i. Gate Global Solutions Ltd. Vs. Assistant Commissioner of Income

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Court : Income Tax Appellate Tribunal ITAT

Decided On : Nov-27-2007

Reported in : (2007)112TTJ(Bang.)1002

Judge : P Mohanarajan, N Kalra

Appellant : i. Gate Global Solutions Ltd.

Respondent : Assistant Commissioner of Income

Judgement :

1. The assessee has filed the appeals against the order of learned CIT(A)-I, Bangalore dt. 19th Dec, 2006 and 6th Jan., 2007. Some of the grounds of appeal for both the assessment years are the same, therefore, these appeals are being decided by a single consolidated order.

2. One of the common ground of appeal raised is that the learned CIT(A) has erred in concluding 80 per cent of the uplinking charges are to be reduced from export turnover in arriving at the amount of deduction eligible under Section 10A.3. The learned CIT(A) during the course of appellate proceedings referred to the definition of export turnover as given in Clause (iv) of Expln. 2 below Section 10A(8). From the consideration received, freight, telecommunication charges or insurance attributable to delivery of software have to be reduced. The learned CIT(A) noticed that no expenditure was reduced from the export turnover. Hence, it was indicated to the learned Authorised Representative that income has to be enhanced. Expenditure on delivery of software has not been reduced from the

export turnover. Before the learned CIT(A), the assessee made the following submissions in respect of the above issue: Link lines are obtained using a WAN (wide area network). The WAN provides video, data and voice connectivity services across a large geographical area from iGate locations in India. A wide area network (WAN) or leased line link includes communication lines and equipment upto and including the router at a particular end user site, excluding local area networks (LANs). Our links are connected between offices as well as to our overseas collocation centres. AT&T provides a rack space specifically for iGate. IGate will use this rack space through the telecom infrastructure/telecom lines and put the network equipments in that rack and, finally, connect to the end customer.

These link lines are required to receive inputs i.e. (raw data and information) from the customer who is based outside and to transmit the software outside India which is based on the inputs received from the customer.

1. Transfer in i.e. receiving raw data and information from the customer.

At any given point of time; the raw data and information received from the customer is very voluminous and requires 60 per cent of the time whereas the software transmitted to the customers is in a processed form and the same requires 40 per cent of the time.

However, so to say if not 40 per cent at least a minimum of 50 per cent of the leased lines will always be used for inbound transmission of data and balance 50 per cent of the leased lines will always be used for outbound transmission of data.

During the financial year 2001-02, as per the profit account total expenditure incurred on data processing transmission was Rs. 1,71,59,189., The break up of the same is as follows: S. Description Amount (in Rs.) 1.

Expenses towards computer consumables, office supplies, 47,24,974 2.

Expenses towards link charges 1,24,34,215 Total as per P&L a/c 1,71,59,189 As per the above Table, Rs. 1,24,34,215 is the link costs incurred out of which 50 per cent i.e. Rs. 62,17,108 can be considered as being telecommunication charges attributable to the delivery of computer software outside India.

4. The learned CIT(A) discussed the business model of software company with representatives of various companies. From the discussion, the learned CIT(A) gathered that in a software development product, initial discussions are held in the form of personal meetings and conferences.

Hence, for initial discussions, not much of the dedicated facilities utilized for inward transmission of data. Once the development work starts, the software developer has to continuously send data outwards.

In many instances, development of software is done in separate modules.

It is sometimes done by different individuals or entities. All the modules need not be developed from. India. Software development also includes modification of software already developed. The dedicated line is used for all such operations. The learned CIT(A), therefore, held that estimate of 50 per cent of data link charges as made by the assessee, as attributable to delivery of software is on the lower side.

The learned CIT(A) estimated it at 80 per cent of the uplinking charges.

5. On the above referred issue, we have heard both the parties. The details of expenses incurred towards link charges are available with the assessee company. It would not have been difficult for the assessee company to have asked the services provider to give the details of expenses incurred in transmitting information from India. The assessee could have obtained the details of expenses of outward transmission of data. When a specific information is available with the assessee and if the same is not produced, then adverse inference can be drawn. The assessee in the course of proceedings before the learned CIT(A) estimated such expenditure for transmission of data at 50 per cent of the expenditure on link charges. The learned CIT'(A) discussed the software development with a number of representatives of various companies. Facts as mentioned by the learned CIT(A) in his order have not been controverted by the learned Authorised Representative.

Therefore, we decline to interfere with the finding of the learned CIT(A) in estimating that 80 per cent of uplinking charges are to be reduced from the export turnover. Such finding is upheld for both the assessment years.

6. The second common grievance for the assessment year is that the learned CIT(A) has erred in not appreciating that uplinking charges reduced from the export turnover are also to be reduced from the total turnover.

7. The above referred issue has been decided by the Bangalore Bench in the following cases: The term 'total turnover' no doubt is not defined in s. 10A. However, the term 'total turnover' would be an enlargement of the term 'export turnover'. In other words, the sum total (of) export turnover and domestic turnover would constitute 'total turnover'.

The formula for computation of the deduction under Section 10A, when restated in the above manner, would be as under: Export turnover The term 'export turnover' would then be a component or part of the denominator; the other component being the domestic turnover. In other words, to the extent of 'export turnover' there would be a commonality between the numerator and denominator of the formula. In view of the commonality, the understanding should also be the same.

In other words, if the 'export turnover' in the numerator is to be arrived at after excluding certain expenses, the same should also be excluded in. computing the 'total turnover' in the denominator.

Though there is no definition of the term 'total turnover' in Section 10A, there is also nothing in the said section to mandate that what is excluded from the numerator (export turnover) would nevertheless form part of the denominator. One would have to apply consistent standards in understanding and applying a term, particularly when, such term, viz, export turnover has an independent function and at the same time a part of a larger term viz., total turnover. Thus, if some expenses, for any reason are excluded in arriving at the 'export turnover' the same should be reduced from 'total turnover' also.

Even otherwise, in the context of Section 80HHC whereunder a similar formula is applicable, it has been held that the components entering into export turnover and the total turnover should be the same. In other words, one should compare apples with apples and not apples with oranges.

9. Reliance was also placed on the number of judgments of the High Courts, vide which, it has been held that excise duty and sales-tax should not be included in the total turnover, as the same are not includible in the export turnover. The learned apex Court in the case of CIT v. Lakshmi Machine Works and in the case of CIT v. Cataphatma (India) (P) Ltd. (2007) 211 CTR (SC) 83 : (2007) 292 ITR 641 (SC) has held that excise duty and sales-tax are not includible in the total turnover. It was, therefore, held in the cases of Tata Elxsi (supra) and Infosys Technologies (supra) that expenditure incurred in foreign currency by the assessee should be excluded from the total turnover, as the same is not to be considered in export turnover. Following the same reasoning, it is held that uplinking charges which are reduced for ascertaining the export turnover are also not to be considered for the purposes of total turnover, as total turnover is sum total of export turnover and internal turnover.

10. This ground of appeal is common for both the assessment years and, therefore, the decisions mentioned will be applicable for both the assessment years.

11. Now, we will consider the grounds of appeal, which are relevant only for asst. yr. 2003-04.

12. The assessee is aggrieved against the finding of the learned CIT(A) that loss of one STP unit is to be set off from profits of other STP units along with deduction under Section 10A. The assessee company is having three STP(I) units located at Bangalore, Chennai, and Pune. From Pune unit, the assessee has shown loss. The AO has set off loss from Pune unit from the profits of Bangalore and Chennai units and has allowed deduction on the resultant profit. Before the learned CIT(A), it was contended that loss of unit at Pune should be disregarded and deduction under Section 10A should be allowed in respect of profits of other two units. Before the learned CIT(A), it was argued that the computation of deduction under

section is undertaking specific and has to be computed in isolation of other similar units. The learned CIT(A) has referred to Section 10A(6), according to which, the loss of Section 10A unit is to be carried forward and set off against profits of subsequent years. The learned CIT(A) has referred to the decision of the jurisdictional High Court in the case of CIT v. Himatasingike Seide Ltd. (2006) 206 CTR (Kar) 106 : (2006) 286 ITR 255 (Kar). In that case before the learned High Court, the assessee adjusted the unabsorbed depreciation against other business income. The learned High Court held that unabsorbed depreciation is to be set off against the profit eligible for deduction against Section 10B. The calculation of exemption cannot be at whims and fancies of the assessee for exemption of tax. The learned CIT(A) also referred to the decision of this Bench in the case of Sun Micro Systems and mentioned that the Tribunal has clearly held that Sections 70 and 71 are to be applied in arriving at eligible profit for the purposes of Section 10A. The learned CIT(A), therefore, held that provisions of Sections 70 and 71 are applicable for determining profits of the business for the purposes of Section 10A/10B.13. During the course of proceedings before us, the learned Authorised Representative referred to the decision of this Bench in the case of Webspectrum Software (P) Ltd. The ground of appeal raised by the Revenue in this appeal appearing in ITA No. 387/Bang/2006 was as under: The learned CIT(A) erred in directing the AO to allow the deduction under Section 10A without setting off of brought forward and current year losses of non Section 10A unit and also in directing the AO to allow to carry forward of losses of the non Section 10A unit.

Thereafter, he drew our attention to the findings given in para 11 of the order and these are reproduced for ready reference.

14. The learned Authorised Representative drew our attention to the reference of findings given in the case of CIT v. Canara Workshops (P) Ltd. of the order, while considering the appeal in the case of Webspectrum (supra), following observations were made from the case of Canara Workshops (P) Ltd. (supra).

80E. Deduction in respect of profits and gains from specified industries in the case of certain companies.-(1) In the case of a company to which this section applies, where the total income (as computed in accordance with the other provisions of this Act) includes any profits and gains attributable to the business of generation or distribution of electricity or any other form of power or of construction, manufacture or production of any one or more of the articles or things specified in the list in the Fifth Schedule, there shall be allowed a deduction from such profits and gains of an amount equal to eight per cent thereof, in computing the total income of the company.

15. The learned Authorised Representative further submitted that principle of interpretation in respect of incentive provision is that beneficial provision should be liberally construed. The learned Authorised Representative thereafter drew our attention to the decision of this Bench in the case of Asstt. CIT v. Yokogawa India Ltd., ITA No.1802/Bang/2005 [reported at (2007) 111 TTJ (Bang) 548-Ed], Our attention was drawn to the following observation: The deduction is in respect of profits and gains and the word 'such' mentioned before the profits and gains refers to the profits and gains of the undertaking, which is related in the export of articles or things or computer software. Before the word 'undertaking', it is qualified by the word 'an'. It means that it refers to a single undertaking.

Hence, business losses of the undertaking whose income is not exempt under Section 10A cannot be set off to ascertain the profits and gains derived by an undertaking from the export of computer software. Hence, business losses of other units will not be set off against the profits of the undertaking engaged in export of computer software for the purposes of determining the allowable deduction under Section 10A of the IT Act.

Profits and gains of the software services divisions will be exempt under s. 10A without setting off the loss of other division or the setting off of carry forward losses of other division.

16. On the other hand, the learned Departmental Representative supported the order of the learned CIT(A).

17. We have heard both the parties. Before proceeding further, it will be relevant to reproduce Section 10A(1).

Section 10A. Special provision in respect of newly established undertakings in free trade zone, etc.--(1) Subject to the provisions of this section, a deduction of such profits and gains as are derived by an undertaking from the export of articles or things or computer software for a period of ten consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce such articles or things or computer software, as the case may be, shall be allowed from the total income of the assessee: Provided that where in computing the total income of the undertaking for any assessment year, its profits and gains had not been included by application of the provisions of this section as it stood immediately before its substitution by the Finance Act, 2000, the undertaking shall be entitled to deduction referred to in this Sub-section only for the unexpired period of the aforesaid ten consecutive assessment years: Provided further that where an undertaking initially located in any free trade zone or export processing zone is subsequently located in a special economic zone, by reason of conversion of such free trade zone or export processing zone into a special economic zone, the period of ten consecutive assessment years referred to in this Sub-section shall be reckoned from the assessment year relevant to the previous year in which the (undertaking began to manufacture or produce such articles or things or computer software) in such free trade zone or export processing zone: Provided also that for the assessment year beginning on the 1st day of April, 2003, the deduction under this sub-section shall be ninety per cent of the profits and gains derived by an undertaking from the export of such articles or things or computer software: Provided also that no deduction under this section shall be allowed to any undertaking for the assessment year beginning on the 1st day of April, 2010 and subsequent years.

18. Section 10A(4) has also been amended w.e.f 1st April, 2001. Before amendment, the profit derived from export of articles or things was the amount which bears to the profit of the business, the same proportion as the export turnover in respect of such article or thing or computer software, bears to the total turnover of the business. With effect from 1st April, 2001, instead of profits of the business, the words 'profit of the business of the undertaking' have been substituted. The word 'undertaking' has not been defined under Section 10A. The words 'industrial undertaking' have been defined in the book Law Lexicon by

Venkataramiya, at p. 1133 it has been defined as under: The expression 'industrial undertaking' must have a technical and economic content. An industrial undertaking would normally be in its ordinary acceptation some industrial concern or enterprise for adventure which is undertaking to be done by the person concerned.

The definition of 'industrial undertaking' in Section 3(d) of the Industrial Development and Regulation Act, 1951, means 'any undertaking pertaining to a scheduled industry carried on in one or more factories by any person or authority including Government.--CIF v. Textile Machinery Corporation Ltd. , see also Union of India v. Sakseria Cotton Mills Ltd. (1973) 75 Bom. L.R. 100 at p. 105.

19. Industrial undertaking has been defined in Section 33B of the IT Act for that section. As per this definition, 'industrial undertaking' means an undertaking, which is mainly engaged in the business of generation or distribution of electricity or another form of power or in the construction of ships or in the manufacture or processing of goods or in mining. Hence, the meaning of 'industrial undertaking' is not restricted to one unit. The undertaking is to be considered as consisting of a number of units provided all the units are engaged in any of the activities mentioned in Explanation to Section 33B.Industrial undertaking has also been defined in Explanation to Section 10(15).

20. Before us, it has not been clarified that Pune unit is an independent unit and is in no way related with the activities carried out at Bangalore or Chennai unit. In absence of the facts, it is not possible to say that Pune unit was an independent undertaking engaged in the business of software development, which was in no way related to the software development done at Bangalore or Chennai unit. In case, the Pune unit is found to be independent, then loss from such unit is to be independently calculated. In case such unit is associated with the activities, which are carried out at Bangalore or Chennai unit, then Pune unit will be considered as part of that undertaking. Hence, the issue of ascertaining as to whether Pune unit was an independent unit or a unit associated with activities of other two units is restored back on the file of the AO. In case it is found that it is part of the other two units and is associated with the activities done in other two units, then it will be

considered as part of the same undertaking and loss will be adjusted. However, in case, if it is found, it is an independent unit, then it will be treated as independent undertaking and the assessee cannot be forced to have exemption in respect of such independent undertaking. In that case the loss will (not) be adjusted against other income.

21. The last grievance is in respect of not allowing deduction under Section 10A on the adjustment made by the assessee to the arm's length price.

22. In the instant case, the assessee company entered into transaction with associated enterprise. The assessee company determined arm's length price and accordingly made adjustment to the income because arm's length price determined was more than the consideration, at which the transactions were shown in the books of account. The deduction under Section 10A has not been allowed as per proviso to Section 92C(4). As per this proviso, no deduction under Section 10A or 10B or under Chapter VI-A is to be allowed in respect of amount of income, by which the total income of the assessee is enhanced after computation of income under the sub-section. The learned Authorised Representative during the course of proceedings has referred to the word 'enhanced'.

In case the income is enhanced, then deduction is not permissible.

However, in the instant case, income has not been enhanced because the same was already returned by the assessee. In the Memo Explaining the Provisions of Finance Bill, 2006, it has been mentioned as under: Under Sub-section (4), it has been provided that on the basis of arm's length price so determined, the AO may compute the total income of an assessee. The first proviso to Sub-section (4) provides that where the total income of the assessee as computed by AO is higher than the income declared by the assessee, no deduction under Section 10A or Section 10B or under Chapter VI-A will be allowed in respect of the amount of income, by which the total income of the assessee is enhanced after computation of income under sub-section.

23. From the Memo Explaining the Provisions of Finance Bill, 2006 as well as from the literal meaning of the word 'enhanced', it is clear that if income increased, as a

result of computation of arm's length price, then such increase is not to be considered for deduction under Section 10A. In the instant case, the assessee himself has computed the arm's length prices and has disclosed the income on the basis of arm's length prices. It is not a case, where there is an enhancement of income due to determination of arm's length price. Hence, it is held that assessee was entitled to deduction under Section 10A in respect of income declared in the return of income on the basis of computation of arm's length price.