or prohibit set off."*

The Hon'ble Delhi High Court in case of Ramp Green Solutions Pvt. Ltd vs CIT (ITA 102/2015) reaffirmed the finding of Sony Ericssion *(supra)* and held that **"*The object of Chapter X of the Act is not to tax any notional income but to ensure that the real income is brought to tax under the Act".***

Reliance in this regard is also placed on the decision of Delhi High Court in the case of Li & Fung (India) Pvt. Ltd. vs. DCIT (ITA No 306/2012), wherein too, the Hon'ble High Court, rejected the action of the revenue in imputing notional adjustment/income in the assessee's hand on the basis of fixed percentage of the free on board value of export made by unrelated third parties.

The Hon'ble Delhi Bench of Tribunal in the case of Hyper Quality India Pvt. Ltd. vs. Vs. ACIT (ITA No. 5630/Del/2011), too, held that:

> *"18. We have heard the rival contentions and perused the material available on record. In our considered view the TP adjustments made to assesses ALP is not justified in view of following reasons:*
> *i. Assessee furnished its split financials along with AE. Whereas the assessee has earned profit in India, its AE has continuously sustained losses. Thus with no element of profit in the hands of the AE, in all fairness there is no case of shifting of profits, practicable or probable.*
>
> *ii. AE is resident in USA which has a higher tax rate in India, therefore, we see little commercial prudence to shift profit out of India.*

Similarly in the case of Apollo Health Street vs. DCIT (ITA No. 1760/Hyd/12), Hon'ble Hyderabad Bench of Tribunal held that:

> *"9. Having heard both the parties and having considered the rival contentions, we find that the assessee had in fact raised an objection on this issue before the DRP, and the DRP had given a direction to the Assessing Officer that the TP adjustments should not exceed the global profits of the assessee company. We find that the Assessing Officer has not given effect to this finding of the DRP while passing the assessment order and therefore, this ground is very much admissible and has to be considered on merits. Therefore, we admit the additional ground of appeal.*
>
> *10…… Therefore, we are of the opinion that the issue needs to be remitted to the file of the Assessing Officer to recompute the Transfer Pricing Adjustment, duly complying with the directions of the DRP that the TP adjustments shall not exceed the global profits earned by the assessee company……."*

It was held similarly in the case of:

- Moser Bear India Limited vs. DCIT (ITA No. 882/Del/2008)
- Interra Infotech (India) P. Ltd. vs. ITO (ITA No. 5620/Del/2012)

The Hon'ble Delhi Bench of Tribunal in the case of HCL Technologies BPO Services Ltd., Vs. ACIT, CC-2, (Now stands amalgamated with the assessee) in ITA No. 3547/Del/2010, too, following the aforesaid precedents on the said issue, held:

> *"21. We have head rival submissions and perused the material on record. Ld. CIT(A) had followed the ratio laid down in the case of Global Ventedge P. Ltd. (supra) (in I.T.A. No. 1432 & 2321 / Del/2009*

*and 116/Del/2011). This decision was affirmed by both Hon'ble High Court and Hon'ble Supreme Court and his ratio was followed in subsequent decisions as submitted earlier and, therefore, the order of Ld. CIT(A) on this issue is reasonable and we do not find any reason to interfere with this finding of Ld. CIT(A) and hence, the grounds of appeal filed by revenue are dismissed. Accordingly, appeal filed by revenue is dismissed."*

In view of the aforesaid, it is respectfully submitted that the adjustment, at best, cannot exceed the revenue retained by the associated enterprises, as reduced by the compensation for marketing function.

In the present case, the adjustment of Rs. 44.73 crore made by the Ld. TPO represents the revenue retained by the associated enterprise, i.e. Revenue earned from third party customers less Cost of services already paid to the assessee.

However, the Ld. TPO failed to appreciate that the AEs have incurred cost in undertaking marketing function on the behalf of the assessee and after making payments to employees and third party vendors, has only suffered a loss in undertaking transaction with the assessee.

It is submitted that while the assessee has earned a margin of 1.04% over cost (unadjusted margin) in providing BPO services, the AEs, HCL America and HCL GB have only suffered loss of -5.64% and -3.22%, respectively, from undertaking transaction with the assessee. The computation of margin of AEs is provided as under –

| **HCL America** | | **Amount in $M** |
|---|---|---|
| **Particulars** | **References** | **June 30, 2010** |
| BPO Services *(Received from customers)* | | 51.00 |
| **Total Operating Revenue** | **A** | **51.00** |
| | | |
| Cost of Services *(Paid to assessee)* | | 48.91 |
| Sales & marketing | | 3.40 |
| Administration & general cost | | 1.29 |
| Depreciation | | 0.31 |
| **Total Operating Expenses** | **B** | **53.91** |
| **Segment Profits** | **C = A - B** | **-2.88** |
| Converting in INR/ Cr. | D = C x 47.42 | -13.66 |
| **NPM (%)** | **C / B x 100** | **-5.64%** |

| **HCL GB** | | **Amount in £M** |
|---|---|---|
| **Particulars** | **References** | **June 30, 2010** |
| BPO Services *(Received from customers)* | | 41.60 |
| **Total Operating Revenue** | **A** | **41.60** |

| | | |
|---|---|---|
| Cost of Services *(Paid to assessee)* | | 36.60 |
| Sales & marketing | | 4.70 |
| Administration & general cost | | 1.40 |
| Depreciation | | 0.20 |
| **Total Operating Expenses** | **B** | **42.90** |
| Segment Profits | C = A – B | -1.30 |
| Converting in INR/ Cr. | D = C x 75.65 | -9.83 |
| **NPM (%)** | **C / B x 100** | **-3.22%** |

> In view of the aforesaid, since the AEs have only suffered a loss in undertaking transaction with the assessee, no transfer pricing adjustment ought to be made in the case of the assessee as there could not be a case of shifting of profits in the hands of the AEs by the assessee."

178. On the other hand, ld. DR of the Revenue submitted that he relies on the detailed findings of lower authorities.

179. Considered the rival submissions and material available on record. We observed that the assessee had undertaken transaction of provision of BPO services with its AEs namely HCL GB and HCL America and the assessee in its TP study selected the TNMM as MAM and selected the above said AEs as tested party on the basis of least complex entity considering the functions performed by them and risk involved in the transaction carried on by the assessee with them. After consdiering the detailed submissions and various case law relied, in our view, the fact remains that the AEs are functioning in two different economic zones and also different currencies risk involved. No doubt they have carried out the transaction in the nature of front ending with the end customers but the entire functions are performed by the assessee, the AEs had retained only to the extent of risk and performance carried on by them, it is reflected on the financial transactions, the total volume was of Rs. 423.22 crores and they retained only Rs.44.73 crores. It is 10.57% of the total revenue. However, they have declared negative margins in the respective segments as under:

HCL America - 5.65% (USD 51 Mil / USD -2.88 Mil)

HCL GB - 3.12% (GBP 41.60 Mil / GBP -1.30 Mil)

In our view, once the segments shows negative results and also functions in the different economic zones, even though with the limited risks, the same cannot be taken as tested party, further we observed that the assessee tried to include both the

AEs as the tested party, even though there may be various reasons to such performance particularly the risk factors in both the currencies and risk appetites are different. After considering the observations of the TPO, we do not see any reason to disturb the same. Therefore, we are inclined to reject the submissions of the assessee.

180. Coming to the benchmarking made by the TPO, he has selected the assessee as the tested party and bench marked the transactions by selecting various comparables and made the TP adjustments at Rs.143.49 crores on the basis of average margin of 9 comparables selected at the average OP/OC at 35.19% whereas the AEs had retained only Rs. 44.73 crores for their services. After considering the FAR analysis performed by them, the adjustment proposed by the TPO is apparently absurd. Before us, the assessee brought to our notice that after normalization of the operating profits of the BPO segment on account of various abnormal factors, the net operating margin works out to 15.23% over cost, as per the detailed submissions brought on record at page 685 of the paper book. Considering the commercial and economic factors which the assessee had to face the challenges during the year under consideration and also the comparables selected by the TPO, which needs relook, the assessee had made detailed submissions on the issue of selection of comparables by the TPO, we observed as under:

a. In case of Accentia Technologies, we observed that the company involved in amalgamation activities with Asscent Infoserve Pvt Ltd, it is a abnormal activity which will have substantial impact on its financials, therefore, the same cannot considered as comparables, moreover, it is engaged in the business of providing KPO services in the healthcare industry and its main revenue is form medical coding etc, whereas the assessee is involved in providing front desk services liasoning with the end customers. Further the relevant ITES segment datas are not available, Therefore, this comparable cannot be part of final comparables.
b. In the case of Cosmic Global Ltd, it is also engaged in BPO even though engaged in the medical transcription and consultancy, the same cannot be rejected. It qualifies for final list of comparables.
c. In the case of E4e Healthcare, it was submitted that the annual report for FY 2009-10 is not available in the public domain, they are providing healthcare outsourcing services and they are into software development centers in India as wellas 100%

export Oriented unit as per government guidelines. In our view, TPO collects the relevant data from the above entity and shares the same with the assessee along with the segmental data, the above said company can be part of final list of comparables.

d. In the case of Fortune Infotech Ltd, it is engaged in the provision of BPO and KPO services, in case TPO collects and provides the segmental data to the assessee in order to do the bench marking, this company also can be part of final comparables.

e. With regard to Infosys BPO, this company cannot be part of final comparables for the reason of huge turnover, FAR employed by them and also they have acquired Infosys Limited during the year under consideration.

f. In the case of TCS E-serve Limited and TCS E-Serve International Ltd, these are also cannot be part of final comparables on the same basis of Infosys BPO.

g. In the case of I Gate Global Solutions, we observed that the company involved in restructuring activities and acquired iGATe Global Solutions, it is an abnormal activity which will have substantial impact on its financials, therefore, the same cannot considered as comparables, moreover, it is engaged in the business of providing IT and ITES services however, no segment data available. Therefore, this comparable cannot be part of final comparables.

h. In the case of ICRA Techno, it is engaged in rendering software development services and engineering design services, it is more of entrepreneurial and not into providing BPO services. Further there is no segmental data on the activities of ITES. In our view, TPO can provide the segmental data of ITES services provided by them apart from the software development and design services, the above company can be part of final comparables otherwise it cannot.

181. With the above findings, we are inclined to remit this issue of finalizing the final comparables and also we direct the TPO to consider the FAR analysis in the case of the assessee for the reason that the assessee incurs cost of taking BPO services from the AEs only to the extent of about 10% of the total revenue involved, he should restrict himself only to bench mark the same and cannot make addition of whole amount retained by them as ALP adjustment is in our view absolute absurd. With the above observations, we are inclined to remit the grounds raised by the assessee back to the file of AO/TPO to bench mark the same afresh by following the above

directions after giving proper opportunity of being heard to the assessee. In the result, grounds raised by the assessee are allowed for statistical purposes.

182. Grounds No.4 to 4.16, Grounds No.6 to 6.16 and Grounds No.2 to 2.13 in the AYs 2009-10, 2010-11 and 2011-12 are with regard to deduction u/s 10A/10AA/10B – Building wise vs. license wise.

183. At the time of hearing, with regard to above grounds, ld. AR brought to our notice the relevant facts and his submissions as under :-

**Re: <u>Ground of Appeal No.4 to 4.16 – Rejecting claim of the Assessee that each of the STPI unit be treated as separate undertaking</u>**

The Assessee in the relevant previous year claimed deduction under section 10A of the Act at Rs.880,62,28,644 in respect of 51 independent undertakings, (software development centers) which were registered and approved with the STP authorities under 24 licenses. In the revised return of income, deduction claimed under section 10A was reduced to Rs.862,03,94,316. The assessing officer, however, denied deduction under section 10A of the Act claimed by considering each of the 51 independent undertakings as eligible units for computing deduction under that section and instead computed deduction on the basis of 24 licenses treating several units under one STP license as an eligible undertaking for claim of deduction under section 10A of the Act. The assessing officer, accordingly, re-computed deduction under section 10A of the Act at Rs.997,04,50,777 as against Rs.880,62,28,644 claimed by the Assessee.

At the outset, it is submitted that in the assessment order for the relevant year under consideration and also in the past, the assessing authorities have refused to adjudicate the issue relating to enhanced claim of deduction under section 10A of the Act on merits on the ground that the tax holiday claim in respect of higher number of undertakings has been raised belatedly and it is not permissible for the Assessee to resile from its own stated position in the earlier years.

Kind attention is invited to the decision of the **Hon'ble Delhi High Court in Assessee's own case for assessment year 2005-06, wherein vide order dated April 15, 2015 reported in 377 ITR 483 (Del)**, it was held that an assessee's treatment of facts in any given manner is not relevant for the purposes of determining liability under the Act and even a belated claim could not preclude the assessee from availing the benefits available to it on application of statutory provisions. The relevant findings of the Hon'ble Delhi High Court are reproduced as under:

> *"15. The first issue that this Court has to determine is whether in the event of an assessee's failure to avail the benefits of a statutory provision, such as Section 10A of the Act, creates an estoppel*

*precluding it from availing such benefits in future. The AO, DRP as well as the ITAT concurrently have rejected the Assessee's claims under its revised return primarily on the ground that the Assessee itself did not treat all 31 units as separate undertakings previously, and in fact, for the subject assessment year as well, it originally adopted its earlier approach. <u>On an examination of the authorities relied upon by the Assessee, this Court notices that they are overwhelmingly in its favour and therefore, this Court answers the first question in favour of the Assessee.</u>*

*16. <u>**The starting point for the discussion is the Supreme Court's decision in CIT v. C. Parekh& Co. (supra), where the Court held that the assessee's treatment of a claim would not be determinative of the treatment that it ought to be given under the provisions of the statute.**</u> The Court noted:*

*"On the question of the admissibility of the deduction of Rs. 1,23,719 the contention of the Assessee is that as the respondent had itself split up the commission of Rs. 3,12,699 paid to the managing agents, and the appropriated Rs. 1,23,719 thereof to the profits earned at Karachi and had debited the same with it, it was not entitled to go back upon it. and claim the amount as a deduction against the Indian profits. We do not see any force in this contention. Whether the respondent is entitled to a particular deduction or not will depend on the provision of law relating thereto, and not on the view which it might take of its rights, and consequently, if the whole of the commission is under the law liable to be deducted against the Indian profits, <u>the respondent cannot be estopped from claiming the benefit of such deduction, by reason of the fact that it erroneously allocated a part of it towards the profits earned in Karachi. What has therefore to be determined is whether, notwithstanding the apportionment made by the respondent in the profit and loss statements, the deduction is admissible under the law.</u>"*

*…………….*

*20. <u>**The impugned judgment erred in holding that the assessment would be guided by the Assessee's treatment of its internal affairs and that the assessee's claim must fail because it has "consistently taken a decision as per facts exclusively available to it in its personal domain on the basis of which the assessee has chosen to treat the expanded units as part of the 13 units". The authorities quoted above unequivocally establish that an assessee's treatment of facts in any given manner is not relevant for the purposes of determining liability under the Act. If, on an application of the statutory provision, the party is entitled to the benefits under the Act, the mere circumstance that for the past 5 to 7 years, or even 10 years, it did not claim such benefit would not preclude it from availing it in the assessment year**</u>*

> ***in question. What the Assessee cannot resile from is the existence of a given set of facts which it has not challenged earlier. However, if, based on the same set of facts, it now seeks to claim deduction under Section 10A which it had foregone earlier, the Assessee's claim must be allowed, provided, of course, the requirements of Section 10A are satisfied.*** *Therefore, in the instant case, in the event that the Assessee establishes that the 31 units constitute separate undertakings for the purposes of Section 10A, it would be entitled to the claims made in the revised return.*
>
> ***Accordingly, the first question is answered in favour of the Assessee and against the revenue.***"

(emphasis supplied)

Therefore, as held by the Hon'ble Delhi High Court, there is no estoppel under the law and the assessee was allowed to resile from its own position in the return, more so when the position taken was on wrong application of the statutory provisions.

In view of the aforesaid, it is submitted before your Honours that the assessee's claim for deduction under section 10A of the Act treating 51 units including units endorsed on the existing STPI licenses as separate units, cannot be rejected at the outset on the ground that the claim is made for the first time in AY 2005-06. As held by Hon'ble jurisdictional High Court, the claim for deduction warrants determination on the merits of the case and therefore, fact finding authorities including the assessing officer was duty bound to examine the claim on merits.

Therefore, the action of the assessing officer is unlawful and not sustainable for the reasons submitted hereunder:

The Assessee in the relevant previous year has 51 undertakings (software development centers) registered with STPI and Customs authorities eligible for deduction under section 10A. Each undertaking of the Assessee was set up as an independent standalone unit for production of computer software. The STPI and Customs Authorities, it is submitted, have registered all the 51 STPI undertakings under 24 licenses as follows:

| Particulars | Number of Undertakings |
|---|---|
| Total Number of Undertakings in existence as on 1st day of April, 2008 [including the Undertakings owned by the erstwhile DSL Software Limited, HCL BPO Services Limited &Shipara Technologies Limited] | 60 |
| **Add**: Total number of Undertakings newly set up during the year under review | 1 |

| | |
|---|---|
| **Total number of Undertakings** | **61** |
| **Less**: Total number of Undertakings which had become taxable till March 31, 2008 | 9 |
| **Less**: Number of Undertakings which had become taxable under the financial year under review | 1 |
| **Total number of Undertakings covered under Section 10A of the Act as on March 31, 2009** | **51** |

The Assessee has set-up STPI Units (hereinafter referred to as 'undertakings') from time to time by seeking the necessary approval from the STPI and Customs Authorities in accordance with the provisions as contained in the Software Technology Park Scheme (the STP Scheme) notified by the Government of India in the Ministry of Commerce and Industry. Whenever an undertaking was set-up by the Assessee, it was for the purpose of meeting the requirement of business growth and expansion, as evident from the following:

| **Financial Year** | **Revenues (in Rs. crores)** | **Employees (in number)** | **Undertakings (in number)** |
|---|---|---|---|
| 1995-96 | 21.05 | 602 | 2 |
| 1996-97 | 48.22 | 917 | 3 |
| 1997-98 | 93.55 | 1,223 | 5 |
| 1998-99 | 227.08 | 1,458 | 6 |
| 1999-00 | 367.32 | 2,575 | 8 |
| 2000-01 | 663.08 | 3,488 | 16 |
| 2001-02 | 720.10 | 4,044 | 21 |
| 2002-03 | 824.89 | 5,670 | 25 |
| 2003-04 | 1,058.42 | 7,673 | 35 |
| 2004-05 | 1,353.31 | 10,996 | 47 |
| 2005-06 | 2,629.56 | 25,768 | 52 |
| 2006-07 | 3,599.31 | 32,948 | 58 |
| 2007-08 | 4,437.69 | 38,663 | 64 |
| 2008-09 | 4,759.97 | 39,299 | 67 |
| 2009-10 | 4,806.61 | 46,472 | 71 |
| 2010-11 | 6,269.67 | 63,629 | 73 |

The Assessee company seeks to submit that ***a separate approval has been granted by the STPI to the Assessee company for establishing each of the above referred fifty-one (51) undertakings which are still covered under Section 10A of the Act during the year under review in accordance with the Software Technology Park Scheme notified by the Government of India in the Ministry of Commerce and Industry as required by Section 10A of the Income Tax Act, 1961 [Clause(i)(b) of Sub-Section (2) of Section 10A read with Explanation 2(vii) of Section 10A of the Act]***. Whenever such an approval has been granted by the STPI to the Assessee company for expansion, the Assessee was eligible to and has in fact expanded its operations by setting up these undertakings from time to time.

It is submitted that each undertaking has been registered with the STPI Authorities and Customs Authorities as separate unit and necessary approvals have been obtained by the Assessee in respect of each of the undertakings from the STPI and Customs Authorities.

It is thus clearly evident that all the undertakings owned by the Assessee are clearly separate and distinct STPI units being registered with the STPI Authorities from time to time under ***<u>the Software Technology Park Scheme notified by the Government of India in the Ministry of Commerce and Industry</u>*** as required by Section 10A of the Act.

Further, regarding the allegation of splitting of an undertaking into multiple undertakings, the Assessee company seeks to submit that such an allegation is not correct and the same is devoid of actual facts and circumstances. As already explained above, each one of the fifty-one (51) undertakings owned by the Assessee company represents **<u>an independent and separate viable unit, being registered with the STPI Authorities</u>** ***<u>in accordance with the Software Technology Park Scheme notified by the Government of India in the Ministry of Commerce and Industry as required by Section 10A of the Income Tax Act, 1961 [Clause(i)(b) of Sub-Section (2) of Section 10A read with Explanation 2(vii) of Section 10A of the Act].</u>***

*Further,* a separate approval has been obtained by the Assessee from the STPI and Customs Authorities in respect of each of these undertakings.

It is further submitted that as explained herein below, the requirement for claim of deduction under section 10A of the Act is that the undertaking should be established/ set up in a Software Technologies Park. The provision does not specify the manner in which the approval/ registration is to be issued by the STPI authorities. Further, the section does not specify a separate license as a condition precedent for holding an independent unit operating in Software Technology Park as eligible for deduction under that section.

The Assessee seeks to clarify that till AY 2004-05, the Assessee was claiming deduction under Section 10A on the basis of consolidated figures of net profits of all the undertakings covered under the respective STPI Licenses and separate Form 56Fs were being filed by the Assessee for different STPI Licenses. However, deduction under Section 10A has been claimed by the Assessee in the assessment year under consideration separately for each undertaking and a separate Form 56F has been filed by the Assessee for each separate undertaking.

Under these circumstances, it is not correct to draw a presumption that the original undertakings have been split up into different undertakings merely because till AY 2004-05, no separate Form 56F was filed in respect of other undertakings which were covered under the respective STPI license. Further, the Assessee seeks to humbly submit that there is no justification in drawing an adverse inference regarding separate and independent nature of each undertaking covered under a STPI merely on the ground that no separate Form 56F was filed by the Assessee in respect of each of such undertaking till AY 2004-05. In this regard, the Assessee seeks to clarify that the question of filing Form 56F, being in the nature of certification of correctness of amount of deduction claimed under Section 10A of the Act in respect of an undertaking, arises only when a separate claim under Section 10A of the Act has been made in respect of such an undertaking. However, since till AY 2004-05, the Assessee was claiming deduction under Section 10A on the basis of consolidated figures of net profits of all the undertakings covered under the respective STPI Licenses, separate Form 56Fs were being filed by the Assessee for different STPI Licenses only and no separate Form 56F was being filed by the Assessee for each of the undertaking covered under each STPI License.

Nevertheless, since each undertaking was a separate and distinct viable unit and it was eligible for deduction under Section 10A, deduction under Section 10A has been separately claimed in respect of each of these undertakings in the year under consideration and a separate Form 56F has been filed in respect of each undertaking.

Regarding the observation of the assessing officer in respect of changes in the addresses of the undertakings and, as explained herein above, the details containing the addresses of the undertakings have been duly furnished by the Assessee from time to time and the same are on record.

The Assessee seeks to reiterate the fact that there has not been any change in the address of any of the undertakings and drawing a presumption regarding change in the addresses of the undertakings merely because no Form 56F was filed along with the return of income in respect of these undertakings till AY 2004-05 is completely baseless and incorrect, being devoid of actual facts and circumstances. As already explained above, a separate approval has been obtained by the Assessee from the STPI and Customs Authorities in respect of each of these undertakings.

Accordingly, based on the settled legal position, each of the undertakings owned by the Assessee is an independent and separate viable unit in view of the following factors:

Separate Lease Deeds/ Sale Deeds have been executed in respect of each undertaking and these deeds represent contemporaneous documents which were executed in the relevant year in which these undertakings were set up.

Wherever applicable, each undertaking had obtained the necessary approval from the prescribed authority under the Shops and Commercial Establishment Act.

The Assessee company has maintained a separate Profit & Loss account which facilitates the determination of profits attributable to each undertaking separately for the year under consideration.

Each undertaking has its own separate infrastructure and has its own seating capacity. **Details of the seating capacity of the different undertakings are also placed on record with the assessing officer.**

A separate Bond Register is being maintained by each undertaking in respect of the various items of capital assets purchased/ obtained by it.

The above would establish beyond doubt that the units are physically separate & distinct from one another with no overlapping/ co-mingling and each of the units is set up with substantial capital investment.

The following documents evidencing setting up of each of the undertakings at different points in time as independent, stand alone unit at separate and independent location pursuant to registration with the STPI/ Customs authorities were also placed before the assessing officer:

**(a) Separate existence of each undertaking:**

i. Copies of the relevant lease deeds/sale deeds showing that a separate lease deed/ sale deed was executed whenever a new undertaking was set up by the Assessee.

ii. Each undertaking has been registered with the STPI Authorities and Customs Authorities as separate unit, as evident from copies of STPI Registration documents. Copies of custom bonding of premises of each of the undertakings by the Customs Authorities.

iii. A separate Bond Register is being maintained by each undertaking in respect of the items of capital assets purchased/obtained on loan, viz., (a) Outright Purchases (Imported Items), (b) Outright Purchases (Indigenous Items) and (c) Loan Assets which are supplied by the end customers for the execution of their projects.

**(b) Fresh capital investment in plant & machinery**

1. Details of amount of investment which each undertaking has made in the new plant and machinery in the first year of operation.

2. Relevant extracts from the Customs Bond Registers maintained by each of the undertakings evidencing the actual receipt of the imported and indigenous assets in the premises of the concerned undertaking.

3. Copies of the invoices raised by the vendors supplying the fixed assets containing the reference of the respective undertaking which had purchased the underlying assets on sample basis.

**(c) New employees**

1. Organization structure of different undertakings.

2. Details of employees of different undertakings in the first year of operation (including the STPI undertaking which was set-up during the financial year under consideration).

3. Salary registers of different undertakings showing the payroll details of the respective undertakings in the first year of operation.

4. Chart showing the total number of employees of the Assessee as at the end of the financial years beginning from June 30, 1995 till 30th day of June of the financial year immediately falling after the relevant FY for AY 2005-06, 2006-07 & 2008-09. Further, the total number of employees of the Assessee as at the end of the financial years beginning from June 30, 1995 to June 30, 2011 is being reproduced as under:

| Financial Year ending on | No. of Employees |
|---|---|
| June 30, 1995 | 172 |
| June 30, 1996 | 602 |
| June 30, 1997 | 917 |
| June 30, 1998 | 1,223 |
| June 30, 1999 | 1,458 |
| June 30, 2000 | 2,575 |
| June 30, 2001 | 3,488 |
| June 30, 2002 | 4,044 |
| June 30, 2003 | 5,670 |
| June 30, 2004 | 7,673 |
| June 30, 2005 | 10,996 |
| June 30, 2006 | 25,768 |
| June 30, 2007 | 32,948 |
| June 30 , 2008 | 38,663 |
| June 30, 2009 | 39,299 |
| June 30, 2010 | 46,472 |
| June 30, 2011 | 63,629 |

The above table clearly shows that the number of employees employed by the Assessee during the period beginning with June 30, 1995 and ending with June 30, 2011, has ***increased by almost 370 times***. This is corroborative of the fact of establishment of new units year after year.

**(d) New business and new technology/ service offerings**

1. Different undertakings were set-up by the Assessee company at different points of time to offer different technology/ service. In response to the query raised by the learned AO in the course of the assessment proceedings for AY 2005-06 regarding the nature of technology/ service offerings of the different undertakings being set-up during the period beginning with 1st day of April, 1995 and ending with 31st day of March, 2001, the Assessee had duly furnished the same as contained in the box files filed by the Assessee company in the course of relevant assessment proceedings and the same is very much on record.
2. Detailed description of Technology/ Service offering of the undertakings which had commenced their operations during the period beginning with 1st day of April, 1995 and ending with 31st day of March, 2001 has already been furnished in the course of assessment proceedings for the earlier assessment years and the same is also on record.
3. Chart showing the total revenue of the Assessee company for the financial years beginning from FY 1994-95 till the end of the relevant FY for AY 2005-06, 2006-07, 2008-09, 2009-10, 2010-11 & 2011-12. Further, the total revenue of the Assessee company beginning from FY 1994-95 till FY 2010-11 is being reproduced as under:-

| Financial Year ending on | Amount of Revenue (in Crores) |
|---|---|
| March 31, 1995 | 8.75 |
| March 31, 1996 | 21.06 |
| March 31, 1997 | 48.21 |
| March 31, 1998 | 93.55 |
| March 31, 1999 | 227.08 |
| March 31, 2000 | 367.32 |
| March 31, 2001 | 663.08 |
| March 31, 2002 | 720.10 |
| March 31, 2003 | 824.89 |
| March 31, 2004 | 1,058.42 |
| March 31, 2005 | 1,353.31 |
| March 31, 2006 | 2,629.56 |
| March 31, 2007 | 3,599.31 |
| March 31, 2008 | 4,437.69 |
| March 31, 2009 | 4,759.97 |
| March 31, 2010 | 4,806.61 |
| March 31, 2011 | 6,269.67 |

The above table clearly shows that the Assessee's business has grown at an ever-increasing pace during the period beginning with March 31, 1995 and ending with March 31, 2011, viz., ***it has increased by almost 717 times during the said period***.

4. Relevant extract from the Financials of the Assessee company as on 30/06/2000 which clearly reveals that the Assessee company was having seven (7) undertakings as on that date as against the number of STPI Licenses which the Assessee company had obtained as on that date.

5. Representative list of customers being served from different undertakings along with the reference of the relevant undertakings for the period beginning with 1st day of April, 1995 and ending with 31st day of March, 2001.

6. Invoice-wise revenue details of all the undertakings which had commenced their operations during the period beginning with 1st day of April, 1995 and ending with 31st day of March, 2001 for the first year of operation along with the copies of relevant invoices.

7. Customer-Wise and Project-Wise details of the undertakings being set-up during the AY 2006-07, 2007-08 & 2009-10.

8. List of employees of different undertakings for first year of operation on sample basis.

9. Organization structure of all the undertakings which had commenced operations during the period beginning with 1st day of April, 1995 and ending with 31st day of March, 2000.

10. Copies of SOFTEX Returns which the different undertakings have filed before the STPI Authorities in the first year of operation (including the undertaking being set-up during the financial year under consideration)

11. Copy of the Quality Certificate dated April 22, 2008, obtained by the Company from BUREAU VERITAS (containing the reference of all the undertakings of the Assessee) showing that the Assessee has obtained the necessary quality certificates from the various recognized agencies from time to time to demonstrate the requisite quality standard of the services offerings of each undertaking to the prospective customers.

12. Details of assets supplied by different customers on loan basis to different undertakings as contained in the box files filed in the course of earlier assessment proceedings.

13. Details of re-export of assets obtained on loan basis to the respective customers on sample basis as contained in the files filed in the course of earlier assessment proceedings.

    Further, a comparative chart showing yearly figures of the following key growth indicators during the period from FY 1995-96 to FY 1999-2000 was also furnished before the assessing officer vide letter dated 16.02.2015.

1. Total number of Undertakings owned by the Assessee.

2. Total number of employees (which has increased 4.28 times during the said period)

3. Revenue (which has increased 17.44 times during the said period)

4. Salary cost (which has increased 14.26 times during the said period)

5. Rent (which has increased 19.96 times during the said period)

6. Electricity & water charges (which has increased 39.66 times during the said period)

7. Communication cost (which has increased 4.43 times during the said period)

**(e) <u>STPI & Customs approvals</u>**

1. Copies of the relevant lease deeds/ sale deeds showing that a separate lease deed/ sale deed was executed whenever a new undertaking was set up by the Assessee.

2. Copies of the original STPI Licenses obtained by the Assessee from time to time.

3. Copies of separate approval obtained by the Assessee from STPI and Customs Authorities from time to time for setting up all the undertakings.

4. Copy of the Certificate issued by the Chennai STPI Authorities dated January 28, 2005, certifying the addresses and dates of STPI Registration of all the Chennai based undertakings till that date.

5. Copy of the STPI Certificate bearing reference number Ref: STPIC/A111/2008-09/A5519 dated 24/10/2008 whereby Chennai STPI Authorities have certified as under:-

   ***"Approval has been granted to the Company from time to time to set up all the undertakings covered under STPI Chennai-I in accordance with the provisions as contained in the Software Technology Park Scheme (the STP***

***Scheme) notified by the Government of India in the Ministry of Commerce and Industry. Whenever the approval has been granted to the Company for expansion, the Company is eligible to expand its operations by setting up new undertakings subject to fulfillment of conditions as contained in the first approval."***

6. Similar certificate issued by STP, Noida authorizes bearing reference No. STPIN/101217 dated 16-04-2013.

With reference to the aforesaid records, it would be appreciated that each undertaking is an independent and separate undertaking registered with STPI and is eligible for deduction under section 10A of the Act in as much as:

(i) Each undertaking was set up with substantial capital investment, new business and new models.

(ii) The undertaking had identified workforce.

(iii) Each undertaking is situated in a separate identifiable premises bounded by custom authorities and registered with STPI, and

(iv) Each undertaking is independently executing computer software projects.

It would also be appreciated that each software development center owned by the Assessee constitutes independent viable undertaking and fulfill all the conditions as prescribed under Section 10A of the Act as under:

**(a)** **Approval has been granted by the STPI to the Assessee for establishing each of the above referred 51 undertakings**(which are still covered under section 10A of the Act during the year under review) in accordance with the Software Technology Park Scheme notified by Government of India, Ministry of Commerce and Industry as required by Section 10A of the Act [Clause(i)(b) of sub-section (2) of section 10A read with Explanation 2(vii) of Section 10A of the Act].

At the request of the Assessee, Chennai STPI Authorities have, vide Certificate bearing reference number Ref: STPIC/A111/2008-09/A5519 dated 24/10/2008 clarified the nature of permission granted for setting up of the undertaking, as under:

"Approval has been granted to the Company from time to time to set up all the undertakings covered under STPI Chennai-I in accordance with the provisions as contained in the Software Technology Park Scheme (the STP Scheme) notified by the Government of India in the Ministry of Commerce and Industry. Whenever the approval has been granted to the Company for expansion, the Company is eligible to expand its operations by setting up new undertakings subject to fulfillment of conditions as contained in the first approval."

The requirement for claim of deduction under section 10A of the Act is that the undertaking should be established/ set up in a Software Technologies Park. The provision does not specify the manner in which the approval/ registration is to be issued by the STPI authorities Further, the section does not specify a separate license as a condition precedent for holding an independent unit operating in Software Technology Park as eligible for deduction under that section.

Reliance in this regard is placed on the decision of the Karnataka High Court in the case of **CIT vs Caritor (India) (P) Ltd: 230 Taxman 511 (Kar)**wherein it has been categorically held that an Assessee is entitled to claim tax holiday benefit once conditions stipulated in the relevant statutory provision are fulfilled. Relevant extracts of the judgment are as under:

*"The conditions stipulated in the permission granted by the STPI is the units shall be customs bonded. The benefit of such customs bonding is that the assessee would be entitled to the benefit of customs duty and excise duty. It has nothing to do with the grant of exemption under section 10A of the Income-tax Act.* ***To be eligible for exemption under section 10A, the conditions stipulated in sub-section (2)(i) of section 10A has to be fulfilled, i.e., the assessee has to begin manufacturing the products on or after the first day of April, 1994, in any electronic hardware technology park. In order to start the unit in software technology park, the permission is required. Once permission is obtained and the unit is started in software technology park, after the aforesaid date, the assessee is entitled to the benefit under section 10A of the Act. Customs bonding is not a requirement or a condition precedent for granting exemption under section 10A.****"*

Pune Bench of the Tribunal in the case of **Patni Computer Systems Ltd vs DCIT (ITA Nos. 426 & 1131/PN/06)**, considering the identical issue, held that the manner in which the approval has been granted, is not relevant to examine the Assessee's claim of deduction under section 10A of the Act with respect to various units and that there was no prohibition to claim under that section. Expansion in the same line of business achieved by setting up a new independent unit would lead to denial of deduction. The relevant findings of the Hon'ble Tribunal read as follows:

> "51. The only plea of the Revenue is that in the approvals granted by the STPI, the three units have been referred to as an expansion of the corresponding old units. The moot question is as to whether such a plea of the Revenue is potent to effect the assessee's entitlement for deduction under section 10A of the Act. Similar plea of the Revenue in the context of section 10B of the Act was a subject matter of consideration by our coordinate Bench in the case of Jayant Agro

Organics Ltd. Akhandanad, (supra) wherein following discussion is worthy of notice:

*"8. Revenue has vehemently contended that there is no independent Government approval of the new unit and all that the Government has permitted is enhancement in capacity of the existing unit. As evident from the land allotment letter dated 19th July, 1995 issued by the Gujarat Industrial Development Corp. Ltd. it is clear that the land allotted for the new unit is plot #624/1 and 2, and 625 to 627 whereas the existing plant was in plot 3 602. The production of 12 Hydroxy Stearic Acid is authorized by the letter dt 27th January 1995 which states that the Government has taken note of assessee's wish to manufacture Hydroxy Stearic Acid also by way of forward integration and amended the letter of permission to include 12 Hydroxy Stearic Acid of 12,000 MT in the very next sentence. It is observed that "Govt also approves of your request for the import of additional capital goods worth Rs 550 lakhs for the project". That clearly demonstrates that the production of Hydroxy Stearic Acid of 12,000 MT was viewed by the Government as an independent project. It was not a case for purchase of addition capital goods for the existing project. The assessee is irrespective of the number of units, is one of artificial juridical person. Therefore, a combined permission, which involves setting up for different units, is quite in order. The fact of amendment of earlier permission or of grant of separate permissions, is not really relevant. What is really to be examined is whether the units are independent of unit and whether the units are covered by the permission or not. In our humble understanding it meets both the tests. We have also noted that it is not an statutory requirement that there has to be separate permission for each unit and therefore just because the permission is granted by the Government by way of amending the original permission letter does not affect the eligibility for deduction u/s 10B in any manner."*

42. From the aforesaid, it is quite clear that the manner in which the approval has been granted is not relevant to examine the assessee's case for claim of deduction under section 10A of the Act with respect to the three units. What is really to be examined is as to whether the three units are independent units and that they fulfill the conditions prescribed under section 10A(2) of the Act. There is no prohibition that an expansion in the same line of business achieved by setting up a new independent unit would lead to denial of deduction under section 10A of the Act. In this background, in the earlier part of this order we have already noted with approval the factual findings of the Commissioner of Income-tax (Appeals) that the three units are separate and independent production units and the same cannot be treated as mere expansions of the existing undertakings. Therefore, the mere fact that the requisite permissions from STPI refer them as expansions of the

> existing units, would not dis-entitle the assessee from the claim of deduction under section 10A of the Act. In this view of the matter, we find no error in the approach of the Commissioner of Income-tax (Appeals) in having allowed the claim of assessee for the benefits under section 10A of the Act on the three units treating the same as independent units. Thus, Ground Nos 1 & 2 of the appeal of the Revenue are dismissed."

The aforesaid decision of the Hon'ble Pune bench of the Tribunal was affirmed by the Hon'ble Bombay High Court in the case reported as **CIT-II, Pune vs Patni Computer Systems Ltd: 215 Taxman 108 (Bom)**.

Kind attention is invited to the decision of the Hon'ble Tribunal in the case of **ITO vs AMD Export Corporation reported in 79 ITD 381 (Del)** wherein it is held as under:

> "21. Here it may also be pertinent to point out that in the current age of administration where there is delegation of authority to different Ministries/Departments of the Government, the action of each is to be understood in the context for which it was made. The Ministry of Commerce which was looking after the requirements to be met in order to certify an industry a manufacturing or processing industry within the premises of its area or zone was to look into various aspects of the manufacturing or processing industry and only then if the requirements envisaged by its Orders, Rules or Notifications were stringently met would the Certificate-cum-Registration be granted. The conditions/ requirements to be met in order to get this certificate and claim benefits thereunder were for a different set of benefits and not the benefits under the Income-tax Act. These benefits may have been the import facilities, the duty drawback assets etc.
>
> 22. As far as the requirements for availing of exemption under section 10A of the Income-tax Act, 1961 is concerned, they are clearly laid down in Section 10A of the Income-tax Act, sub-section (2) thereof reads as under:--
>
> "10(A)(2). This section applies to any industrial undertaking which fulfils all the following conditions, namely:--
>
> (i) it has begun or begins to manufacture or produce articles or things during the previous year relevant to thy assessment year
>
> (a) commencing on or after the 1st day of April, 1981, in any Free Trade Zone; or

(b) commencing on or after the 1st day of April, 1994, in any electronic hardware technology park, or as the case may be, software technology park;

(ia) in relation to an undertaking which begins to manufacture or produce any article or thing on or after the 1st day of April, 1995, its exports of such articles of things are not less than seventy five per cent of the total sales thereof during the previous year,

(ii) it is not formed by the splitting up, or the reconstruction, of a business already in existence:

Provided that this condition shall not apply in respect of any industrial undertaking which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such industrial undertaking as is referred to in section 33B, in the circumstances and within the period specified in that section,

(iii) it is not formed by the transfer to a new business of machinery or plant previously used for any purpose."

23. The above conditions having been met, there is no basis for reading any more requirements to be met which have not been applicable in the section by the legislature. It may be pertinent to state here that provisions granting incentives for promoting economic growth have to be interpreted liberally so as to advance the object and not to frustrate the purpose for which they are made."

The Bombay High Court in the case of **Pr. CIT vs Hinduja Ventures Ltd in ITA No.63 of 2016 vide order dated 26.07.2017 dismissed the appeal filed by the Revenue on the following question:**

*"Whether on the facts and in the circumstances of the case and in law, the Hon. ITAT erred in concluding that the benefits of Section 10A of the Act in respect of Unit II and Unit III are allowable by treating such units as distinct undertaking* ***by ignoring the fact that assessee in his application to the STPI Authorities has stated that these units are expansion and not distinct undertakings****?"*

To same effect are the following decisions:

- ACIT vs Symantec Software India (P) Ltd (ITA Nos. 787 & 805/PN/09)
- ITO vs. DSM Soft (P) Ltd. : 115 TTJ 469 (ITAT Chennai)
- Jayant Agro Organics Ltd, Akhandanad, Mumbai vs. Jt. CIT (ITA No. 5439/Mum/01 dated 03-03-2006
- Maral Overseas limited vs ACIT: ITA Nos. 777& 900 of 2004 & 295 & 356 of 2006 (ITAT Indore Special Bench)

It is not disputed that each of the 24 undertakings of the Assessee are registered with STPI Authority. Merely because approval for setting up one or more STP units is granted under one license, would not imply that the unit is not registered by the STP authorities, for purposes of section 10A of the Act.

**(b) Each STP unit represents a separate undertaking:**

The word "undertaking" would mean an activity carried on by the Assessee. For the purpose of section 10A, the business of undertaking, in our respectful submission, would mean any activity carried on systematically or in the organized manner with a view to earn profit. **The term 'undertaking' as referred to in section 10A of the Act may refers to any business venture or enterprise or project, which a person undertakes to do with the view to earn profit. An 'undertaking' or 'enterprise' would have, inter alia, the following features, (i) it is a venture to earn profits, i.e., a business venture, (ii) the activity involves investment of capital, (iii) activity involves utilization of resources and risk factor, and (iv) is carried on in an organized manner**.

All the undertakings owned by the Assessee are clearly separate and distinct STPI units being registered with the STPI Authorities from time to time under ***the Software Technology Park Scheme notified by the Government of India in the Ministry of Commerce and Industry*** as required by Section 10A of the Act.

Further, it is respectfully submitted that it is not a case of splitting of an undertaking into multiple undertakings. As already explained above, each one of the undertakings owned by the Assessee company **(*which are still covered under Section 10A of the Act during the year under review)* represents an independent and separate viable unit, being registered with the STPI Authorities *in accordance with the Software Technology Park Scheme notified by the Government of India in the Ministry of Commerce and Industry as required by Section 10A of the Income Tax Act, 1961 [Clause (i) (b) of Sub-Section (2) of Section 10A read with Explanation 2(vii) of Section 10A of the Act].***

The Supreme Court in the case of **Textile Machinery Corporation Ltd vs CIT : 107 ITR 195 (SC)**, in the context of section 15C of the Income-tax Act, 1922 (corresponding to section 80J of the Act) while holding the benefit of that section being available to the assessee, observed at page 203 of the judgement as under:

> *"The answer, in every particular case, depends upon the peculiar facts and conditions of the new industrial undertaking on account of which the assessee claims exemption under section 15C. No hard and fast rule can be laid down. Trade and industry do not run in earmarked*

*channels and particularly so in view of manifold scientific and technological developments. There is great scope for expansion of trade and industry. The fact that an assessee by establishment of a new industrial undertaking expands his existing business, which he certainly does, would not, on that score, deprive him of the benefit under section 15C. Every new creation in business is some kind of expansion and advancement. The true test is not whether the new industrial undertaking connotes expansion of the existing business of the assessee but whether it is all the same a new and identifiable undertaking separate and distinct from the existing business. No particular decision in one case can lay down an inexorable test to determine whether a given case comes under section 15C or not. <u>In order that the new undertaking can be said to be not formed out of the already existing business, there must be a new emergence of a physically separate industrial unit which may exist on its own as a viable unit. An undertaking is formed out of the existing business if the physical identity with the old unit is preserved. This has not happened here in the case of the two undertakings which are separate and distinct.</u>*

*Section 15C partially exempts from tax a new industrial unit which is physically separate from the old one, the capital of which and the profits thereon are ascertainable. <u>There is no difficulty to hold that section 15C is applicable to an absolutely new undertaking for the first time started by an assessee</u>. The cases which give rise to controversy are those where the old business is being carried on by the assessee and a new activity is launched by him by establishing new plants and machinery by investing substantial funds. The new activity may produce the same commodities of the old business or it may produce some other distinct marketable products, even commodities which may feed the old business. These products may be consumed by the assessee in his old business or may be sold in the open market. <u>One thing is certain that the new undertaking must be an integrated unit by itself wherein articles are produced and at least a minimum of ten persons with the aid of power and a minimum of twenty persons without the aid of power have been employed. Such a new industrially recognizable unit of an assessee cannot be said to be reconstruction of his old business since there is no transfer of any assets of the old business to the new undertaking which takes place when there is reconstruction of the old business. For the purpose of section 15C the industrial units set up must be new in the sense that new plants and machinery are erected for producing either the same commodities or some distinct commodities. In order to deny the benefit of section 15C the new undertaking must be formed by reconstruction of the old business</u>. Now, in the instant case, there is no formation of any industrial undertaking out of the existing business since that can take place only when the <u>assets of the old business are transferred substantially to the</u>*

> *new undertaking. There is no such transfer of assets in the two cases with which we are concerned." (Emphasis supplied).*

Again at page 206 of the judgment, their Lordships summarized the requirements to be satisfied by a new industrial undertaking to enjoy the tax holiday as under:

> *"…………………. The fact that the assessee is carrying on the general business of heavy engineering will not prevent him from setting up new industrial undertakings and from claiming benefit under section 15C if that section is otherwise applicable. However, in order to be entitled to the benefit under section 15C, the following facts have to be established by the assessee, subject always to time schedule in the section:*

*(1) investment of substantial fresh capital in the industrial undertaking set up,*
*(2) employment of requisite labour therein,*
*(3) manufacture or production of articles in the said undertaking,*
*(4) earning of profits clearly attributable to the said new undertaking, and*
*(5) above all, a separate and distinct identity of the industrial unit set up."*

The Supreme Court in the case of Textile Machinery Corporation Ltd vs CIT (supra) pointed out that the new industrial undertaking should emerge as physically separate industrial unit which may exist on its own as a viable unit.

The issue is one to be decided on the facts of each case by applying following tests laid down by the apex Court in the case of **Textile Machinery Corporation Ltd vs CIT: 107 ITR 195 (SC)**:

> *"(1) investment of substantial fresh capital in the industrial undertaking set up,*
>
> *(2) employment of requisite labour therein,*
>
> *(3) manufacture or production of articles in the said undertaking,*
>
> *(6) earning of profits clearly attributable to the said new undertaking, and*
>
> *(7) above all, a separate and distinct identity of the industrial unit set up."*

In the case of the Assessee, it would be appreciated that each of the 51 undertakings (software development centers) were registered with STP authority. Each of the undertakings, it would be appreciated, satisfy the test of being an independent undertaking for the purpose of claim of deduction under section 10A of the Act, in as much as, each undertaking has identified work force and has an independent functional identity and is a separate profit centre. Each unit has (i) independent infrastructure, separate plant and machinery, etc. employed therein; (ii) been set up with substantial capital investment; (iii) new employees; (iv) independently executing computer software development project and has identifiable output and the profits attributable thereto can be determined. The assessing officer, too, it is respectfully submitted, did not dispute the test laid down for constituting an undertaking as independent in terms of dictionary meaning and other jurisprudence available in this regard. The assessing officer also did not record a finding that each of the software development centers were not functioning as independent viable unit, independently executing software development project.

The facts of that case are similar to the Assessee's case. The approval in these cases were similarly worded as in the case of the Assessee. The conclusion reached by the Hon'ble Tribunal on the facts of that case also needs to be followed in the present case.

The assessing officer did not dispute the findings in the aforesaid decisions of the Tribunal that the manner of seeking approval from STPI is not conclusive and the nature of the undertaking would have to be determined on the basis of the test laid down by the Supreme Court in the Textile Machinery.

The assessing officer, in fact, accepts the contention of the Assessee when he says that whether these 51 units would be treated as separate undertakings for claim of deduction under section 10A does not depend on whims and fancies of the Assessee. It has to be seen in the light of the test laid down by the apex Court and has to be decided on that basis.

The assessing officer has also admitted that the manner of approval by STPI is of no consequence and it is also not the Department's case. The Assessee's contention is that the conduct of the Assessee is to be seen. The fact that the Assessee in the past did not inadvertently claim deduction under section 10A treating these 51 units as separate units led to a loss of deduction to the Assessee and cannot be a reason to deny the correct deduction as per the tests laid down by the Supreme Court, in this year.

The case of the assessing officer is that, since the Assessee himself, in earlier years, did not treat these 51 units as separate undertakings, they do not for that reason qualify as separate and distinct undertakings eligible for deduction under section 10A.

It is reiterated that each of the 51 units set up by the Assessee are self-sustained, independent and viable undertaking with complete infrastructure such as employees, equipment, building premises, electricity connections etc. Each undertaking is housed in a distinct and separate location/ premises and is headed by a business unit head and is engaged in delivering the software services independently to the customers.

It would be appreciated that intention of the Assessee is not determinative of the nature of these undertakings or SDCs or business units. What is to be seen is whether in reality there is emergence of independent viable undertakings in terms of the tests laid down by the Supreme Court.

These 51 units undisputedly satisfy the tests laid down by the Supreme Court in Textile Machinery's case. In fact, the assessing officer himself did not dispute this fact, but is seeking to deny deduction claimed under section 10A of the Act solely on the basis that the Assessee himself erroneously did not treat these 51 units independent and separate undertakings in the past.

The computation of deduction under section 10A of the Act by the assessing officer considering each license as the eligible unit, therefore, is unlawful and not sustainable.

**(c) <u>Requirement of separate books of accounts:</u>**

The Assessee has produced complete unit-wise profit & loss account before the assessing officer and also explained the manner of maintenance of separate books of accounts for each of the undertakings to the assessing officer. The assessing officer has noted the same at page 36 of the assessment order.

In any case, there is no requirement in section 10A of the Act for the undertaking to maintain separate books of accounts. There is no provision in the said section analogous to sub-section (7) of section 80-IA/ 80-IB(13) of the Act. In the following cases, the Courts have held that in the absence of a stipulation in section 10A/ 10B of the Act for maintenance of separate books of accounts for each undertaking, such a condition cannot be read into the said sections:

- CIT V. Dunlop Rubber Co (India) Ltd.: 107 ITR 182 (Cal.) [Section 84]
- Mahindra Sintered Products Limited V. CIT: 177 ITR 111 (Bom) [Section 80-J]
- CIT V. J.K. Synthetics Limited: 182 ITR 125 (Del.) [Section 84]
- CIT V. Hind Lamps Limited: 190 ITR 553 (All.) [Section 80J]
- CIT V. Mazagaon Dock Limited: 191 ITR 460 (Bom.) [Section 80J]
- CIT V. Hindustan Malleables & Forgings Limited: 191 ITR 70 (Pat.) [ Section 80J]
- CIT V. Abirami Cotton Mills (P) Ltd: 220 ITR 84 (AP) [Section 80J]
- CIT V. Sree Krishna Pulversing Mills: 251 ITR 262 (AP) [Section 80HH and 80I]
- CIT V. Technotive Eastern (P) Ltd: 255 ITR 253 (Gau) [Section 80-HH and 80I]
- Rajasthan Petro Synthetics Limited V. DCIT: 60 ITD 682 (Del) [Section 80I]

- Punjab Tractors Limited V. DCIT: 128 Taxman 28 (Chd.) (Mag.) [Section 80I].
- DCIT v. Arabian Exports Limited : 109 TTJ 440 (Mum.)

**CBDT Circular No. 1 of 2013 dated 17-01-2013 also clarifies the position to the aforesaid fact.**

**(d) <u>The following documents evidencing setting up of each of the undertakings as independent, stand along unit, at separate and independent location, registration with the STPI/ Customs authorities were also placed before the assessing officer:</u>**

- Copies of the relevant lease deeds/sale deeds showing that a separate lease deed/sale deed was executed whenever a new undertaking was set up by the Assessee.

- Copies of STPI Registration documents.

- Copies of custom bonding of premises of each of the undertakings by the Customs Authorities.

- Relevant extracts from the Customs Bond Registers maintained by each of the undertakings showing the actual receipt of imported and indigenous assets in the premises of the concerned undertaking.

- Copy of the Certificate issued by the Chennai STPI Authorities dated January 28, 2005, certifying the addresses and dates of STPI Registration of the Chennai based undertakings till that date.

With reference to these records, it was demonstrated that each undertaking is an independent and separate undertaking and eligible for deduction under section 10A of the Act on the following basis:

(a) Each undertaking was set up with substantial capital investment, new business and new models;

(b) The undertaking had identified workforce

(c) Each undertaking is situated in a separate identifiable premises bounded by custom authorities and registered with STPI and

(d) Each undertaking is independently executing computer software projects.

Voluminous papers and documents have been placed on record in order to demonstrate the aforesaid.

Attention is invited to the decision of Chennai Branch of the Tribunal in the case of **ITO vs DSM Soft (P) Ltd : 115 TTJ 469**, wherein the assessee company, with a unit in Chennai, was incorporated on 8.6.1991 and since then had been engaged in development of software both for export and local market. The assessee had claimed deduction u/s 80HHE till assessment year 2000-01. During the financial year 2000-01 relevant to assessment year 2001-02, the assessee started a new STPI Unit at Trichy and claimed that the entire export had been affected by its export unit situated at Trichy. During the course of scrutiny assessment, the Assessing Officer noted that the STPI Unit continued to have the same export clients as in the last year. The majority of the employees of the Chennai Unit were taken into the STPI Unit. The Assessing Officer held that the unit at Trichy was established by splitting the earlier business and hence was not eligible for Section 10A rebate.

On appeal, the Commissioner of Income Tax (Appeals) after obtaining remand report from the Assessing Officer, concluded as under:-

> "i) Substantial fresh investment in Plant and Machinery exceeding Rs. 50 lakhs was made in STPI Unit at Trichy.
>
> ii) A net addition of 153 employees by STPI Unit at Trichy was made during the year under consideration.
>
> iii) Four new foreign clients were added to the existing six clients during the year under consideration. More than two crore worth of export has been made in rendering new services of Geographical Information Systems (GIS), Photogrammatary, Software exports in addition to CAD services which have been rendered in earlier years as well."

On the basis of above, the Commissioner of Income Tax (Appeals) concluded that there was substantial force in the contention of the assessee that STPI Unit at Trichy was not formed by splitting up or reconstruction of its earlier business. Aggrieved by this order of the Commissioner of Income Tax (Appeals), the Revenue filed appeal before the Tribunal.

The Tribunal, on the aforesaid facts, held that it could not be said that the STPI unit of the assessee was established as a result of the splitting up or restructuring of the unit at Chennai.

The aforesaid decision, it would be appreciated, squarely applies to the Assessee’s case.

Reliance is also placed on the decision of Mumbai Bench of the Tribunal in the case of **JCIT vs Associated Capsule (P) Ltd : 114 ITD 189**, wherein the assessee had been engaged in the business of production of empty hard gelatine capsules and their sale to pharmaceutical companies since 1960. The manufacturing activities were carried out by the assessee with the help of capsule manufacturing machines. Commensurate with the growth of the business, the assessee kept on adding, new undertakings to its existing undertakings. In the relevant assessment year, the assessee had seventeen capsule manufacturing machines installed in four separate undertakings. It claimed deduction under sections 80-I and 80-IA in respect of its undertakings.

The assessing officer held the view that all the four undertakings claimed by the assessee to be separate and independent from each other for the purpose of relief under sections 80-I and 80-IA were essentially one undertaking as all of them were engaged in the production of the same article, namely, capsules in the same factory of the assessee-company. The assessing officer concluded that Undertaking Nos. II and III could not be regarded as separate and independent undertakings for the purpose of relief under sections 80-I and 80-IA and accordingly, denied the relief claimed by the assessee on the basis of the following:

(i) The machines involved in the manufacturing of capsules in all the undertakings/departments were located in the same building.

(ii) The source of power for all the units was one as there was one electricity bill for the factory.

(iii) <u>There was one license for all units</u>.

(iv) Air-conditioning plant for all the units was common.

(v) Annual Report was silent on the establishment of new units.

(vi) Certain ancillary activities, pre and post manufacturing, were common.

The Commissioner of Income-tax (Appeals), however, held that each of the undertaking was separate and independent and was producing capsules in its own right. Following the principles laid down in Textile Machinery Corpn. Ltd. v. CIT [1977] 107 ITR 195 (SC) the CIT(A) accordingly held that the profits and gains derived from each undertaking was eligible for deduction under section 80-I/80-IA of the Income-tax Act.

Before the Hon'ble Tribunal, the Revenue contended as follows:

(i) <u>All the machines involved in the manufacturing of capsules were located in the same premises</u>.

(ii) <u>There was only one power connection for the entire factory</u>.

(iii) Air conditioning unit for all the machines was common. Though the assessee claimed that it had set up units 2, 3 and 4 in August, 1997, March 1993 and October 1994, there was no mention about the establishment of the aforesaid units in the annual report placed before the shareholders.

(iv) The basis on which the assessee had clubbed the machines and identified them with a particular undertaking was not clear.

(v) There was only one license for all the units as one factory.

(vi) The regular information sent to the Central Excise Department could not be treated as amounting to setting up of a new industrial undertaking.

(vii) Gelatine preparation wing was commonly maintained.

(viii) Procurement of raw material was common for all the units.

On the strength of the aforesaid facts, the Revenue contended that all the four undertakings were in fact four units of the same undertaking. The Tribunal, too, while holding that each undertaking was independent undertaking and eligible for deduction under section 80-IA of the Act, observed as under:

> "12. It is quite apparent on bare perusal of section 80-I/80-IA that the notion of 'undertaking' is a core jurisdictional element for the application of section 80-I/80-IA. Other conditions stipulated by section 80-I/80-IA can be satisfied only when there is an 'undertaking'. However, mere existence of an 'undertaking' is not sufficient. The 'undertaking' should also be new in the sense that it should have begun to manufacture or produce specified articles or things after the prescribed time schedule. It is evidently a condition sine qua non that, for the above provisions to apply, there must primarily be manufacture or production of articles or things involving a new undertaking or undertakings. As observed by the Hon'ble Supreme Court in Textile Machinery Corpn. Ltd. case (supra), there is no difficulty in holding that the benefit of section 80-I is applicable to an absolutely new industrial undertaking started for the first time by the assessee. However, controversies do arise in cases, as it has arisen in the present case, where the old business is being carried on by the assessee and the new activity is launched by him by establishing new plants and machinery by investing substantial funds to produce the articles or things which are same as those of the old business or produce some distinct marketable products which may feed the old business. These articles and products may be consumed by the assessee in his old business or sold in the open market. The revenue in such cases generally contends that the establishment of a new unit manufacturing

the same product as the existing ones is not a new 'undertaking' eligible for tax incentives whereas an assessee setting up such a new unit always contends that the new unit is an undertaking notwithstanding that it produces or manufactures the same product as the existing ones or that it is located in the same premises where the existing ones is located.

13. There is no doubt that the benefit of section 80-I/80-IA is not available to a unit or new unit unless the unit is in the nature of an 'undertaking'. The term 'unit', according to The New Oxford Dictionary of English, signifies an individual thing or person regarded as single and complete, especially for purposes of calculation. It also signifies a 'device that has a specified function'. The term 'undertaking', on the other hand, is defined in the same Dictionary as 'task that is taken on' and also as 'the action of undertaking to do something'. In Black's Law Dictionary, the term 'undertaking' is defined to mean, inter alia, 'to take on an obligation or task'. The Income-tax Act does not define the or 'undertaking' though the term 'industrial undertaking' is defined in section 33B of the Income-tax Act as 'any undertaking which is mainly engaged in the business of ... or in the manufacture or processing of goods...'. In the absence of a precise statutory definition of the term 'undertaking', the crucial question of whether a unit is to be considered as an undertaking within the meaning of the section 80-I/80-IA is left to be answered by the Courts and Tribunals, In our view, the term 'undertaking' has to be approached ideologically focusing on the subject-matter the unit in question is concerned with. In order to constitute an 'undertaking', the unit must undertake the specified task. In the context of section 80-I or section 80-IA, the obligation or task to be undertaken by a unit is the manufacture or production of articles or things specified in that section. The 'undertaking' envisaged by the aforesaid provisions is the one which undertakes to manufacture or produce the articles or things in its own right and consequently derives the profits or gains therefrom. In our view, a unit qualifies to be called an 'undertaking' when it undertakes the production or manufacture of articles or things in its own right and produces such articles or things by itself as a separate and independent unit. It should not only be a separate and independent unit but a well-integrated unit capable of undertaking the manufacturing or production of articles or things. As held in Textile Machinery Corpn. Ltd.'s case (supra), an undertaking claiming deduction must be a new integrated unit by itself where articles or things are manufactured or produced. The relevant tests in this behalf have been laid down by the Hon'ble Supreme Court in the said judgment as under :-

(i) Investment of substantial fresh capital in the industrial undertaking set up;

(ii) Employment of requisite labour therein.

(iii) Manufacture or production of article in the said undertaking.

(iv) Earning of profits clearly attributable to the said new undertaking; and

(v) Above all, a separate and distinct identity of the industrial unit set up.

14. Thus what is relevant is whether the unit in question is engaged in the production or manufacture of specified articles or things in its own right. It is not in dispute that the units in question in the assessee-company are engaged in the production of capsules and has also produced the capsules in the year under appeal. The assessee has been denied deduction on the sole ground that all the units are also producing capsules and are therefore, part of the same undertaking. Learned CIT(A), after examining the relevant materials on record, has held that the unit in question is not only a well-integrated unit producing capsules on its own but also has separate and distinct identity of its own. He has given detailed reasoning in his appellate order for coming to the conclusion that each unit in the assessee-company is engaged in the production of capsules in its own right. Organizational features, such as the legal status of the unit or the fact that they are controlled or managed by common management or located in the same premises where existing units are located to derive certain advantages or are producing similar goods as the existing ones are hardly relevant to decide whether a unit is in the nature of undertaking. Likewise, the fact that procurement of raw materials is common or certain post-manufacturing activities are centrally carried out or drawing certain facilities from a common source are not, as rightly pointed out by the learned CIT(A), sufficient enough to hold that each unit is not engaged in manufacturing or producing the articles or things or is not independent or separate from others. The findings recorded by the learned CIT(A) that the unit in question is separately and independently engaged in the production of capsules on its own have not been shown to be incorrect or based on no material. It is also not in dispute that each undertaking has not only produced the capsules but also derived the profits and gains from them. The Department has also not rebutted the assessee's submission that it has treated each undertaking as separate and independent in its accounts. It is also not the case of the Department that any of the negative tests laid down in section 80-I(2) is attracted in the case before us. We therefore endorse the findings recorded as also the order passed by him in this behalf and consequently dismiss Ground No. 1 taken by the Department."

It would be appreciated that in the aforesaid decision, too, the Revenue had, inter alia, contended that there was only one license for all the units. The aforesaid contention raised by the Revenue was held to be of no consequence. The Hon'ble Tribunal considering the settled legal position as laid down in plethora of decisions discussed hereinabove, held each unit to be an independent viable unit separately eligible for deduction under section 80-IA of the Act.

In the case of the Assessee, it would be appreciated that each of the 51 undertakings (software development centers) were registered with STP authority and were established as distinct and independent viable unit, in as much each unit has (i) independent infrastructure, separate plant and machinery, etc. employed therein; (ii) been set up with substantial capital investment; (iii) new employees; and (iv) identifiable output and the profits attributable thereto can be determined.

It is submitted that this issue has been decided against the Assessee by the DRP on the basis of directions passed during the proceedings relating to assessment year 2005-06. The final assessment order passed in pursuance to directions of the DRP for assessment year 2005-06 was challenged before this Hon'ble Tribunal, wherein this Hon'ble Tribunal had refused to adjudicate the claim on merits on the ground that the claim has been raised belatedly and it was not possible to examine the same at a belated stage. However, in light of the Delhi High Court decision in Assessee's own case for assessment year 2005-06 wherein it was held that there is no estoppel against law and the Assessee is free to resile from its own stated position, it is submitted that the Hon'ble Tribunal ought to have adjudicated the issue on the merits of the claim when necessary evidence in that behalf (contained in eight box files) was placed before the assessing officer evidencing setting up of each of the undertakings at different points in time as independent, standalone units at separate and independent locations pursuant to registration with the STPI/ Customs authorities, in the form of:

i. Copies of the relevant lease deeds/sale deeds showing that separate lease deed/sale deed was executed whenever a new undertaking was set up by the Assessee.

ii. Copies of STPI Registration documents and copies of custom bonding of premises of each of the undertakings by the Customs Authorities to evidence that each undertaking had been registered with the STPI Authorities and Customs Authorities as separate unit.

iii. Separate Bond Register maintained by each undertaking in respect of the items of capital assets purchased/obtained on loan, viz., (a) Outright Purchases (Imported Items), (b) Outright Purchases (Indigenous Items) and (c) Loan Assets which are supplied by the end customers for the execution of their projects.

iv. Relevant extracts from the Customs Bond Registers maintained by each of the undertakings showing the actual receipt of imported and indigenous assets in the premises of the concerned undertaking.

v. Copy of the Certificate issued by the Chennai STPI Authorities dated 28.1.2005, certifying the addresses and dates of STPI Registration of the Chennai based undertakings till that date.

vi. Copy of the STPI Certificate bearing reference number ***Ref: STPIC/A111/2008-09/A5519 dated 24/10/2008*** whereby Chennai STPI Authorities had certified as under:-
*"Approval has been granted to the Company from time to time to set up all the undertakings covered under STPI Chennai-I in accordance with the provisions as contained in the Software Technology Park Scheme (the STP Scheme) notified by the Government of India in the Ministry of Commerce and Industry. Whenever the approval has been granted to the Company for expansion, the Company is eligible to expand its operations by setting up new undertakings subject to fulfillment of conditions as contained in the first approval."*

In view of the aforesaid, the deduction claimed under section 10A of the Act in respect of such 51 undertakings has wrongly been denied by combining the 51 independent undertakings on the basis of 24 licenses into 24 undertakings only and accordingly, disallowance of deduction under section 10A of the Act on account of the above is unwarranted and liable to be deleted."

184. On the other hand, ld. DR of the Revenue submtited that the issue under consideration is decided in favour of the revenue by the ITAT in the AY 2005-06. He relied on the above decision and detailed findings of lower authorities.

185. Considered the rival submissions and material availabel on record. We observed that the issue under consideration is already decided by the coordinate bench in favour of the revenue, for the reason that the assessee had claimed deduction u/s 10A of the Act in respect of 51 undertakings which were registered and approved with the STP authorities under 24 licences. The above claim was made in the revised return of income, which was modified from the deduction originally claimed in the original return of income. The assessee had claimed deductions on the basis of combined claim and later determined claim of 51 independent units individually, which was denied by the lower authorities and refused to adjudicate on the enhanced claim of deduction u/s 10A on merits for the reason that the tax holiday claim in respect of

higher number of undertakings was raised belatedly and which deviated from the assessee's own claim in the earlier years. However, Hon'ble Delhi high Court in the assessee's own case for AYH 2005-06 held as under:

> *"15. The first issue that this Court has to determine is whether in the event of an assessee's failure to avail the benefits of a statutory provision, such as Section 10A of the Act, creates an estoppel precluding it from availing such benefits in future. The AO, DRP as well as the ITAT concurrently have rejected the Assessee's claims under its revised return primarily on the ground that the Assessee itself did not treat all 31 units as separate undertakings previously, and in fact, for the subject assessment year as well, it originally adopted its earlier approach. <u>On an examination of the authorities relied upon by the Assessee, this Court notices that they are overwhelmingly in its favour and therefore, this Court answers the first question in favour of the Assessee.</u>*

From the above, it was held that in the event that the assessee establishes that the 31 units constitute separate undertakings for the purposes of section 10A, it would be entitled the claims made in the revised return. Following the above decision, we noticed that in the relevant assessment year, the assessee has 51 undertakings registered with STPI and customs authorities and in our view, as held by the Hon'ble High Court that the court ruled that an assessee can raise a claim on the merits of the law, even if they had not challenged a lower authority's view on the same claim in a previous assessment year. Therefore, we are inclined to remit this issue back to the AO to verify the claim of the assessee as per law and also to verify whether the assessee establishes that the 51 units constitute separate undertakings for the purposes of section 10A in order to claims made in the revised return after giving assessee a reasonable opportunity of being heard. We are inclined to remit the whole issue back to the file of AO and accordingly allowed for statistical purposes.

186. Ground Nos.5 to 5.3 and 6 to 6.2, Grounds No.7 to 7.3 and 8 to 8.2 and Grounds No.3.1 to 3.2 in AYs 2009-10, 2010-11 and 2011-12 are with regard to reducing 60% of expenses incurred in foreign currency from the 'Export Turnover' and reducing link charges attributable to delivery of comuter software outside India from 'Export Turnover' without making similar adjustment from 'Total Turnover'.

187. At the time of hearing, ld. AR of the assessee submitted that ITAT has allowed these grounds in AYs 2006-07 and 2007-08 following the order of AY 2005-06. In this regard he brought to our notice pages 16 to 19 and 27 of the decision of the coordinate

bench in the case of assessee's own case for the AY 2006-07 and AY 2007-08 and also brought to our notice decision of Hon'ble Supreme Court in the assessee's own case (2018) CIT Vs HCL Technologies Ltd 404 ITR 719 (SC). He submitted that the above issue is squarely covered in favour of the assessee.

188. On the othre hand, ld. DR of the Revenue relied on the findings of lower authorities.

189. Considered the rival submissions and material avialable on record. We observed that the issue under consideration is squarely covered in favour of the assessee, the relevant findings of the coordinate bench in AY 2006-07 are reproduced below:

> "6.7 We have heard the rival contentions, and perused the material available on record. This issue had come up in the case of the assessee for A.Y. 2004-05, as noted by the AO in the assessment order and also in A.Y. 2003-04 and on similar facts, the coordinate bench of the Tribunal, in assessee's own case in ITA No. 5023/Del/2010 for A.Y. 2005-06 vide order dated 30.05.2014 in para no. 8 and 9 allowed similar grounds raised by the assessee and directed the AO to grant necessary relief. The above findings of the Tribunal, are reproduced as under:
>
> > "8. On a perusal of Ground No-4 to 4.4 agitated by the assessee it is seen that the assessee has assailed the action of the AO in calculating the amount of deduction allowable u/s 10A of the activity by reducing the expenses incurred in foreign currency for providing technical services. The draft order on this point was confirmed by the DRP leading to the passing of the order under challenge. It is seen that the issue had been decided in assessee's favour by the Tribunal in the immediately preceding assessment year which was not unsettled by the Hon'ble High Court. Only because SLP filing was under consideration the issue was kept alive by the AO. In the afore-mentioned peculiar facts and circumstances the reliance by the assessee on the order dated 23.01.2009 in ITA Nos.-3199 & 3144/Del/07) which view was also taken in 2003-04 assessment year and considering the departmental stand wherein reliance is placed on the orders of the authorities below and no contrary decision or judgement is cited disputing the view taken in the order to deviate from the stand taken by the ITAT we deem it appropriate since facts, circumstances and reasoning is identical to restore the issue back to the AO by allowing the ground raised and directing the AO to grant necessary relief following the orders of the ITAT wherein we note that the view take in 2003-04 A. Year has been considered by the Hon'ble High Court.
> >
> > 9. The next issue addressed by the assessee is set out in Ground No-5 to 5.2 wherein the action of the Assessing Officer has been assailed on the ground that the AO has from the calculation of deduction allowable u/s 10A of the Act reduced the "data link charges" incurred for delivery of computer software outside India from "Export

> Turnover" without making corresponding adjustment from the "Total Turnover". The said issue was also decided by the AO against the assessee in order to keep the issue alive despite the fact that it was brought to the notice of the AO that it had been decided in assessee's favour by the Tribunal in the assessee's own case for 2004-05 assessment year. The Ld. Special Counsel herein also placed reliance upon the assessment order and the factual issue having been considered by the Tribunal was not disputed. In the circumstances respectfully following the order of the Tribunal in 2004-05 assessment year, the ground raised is allowed and the AO is directed to grant necessary relief."
>
> (emphasis supplied by us)
>
> 6.8 Respectfully following the decision, the AO is directed to allow the claim of the assessee after due verification in the event of assessee succeeding in appeal in ground no. 2 to 2.16 of this appeal on further appeal if any filed by the assessee. Ground nos. 3 to 3.3 and 4 to 4.2 of the appeal are allowed as above."

Respectfully, following the above decision, we are inclined to allow the grounds raised by the assessee.

190. Ground Nos.7 to 7.1, Grounds No.9 to 9.1 and Grounds No.4.1 to 4.8 in AYs 2009-10, 2010-11 and 2011-12 are with regard to disallwoacne u/s 14A of the Act.

191. In this regard, since the facts are common, we take facts from AY 2009-10. In this assessment year, tax free income was Rs.7,20,67,775/- and suo motu disallowance was made of Rs.4,35,018/-. The AO considered and accepted the computation of *suo motu* disallowance of treasury expenses by the assessee and did not reject the same. However, the AO invoked Rule 8D and computed disallowance as under:

| | |
|---|---|
| Disallowance under Rule 8D(2)(i) | Rs.4,35,018 |
| Disallowance under Rule 8D(2)(ii) | Rs.1,08,080 |
| Disallowance under Rule 8D(2)(iii) | Rs.44,85,858 |
| **Total disallowance** | **Rs.50,28,956** |

192. At the time of hearing, ld. AR submitted that no satisfaction was recorded by the Assessing Officer. He submitted that the AO erred in re-computing the disallowance under section 14A as per Rule 8D of the Rules, whereas at the same time, also specifically accepting the computation of *suo motu* disallowance made by the assessee. It is submitted that in terms of the unequivocal provisions of section 14A(2)

of the Act, resort can be made to rule 8D of the Rules only when the AO is not satisfied with the *suo motu* disallowance made by the assessee. The same has also been time and again reiterated by the Courts. Reliance in this regard is placed on the following decisions:

- Godrej & Boyce Manufacturing Company Ltd. vs DCIT: 394 ITR 449 (SC)
- Maxopp Investment Ltd vs CIT: 402 ITR 640 (SC)
- Joint Investments Pvt Ltd vs CIT: 372 ITR 694 (Del)
- HT Media Ltd vs Pr. CIT: 399 ITR 576 (Del)
- DCIT vs Nestle India Ltd: ITA No.2020/Del/2014 decided on 22.07.2020 (Del Trib.)
- Coforge Ltd vs ACIT: 436 ITR 546 (Del)

193. He further submitted that onus is on Revenue to bring on record the nexus between expenditure and exempt income and in this regard,

- CIT vs Walfort Share & Stock Brokers: 326 ITR 1 (SC)
- Chemical & Metallurgical Design Co Ltd: ITA No. 803/2008 (Del)
- CIT vs Ms. Sushma Kapoor: 319 ITR 299 (Del)
- CIT vs IP Support Services India (P) Ltd: ITA 283/2014 (Del)
- DCIT vs Maharashtra Seamless Ltd: ITA No. 4063/Del/06 (Del Trib.)
- Minda Investments Ltd.: ITA No.4046/Del/09 (Del Trib.)

194. He submitted that when there are surplus funds lying with the assessee, borrowed funds cannot be presumed to be used for investment purposes. In this regard, he submitted that the **Hon'ble Supreme Court in the case of South Indian Bank Ltd vs CIT: 438 ITR 1 (SC)**,held that where interest free own funds available with assessee exceeded their investments in tax-free securities; investments would be presumed to be made out of assessee's own funds and proportionate disallowance was not warranted under section 14A. He further submitted that similar view has been taken by the Supreme Court in the case of **PCIT vs Sintex Industries: [2018] 255Taxman171 (SC)** wherein it was held that where assessee had surplus funds against which investment was made, no question of making any disallowance of expenditure under section 14A of the Act arose and therefore, there was no question of any estimation of expenditure under Rule 8D of the Income-tax Rules, 1962.

195. Similar view has been taken in the following cases:

- East India Pharmaceutical Works Ltd vs CIT: 224 ITR 627 (SC)
- PCIT vs PTC India Financial Services Ltd: [2022] 449 ITR 309 (Del)
- CIT vs UTI Bank Ltd: [2013] 32 taxmann.com 370 (Guj)
- Indian Explosives Ltd vs CIT: 147 ITR 392 (Cal)
- Woolcombers of India Ltd vs CIT: 134 ITR 219 (Cal)
- CIT vs Max India Ltd: ITA No. 186 of 2012 (P&H)

196. Further he submitted that no disallowance of interest expenditure in case of mixed pool of funds. In this regard, reliance is also placed on the following decisions wherein, while applying the aforesaid theory of mixed pool of funds and presumption drawn in favour of the assessee qua utilization of borrowed funds and interest free funds for investment in shares, the disallowance of interest expenditure made under section 14A read with Rule 8D of the Rules has been deleted:

- Tata Chemicals Ltd. vs DCIT: 72 ITD 1 (Mum); affirmed in CIT vs Tata Chemicals Ltd: 256 ITR 395 (Bom)
- CIT vs Reliance Utilities: 313 ITR 340 (Bom)

197. In view of the above, he submitted that interest paid on borrowed funds had no nexus with the investment made in shares/ securities and, therefore, no portion of the same was relatable to making investments for the purposes of disallowance under section 14A of the Act. Thus, disallowance made under Rule 8D(2)(ii) is unsustainable.

198. On the other hand, ld. DR of the Revenue supported the detailed findings of lower authorities.

199. Considered the rival submissions and material placed on record. We observed that the assessee had earned substantial exempt income of Rs. 7.21 crores and suo moto disallowed only Rs. 4.35 lakhs. The above suo moto disallowance itself is disproportional. The apparently the facts clearly indicate that the AO had not accepted the submissions of the assessee, the AO had clearly discussed in his order and recorded the satisfaction. Therefore, the assessee cannot find fault in not recording the dissatisfaction separately in so many words. The facts are different in each case. Therefore, the AO had already recorded the satisfaction, we are inclined to reject the above submissions of the assessee.

200. Coming to the facts on record, we observed that the AO had disallowed u/s 14A as under:

| | |
|---|---|
| Disallowance under Rule 8D(2)(i) | Rs.4,35,018 |
| Disallowance under Rule 8D(2)(ii) | Rs.1,08,080 |
| Disallowance under Rule 8D(2)(iii) | Rs.44,85,858 |
| **Total disallowance** | **Rs.50,28,956** |

As far as suo moto disallowance sustained by the AO u/r 8D(2)(i), we are sustaining the same and with regard to interest expenses disallowed by the AO, in our view, the courts have already settled the issue that when the excess funds are available in the business which are interest free and the investments are made are less than the above surplus funds, the presumption is that the interest free funds were available with the assessee to make such investments. As held in the case of South Indian Bank Ltd vs CIT: 438 ITR 1 (SC). Further it was also held that when there is mixed funds of interest bearing and interest free in the business, when the assessee demonstrate that the interest bearing funds were actually utilized for the purposes of business then also no disallowance can be made u/s 14A of the Act. In the given case, the assessee had already demonstrated that the assessee controls substantial funds in the form of interest free funds in the business. Therefore, we are inclined to allow the submissions of the assessee relating to rule 8D(2)(ii) of the Rules.

201. With regard to disallowance made u/r 8D(2)(iii) relating to administrative expenses, we observed that the assessee made detailed submissions on the issue of satisfaction and did not make detailed submissions relating to this aspect before us. Since this issue also settled by the various courts, the rule 8D was effective from AY 2008-09, the administrative expenditure @ 0.50% of the investments which actually earned exempt income. In order to meet the ends of justice, we are inclined to direct AO to disallow 0.50% of the investments which actually derived the exempt income, in case the AO had adopted the total investments to determine the above disallowance, which

was made in this year, the same may be revised to give above directions. Therefore, the above issue is allowed for statistical purposes.

202. Accordingly, Ground Nos.7 to 7.1 in AY 2009-10 are partly allowed in above terms.

203. Similarly, Grounds No.9 to 9.1 and Grounds No.4.1 to 4.8 in AYs 2010-11 and 2011-12 are partly allowed in view of our above findings in Grounds No.7 to 7.1 in AY 2009-10.

204. Grounds No.8 to 8.4, Grounds No.10 to 10.5 and Grounds No.5.1 to 5.5 in AYs 2009-10, 2010-11 and 2011-12 are with regard to disallowance of ESOP expenses incurred and addl. claim for enhanced claim of ESOP expenditure.

205. At the time of hearing, ld. AR of the assessee submitted that ITAT in AYs 2006-07 and 2007-08 allowed these grounds following the decision of various High Courts. He further submitted that ITAT allowed enhanced ESOP deduction with directions to the assessee to furnish necessary information before the Assessing Officer regarding additional expenditure and directed the Assessing Officer to allow the same upon verification.

206. On the other hand, ld. DR of the Revenue did not controvert the submissions of the ld. AR of the assessee.

207. Considered the rival submissions and material available on record. We observed that ITAT in AYs 2006-07 and 2007-08 has dealt with this issue and decided the issues in favour of the assessee vide para nos.11 to 11.10 relating to ESOP expenses at pages 60 to 73 of the decision and 11.11 to 11.12 relating to enhanced claim of the ESOP expenditure at pages 74 to 75 of the decision. Since, the facts are exactly similar in the impugned assessment years, we are inclined to allow the grounds raised by the assessee in the appeals in the years under consideration i.e., AY 2009-10, 2010-11 and AY 2011-12.In the result, grounds raised by the assessee in all the years under consideration are allowed.

208. Grounds No.9 to 9.2, Grounds No.11 to 11.2 and Grounds No.6.1 to 6.4 in AYs 2009-10, 2010-11 and 2011-12 are with regard to disallowance of payment of software licence fee.

209. At the time of hearing, ld. AR submitted that ITAT in assessee's own case in AYs 2006-07 and 2007-08 set aside this issue to the AO for denovo consideration; AO to

undertake factual verification whether software purchased by the assessee were 'off-the shelf software' for the smooth functioning of the assessee's business operation.

210. On the other hand, ld. DR of the Revenue did not controvert the submissions of the ld. AR of the assessee.

211. Considered the rival submissions and material available on record. We observed that ITAT in AYs 2006-07 and 2007-08 has dealt with this issue and decided on the issues in favour of the assessee vide para nos.12 to 12.8 at page nos.75 to 80. We are inclined to remit this issue also to the file of AO to factually verify the claim of the assessee and allow the claim made as per law after due verification. In the result, grounds raised by the assessee are allowed for statistical purposes.

212. Grounds No.10 to 10.2, Grounds No.12 to 12.2 and Grounds No.7.1 to 7.4 in AYs 2009-10, 2010-11 and 2011-12 are with regard to disallowance of forex loss incurred on premature unwinding of the forward covers taken by the assessee.

213. At the time of hearing, ld. AR submitted that ITAT in assessee's own case in AYs 2006-07 and 2007-08 allowed this ground following the decision of Hon'ble Delhi High Court in the case of PCIT vs. Simon India Ltd. (2022) 450 ITR 316 (Del.)

214. On the other hand, ld. DR of the Revenue did not controvert the submissions of the ld. AR of the assessee.

215. Considered the rival submissions and material available on record. We observed that ITAT in AYs 2006-07 and 2007-08 has dealt with this issue and decided the issues in favour of the assessee vide para nos.19 to 19.8 at page nos.144 to 173. Respectfully, following the same, we are inclined to allow the grounds raised by the assessee in all the appeals under consideration.

216. Grounds No.11 to 11.1in AY 2009-10 are with regard to disallowance of unrealized foreign exchange loss on account of MTM restatement of forward covers outstanding as at the end of the year.

217. Brief facts of the case are, the assessee is engaged in the business of development/ provision of computer software/ ITES and derives revenue mainly from export thereof. Since the entire amount of export proceeds is received by the Assessee in foreign currencies (which majorly include USD, GBP and Euro), the Assessee is exposed to significant foreign exchange risks, which create significant uncertainties and volatility for operating margins and top line revenue of the Assessee.

218. The Assessee, accordingly, follows a strategy of hedging foreign currency denominated export realizations by taking forward covers consistent with the Risk Management Policy of the Assessee. Such forward covers taken by the Assessee usually have a maturity period ranging from one month to twenty months to hedge the foreign exchange risk associated with the forecasted export realizations, which are expected to be realized during the corresponding period.

219. Such forward covers are not used by the Assessee for speculative purposes. This is categorically stated in the Management Discussion section of the published Annual Reports of the Assessee for financial years 2007-08 and 2008-09, relevant to the subject assessment year. It is submitted that it is common commercial practice in Export/ IT industry to hedge future forecasted revenue and all peers of the Assessee also take hedges for the forecasted forex revenue.

220. As a Board mandated policy, the Assessee neither speculates in foreign currency nor is it permitted to do so by the RBI. The decision as to what future period of forecasted revenue should be hedged is taken by the management in consultation with external advisors. HCL follows a dynamic portfolio management policy where the forward covers taken are also rolled over or cancelled from time to time to match the cover's duration with the future foreign exchange inflow.

221. During the relevant previous year, the Assessee incurred unrealized foreign exchange loss of Rs.133.68 crores on account of Marked to Market ("**MTM**") restatement of forward covers outstanding as at the end of the year. The AO/ DRP disallowed the loss claimed by holding the same to be contingent and notional loss instead of real loss, by relying on CBDT Instruction No.3/2010 dated 23.03.2010.

222. At the time of hearing, ld. AR submitted that forward exchange contracts were booked in the normal course of business and the loss arising on account of MTM restatement of the forward covers was incidental to the Assessee's regular course of business. Since the Assessee is engaged in the business of development of software only, the act of entering into the forward contracts by the Assessee with its bankers to hedge the future foreign currency fluctuation risk cannot be deemed to be a separate/ speculative business of the Assessee.

223. He further submitted that as per Accounting Standard ("**AS**") 11 read with recommendatory AS 30 issued by the Institute of Chartered Accountants of India

("**ICAI**"), companies are required to account for their Mark to Market losses in their books, despite the fact that the contract has not yet matured as on the balance sheet date.

224. He submitted that **Hon'ble Supreme Court** in the case of **PCIT vs Emmsons International Ltd: SLP(C) Diary No(s). 49827/2023** dismissed the SLP filed by the Revenue against the decision of the **Delhi High Court in ITA 318/2012,** wherein, the High Court held that losses on restatement of foreign exchange contracts at the balance sheet date on account of exchange fluctuation is an allowable deduction. Further, the High Court also discussed the applicability of **CBDT Instruction No.3/2010** and held as under:

> *"6. As far as the finding of the ITAT that the CBDT Circular No.3/2010 dated 23rd March, 2010 is contrary to the judgment*
>
> *of the Supreme Court in Oil and Natural Gas Corporation Ltd., Dehradun though Managing Director Vs. The Commissioner of Income Tax, Dehradun (supra) and CIT Vs. Woodward Governor India Ltd (supra), this Court is of the view that the same was not called for, as the said CBDT Instruction has been issued in respect of loss on account of trading in foreign exchange derivatives.* ***In the present case, however, the assessee had entered into derivative contracts in order to hedge its exchange risk in respect of export proceeds receivable by it in foreign exchange. Forward contracts entered into by the assessee were not by way of trading per se in foreign exchange derivatives. Consequently, CBDT Circular No.3/2010 dated 23rd March, 2010 has no application to the facts of the present case****."*
>
> (emphasis supplied)

225. He submitted that in the case of the Assessee, the forward contracts were booked to hedge against the foreign currency fluctuation risk relating to business transactions, viz., export orders undertaken by the Assessee or estimated to be undertaken in the future and hence, the aforesaid hedge cover was incidental to its business. Further, since the forward contracts were related to the export proceeds expected to be received in the course of business and not for acquisition of any capital asset, the loss arising on the same would be on revenue account. It is further submitted that the Assessee had entered into binding contract enforceable in law in the nature of foreign exchange derivative cover. As on the balance sheet date, viz., 31.03.2009, the Assessee incurred losses in view of adverse exchange fluctuations. Such losses, under

the mercantile system of accounting, would be allowable deduction, notwithstanding that the same have not been actually paid. The contention of the Revenue that such loss represented notional loss is, it is respectfully submitted, erroneous and contrary to the decisions of the Supreme Court discussed supra, particularly the decision in the case of **Woodward Governor: 312 ITR 254 (SC)**.

226. He further submitted that the Courts have consistently held that the loss/ gain on account of "mark to market" arising as a result of revaluation of the unmatured forward contracts entered into the normal course of business at the end of the accounting period is allowable business deduction:

- PCIT vs DSP Merill Lynch Capital Ltd: [2023] 153 taxmann.com 178 (SC)
- PCIT vs Vedanta Ltd: [2022] 448 ITR 732 (SC)
- PCIT vs Suzlon Energy Limited: [2018] Tax appeal No. 1000/2017 (Guj) - SLP dismissed in SLP(C) No. 1422/2019 (SC)
- Oil & Natural Gas Corpn. Ltd vs CIT: [2010] 322 ITR 180 (SC)
- DCIT vs Bank of Bahrain and Kuwait: 132 TTJ 505 (Mum Trib.) (SB)
- Bechtel India (P) Ltd vs ACIT: [2013] 33 taxmann.com 213 (Del Trib.)
- VVF (India) Ltd vs ACIT: [2021] 190 ITD 843 (Mum Trib.)
- IndusInd Bank Ltd vs ACIT: ITA No. 931/Mum/2004 (Mum Trib.)
- ACIT vs H. Dipak and Co : ITA No. 7629/Mum/2011 (Mum)
- ADIT vs British Bank of Middle East : [2011] 44 SOT 109 (URO) (Mum)
- ADIT vs Development Bank of Singapore : [2011] 46 SOT 122 (URO) (Mum)
- JCIT vs Dena Bank : [2011] 139 TTJ 81 (Mum)
- Shinhan Bank vs DDIT: [2012] 54 SOT 140 (Mum)
- DCIT vs Banque Indosuez : [2013] 55 SOT 38 (Mum)
- Societe Generale vs DDIT : [2013] 21 ITR (Trib) 606 (Mum)
- Dresdner Bank AG Commerzbank, AG vs ADIT: [2013] 57 SOT 203 (Mum)

**Instruction No.3/2010 issued by CBDT – not applicable**

227. He submitted that as per the aforesaid Instruction, in respect of MTM losses, i.e., unrealized losses debited to the Profit & Loss account, the assessing officers have been instructed to disallow the same while computing the taxable income. As regards the actual or crystallized losses, the assessing officers have been instructed to verify whether the losses are on account of speculative transactions as specified under section 43(5) of the Act or whether contacts were used to hedge currency exposure.

228. He further submitted that the **Delhi High Court** in the case of **Munjal Showa: 382 ITR 555 (Del)** held that Instruction No.3/2010 cannot override the decisions of the Supreme Court/ High Courts on similar issues and that loss on foreign exchange

contracts was allowable business loss. Relevant extracts of the decision are reproduced hereunder:

> *"44. This has to be also appreciated in the context of the Assessee following the mercantile system of accounting and Section 145 of the Act.* ***The income of the Assessee is to be computed consistent with the regular method of accounting followed by the Assessee. The Assessee has been following AS-11 and AS-30 issued by the ICAI, in terms of which the loss/gains on outstanding derivatives contracts are to be recognized on mark to market basis. The Assessee is right in contending that CBDT Instruction No. 3 of 2010 cannot possibly override the existing decisions of the Supreme Court/ High Court on similar issues. The legal position in this regard has been explained in Ratan Melting (supra)*** *and has been reiterated in CIT v. Nagesh Knitwears (P.) Ltd. [2012] 345 ITR 135/210 Taxman 145 (Mag.)/22 taxmann.com 309 (Delhi) and CIT v. Indian Oil Co. Ltd. [2012] 210 Taxman 66/25 taxmann.com 284 (Bom.)."*
>
> (emphasis supplied)

229. Similar view has been taken by the Hyderabad Bench of the Tribunal in the case of **VST Industries Ltd vs ADIT (ITA No.647/Hyd/2012)** wherein it was held that CBDT Instruction No.3/2010 is not applicable to cases of MTM losses.

230. He further submitted that it is also pertinent to highlight here that the assessee had offered to tax gains from forward contracts in the following AYs, which was duly accepted by the AO:

**(In Rs. Crores)**

| AY | Gain arising on MTM |
|---|---|
| 2007-08 | 81 |
| 2010-11 | 599 |
| 2011-12 | 228 |
| 2013-14 | 6 |
| 2014-15 | 7 |

231. He thus submitted that once gains arising on account of MTM have been accepted by the AO, it is submitted that it is not permissible to disallow MTM loss. Reliance in this regard is placed on the following decisions wherein, following the principle of consistency, disallowance of MTM loss has been deleted observing that MTM gains offered to tax by the assessee were accepted by the AO:

- Woodward Governor *(supra)*
- VVF India *(supra)*
- ACIT vs Sopra India Pvt Ltd in ITA No.1175/Del/2019 (Del Trib.); decision dated 16.10.2023
- DCIT vs Asahi India Glass Limited in ITA No.2501/Del/2014 (Del Trib.); decision dated 14.05.2020

232. On the other hand, ld. DR of the Revenue did not controvert the submissions of the ld. AR of the assessee and relied on the findings of lower authorities.

233. Considered the rival submissions and material available on record. We observe that the forward contracts were booked to hedge against the foreign currency fluctuation risk relating to business transactions, viz., export orders undertaken by the Assessee or to be undertaken in the future and hence, the aforesaid hedge cover was incidental to its business. Since the forward contracts were related to the export proceeds expected to be received in the course of business and not for acquisition of any capital asset, the loss arising on the same would be on revenue account. It is further submitted that the Assessee had entered into binding contract enforceable in law in the nature of foreign exchange derivative cover and it will not enter into any contract in order to speculate the same. As on the balance sheet date, viz., 31.03.2009, the Assessee incurred losses in view of adverse exchange fluctuations. Such losses, under the mercantile system of accounting, would be allowable deduction, notwithstanding that the same have not been actually paid. Further we observed that the assessee is following the method of accounting regularly and the assessee had declared forex gain in the previously in AY 2007-08 and also declared substantial gain in the AYs 2010-11 and 2011-12, the revenue had accepted the same. Since the assessee is following the accounting standards governing the foreign currency transaction and also the CBDT circular, the various courts have upheld the method of accounting followed, the same is relied by the assessee in their submissions. Therefore, we are inclined to allow the grounds raised by the assessee in this regard.

234. Grounds No.12 to 12.1, Grounds No.13 to 13.1 and Ground No.8.1in AYs 2009-10, 2010-11 and 2011-12 are with regard to addition on account of static creditors written back.

235. At the time of hearing, ld. AR of the assessee brought to our notice relevant facts and made his submissions. He submitted that for the sake of brevity, the facts are briefed from AY 2009-10 as the issue is similar. He submitted that ITAT has restored this issue to the file of AO for necessary verification of the claim of the assessee regarding payment of the outstanding balances in the future years or the balance amount being offered for taxation in the future years, as the case may be. He submitted that the AO made addition of Rs.56,62,056/-holding the outstanding credit balance at the time of passing the assessment order to be income of the assessee allegedly on the ground that the liabilities in respect of same were no longer enforceable. He submitted that as on date, out of the total amount of outstanding balance of creditors, only an amount of Rs.2,93,341 is appearing in the books of the assessee as remaining to be paid. He further submitted that the balance amount waseither paid by the assessee or was written back and offered to tax under section 41 of the Act in the assessment year relevant for the previous year in which the same was written back, thus, disallowance of Rs.56,62,056 is grossly unsustainable. He placed reliance on the following cases wherein the Hon'ble Delhi High Court held that outstanding liability, unless unilaterally written-back in the books of account, cannot be treated as income under section 41(1) of the Act on the alleged ground that the same has become barred by limitation:

- CIT vs Hotline Electronics Ltd: 205 Taxman 245 (Del)
- CIT vs Shri Vardhman Overseas Ltd: 343 ITR 408 (Del)
- PCIT vs Soorajmul Nagarmull: [2022] 145 taxmann.com 245 (Cal)
- PCIT vs Eco Auto Components (P) Ltd: [2018] 409 ITR 202 (P&H)

236. On the other hand, ld. DR of the Revenue relied on the detailed findings of lower authorities.

237. Considered the rival submissions and material placed on record. We observed that the coordinate bench had remitted this issue back to the file of AO to verify the claim of the assessee in the appeal in the AY 2006-07 at para 20 to 20.6 of the order at pages 173 to 179. Respectfully following the same, we also remit this issue back to the file of AO to verify the claim of the assessee as per law and directed to follow the directions given in the decision in assessee's own case in the previous AYs. In the

result, grounds raised by the assessee in all the appeals before us are allowed for statistical purposes.

238. Ground No.13, Ground No.14 and Ground No.12in AYs 2009-10, 2010-11 and 2011-12 are with regard to interest charged under section 234B/234D of the Act. These grounds are consequential in nature, hence the same are not being adjudicated at this stage.

239. Ground No.10.1 in AY 2011-12 is with regard to addition on account of TDS credit on deferred revenue.

240. At the time of hearing, ld. AR of the assessee submitted that having regard to the nature of the business, it is a common practice on the part of the Appellant that during any financial year, some part of the revenue is deferred to subsequent financial year(s) and revenue being deferred in earlier financial year(s) is booked as revenue in the relevant financial year. He further submitted that the AO did not allow credit of TDS in respect of deferred revenue on the ground that corresponding income is not offered for tax by the Appellant in the said year. He submitted that in terms of section 199 of the Act, the AO held that such TDS will be allowed in the year the corresponding income is offered for tax by the assessee. He submitted that further, the assessing officer also added the amount of TDS to the total income of the Appellant. He further submitted that **Tribunal in the case of HCL Comnet SSL (ITA No.3211/Del/2017)**, decided identical issue as under:

> *"23. We have given thoughtful consideration to the orders of the authorities below. We find that section 199(3) of the Act gives power to the Board to make such rules for the purposes of giving credit in respect of tax deducted or tax paid in terms of provisions of the Act and also A.Y for which such credit may be given. Rule 37BA(3)(ii) provides that where tax has been deducted at source and paid to Central Government and income is sustainable over a number of years, credit for tax deducted at source shall be allowed across those years in same proportion in which income is assessable to tax.* ***We, accordingly, direct the Assessing Officer to give proportionate credit of TDS for the income declared during the year under consideration. With these directions, Ground no. 3 is allowed.****"*

241. He submitted that aforesaid decision was followed by the Hon'ble Tribunal in HCL Comnet Ltd (ITA No.1113/Del/2017). He submitted that the facts emanating in the aforesaid cases and the present case being same, it is respectfully submitted that

similar direction may be given to the assessing officer to allow credit for tax deducted at source proportionately across those years in which income is assessable to tax, in terms of Rule 37BA(3)(ii) of the Rules.

**Re: Addition of TDS credit**

242. Further, it is submitted that in addition to disallowing credit of TDS in respect of deferred revenue, the AO also made addition to the total income of the assessee on account of such TDS credit. It is submitted that the assessee did not debit the said TDS credit in its profit & loss account and therefore, no addition is required to be made on account of the same. He submitted that the assessee only made claim for credit of such TDS, being prepaid taxes, and at the maximum, such claim of credit can be rejected. He submitted that the addition made to the total income of the assessee by the AO on account of TDS credit claimed on deferred revenue, thus, deserves to be deleted.

243. On the other hand, ld. DR of the Revenue relied on the findings of lower authorities.

244. Considered the rival submissions and material placed on record. Since the issue raised before us needs factual verification and the coordinate bench had decided the similar issue in the case of HCL Comnet SSL (supra), we are inclined to remit this issue to the file of AO verify the claim of the assessee and allow the claim as per law. In the result, grounds raised by the assessee are allowed for statistical purposes.

245. Additional Ground in all the three AYs i.e. 2009-10, 2010-11 and 2011-12 raised with regard to not restricted the levy of dividend distribution tax on the dividend distributed/paid to the non-resident shareholder(s), to the rate specified under Article 10 of the relevant Double Taxation Avoidance Agreements.

246. At the outset, ld. AR submitted that this ground is allowed by the ITAT in AYs 2006-7 and 2007-08 following the decision of Hon'ble Bombay High Court in the case of Colorcon Asia Pvt. Ltd. vs. JCIT : (2025) 181 taxmann.com 301 (Bombay.

247. On the other hand, ld. DR of the Revenue did not controvert the submissions of the ld. AR.

248. Considered the rival submissions and material placed on record. The issue under consideration is allowed by the coordinate bench in AY 2006-07 and 2007-08 in the additional grounds raised by the assessee. Since the facts are exactly similar to the facts in the present appeals, we are inclined to allow the above additional grounds

raised before us. In the result, all the additional grounds raised before us in the AY 2009-10 to AY 2011-12 are allowed.

249. Additional Ground in all the three AYs i.e. 2009-10, 2010-11 and 2011-12 is with regard to Education Cess is not pressed by the assessee, hence the same is dismissed as not pressed.

250. Additional Ground along with additional evidences in all the three AYs i.e. 2009-10, 2010-11 and 2011-12 raised with regard to enhanced deduction u/s 10A/10AA/10B of the Act qua interest and other income derived from investment of surplus funds.

251. Ld. AR submitted that the ITAT allowed the additional grounds of appeal in AYs 2006-07 and 2007-08 following the decisions of various High Courts, including in the case of **Hewlett Packard: 403 ITR 453 (Kar)(FB); Riviera Home: 237 Taxman 520 (Del)& Dishman Pharmaceuticals: [2019] 417 ITR 373 (Del)**. He submitted that the AO is directed to verify that income arising to the assessee in respect of interest on fixed deposits from bank, investment from mutual funds and similar other items is out of internal accrual of the funds of the assessee, before allowing the deduction claimed by the assessee.

252. On the other hand, ld. DR of the Revenue did not controvert the submissions of the ld. AR.

253. Considered the rival submissions and material placed on record. The issue under consideration is allowed by the coordinate bench in AY 2006-07 and 2007-08 vide ITA No.5624/D/2010 and ITA No.5465/D/2011 dt. 15.4.2026 in the additional grounds raised by the assessee. Since the facts are exactly similar to the facts in the present appeals, we are inclined to allow the above additional grounds raised before us. In the result, all the additional grounds raised before us in the AY 2009-10 to AY 2011-12 are allowed.

254. Additional Ground alongwith additional evidence in the AYs 2009-10 and 2010-11 and Ground Nos.9.1 to 9.1 in AY 2011-12 raised with regard to claim of FTC in respect of income deductible in India under section 10A/10AA of the Act.

255. Ld. AR submitted that the ITAT admitted additional evidence and allowed additional GOA filed for enhanced FTC in assessee's own case in AYs 2006-07 and 2007-08, on the basis of decision of Karnataka High Court in the case of **Wipro Ltd: 382 ITR 179**

**(Kar)** & Delhi High Court in the case of **HCL Comnet SSL: ITA No.549/2022 (Del HC)**, subject to verification of additional evidence.

256. On the other hand, ld. DR of the Revenue did not controvert the submissions of the ld. AR.

257. Considered the rival submissions and material placed on record. The issue under consideration is allowed by the coordinate bench in AY 2006-07 and 2007-08 in the additional grounds raised by the assessee by accepting the additional evidence. Since the facts are exactly similar to the facts in the present appeals, the additional evidence are admitted and the same remitted back to the file of AO to verify the above additional evidence and allow the claim of the assessee after due verification as per law as decided by the coordinate bench in AY 2006-07 and AY 2007-08, therefore, we are inclined to allow the above additional grounds raised before us with the above directions. In the result, all the additional grounds raised before us in the AY 2009-10 to AY 2011-12 are allowed for statistical purposes.

258. In the result, all the appeals filed by the assessee are allowed for statistical purposes.

**Order pronounced in the open court on this 30th day of July, 2026**

| | |
|---|---|
| **Sd/-** | **sd/-** |
| **(RAJ KUMAR CHAUHAN)** | **(S.RIFAUR RAHMAN)** |
| **JUDICIAL MEMBER** | **ACCOUNTANT MEMBER** |

**Dated: 30.07.2026**
**TS**

Copy forwarded to:
1. Assessee
2. Respondent
3. CIT
4. CIT(Appeals).
5. DR: ITAT

ASSISTANT REGISTRAR
ITAT, NEW DELHI