IN THE INCOME TAX APPELLATE TRIBUNAL
AHMEDABAD "B" BENCH, AHMEDABAD

[Coram: Pramod Kumar AM and S S Godara JM]

ITA No.623/Ahd/2015
Assessment Year: 2009-10

Elitecore Technologies Private Limited **.....Appellant**
904, Silicon Tower, B/h. Pariseema Building,
Off C.G. Road, Ahmedabad – 380 006.
[PAN – AAACE 6815 G]

Vs.

Dy. Commissioner of Income Tax,
Circle 2(1)(1), Ahmedabad. **.....Respondent**

Appearances by:

S.N. Soparkar *for the appellant*
K. Madhusudan *for the respondent*

Date of concluding the hearing : October 5, 2016
Date of pronouncing the order : January 3, 2017

O R D E R

Per Pramod Kumar AM:

1. By way of this appeal, the assessee appellant has challenged correctness of the order dated 31.12.2014, passed by the learned CIT(A), in the matter of assessment under section 143(3) of the Income Tax Act, 1961, for the assessment year 2009-10.

2. Grievances raised by the assessee appellant are as follows:

1. The order passed by the learned CIT(A) is erroneous and contrary to the provisions of law and facts and therefore requires to be suitably modified. It is submitted that it be so held now.

2. The learned CIT(A) erred in law and on facts in not allowing entire Foreign Tax Credit amounting to Rs.11,12,907/- while calculating tax liability of the appellant.

2.1. The learned CIT(A) has erred in disregarding the fact that tax credit has been claimed on the income which has been taxed in both the countries i.e. source country and resident country.

2.2. The learned CIT(A) has erred in not considering actual profitability of the projects while computing the Foreign Tax Credit in respect of doubly taxed income on the basis that the appellant is not maintaining separate accounting in respect of each project.

3. The learned CIT(A) has erred in holding that as the appellant is allowed deduction under section 37 of the Act in respect of the foreign tax for which the set off of credit has not been granted, only that amount has to be allowed as MAT credit which has been adjusted against the tax payable in India. In the facts of the case and law, disallowance of Foreign Tax Credit is irrelevant for computing the allowable MAT credit.

3.1. The learned CIT(A) has erred in holding that MAT credit being allowed to be carried forward should be restricted to the extent of Rs.86,571/- only (in respect of Foreign Tax Credit) and not entire Foreign Tax Credit of Rs.11,12,907/-.

3. All these grounds are somewhat interconnected, and we will, therefore, take up all these grounds together.

4. Briefly stated, the relevant material facts are like this. The assessee before us, a wholly owned subsidiary of a US based company by the name of Elitecore Technologies Inc, is a company engaged in the business of software developments and products. During the relevant previous year, the assessee did not have any income taxable under the normal provisions of the Act, though the book profits taxed under section 115JB were computed at Rs 47,77,950, and, accordingly, tax liability, under MAT (minimum alternate tax) provisions, was computed at Rs 54,13,417. During the course of the scrutiny assessment proceedings, the Assessing Officer noted that the assessee has claimed a foreign tax credit of Rs 11,12,907. This credit was in respect of the taxes withheld abroad, i.e. in Singapore and Indonesia. The assessee had received an amount of Rs 47,02,0256, after deduction of tax at source @ 10% i.e. Rs 5,41,029, from a Singapore based concern by the name of IBM Corporation. The assessee had also received amounts aggregating to Rs 31,63,551, after deduction of tax at source @15% i.e. Rs 5,71,878, from an Indonesia based company by the name of P T Tech Mahendra. It was the aggregate of these tax deductions, which comes to Rs 11,12,907, that the assessee had claimed the foreign

tax credit. The Assessing Officer, however, did not approve the claim so made by the assessee. He was of the view that the tax credit is to be allowed only to the extent corresponding income has suffered tax in India, and that the extent to which income has suffered tax in India in respect of these receipts is to be computed by reference to the actual MAT liability being divided in the same ratio as the ratio of corresponding foreign receipts to the overall turnover of the assessee. The amount of eligible tax credit was thus worked out to Rs 75,935. When the assessee was required to show cause as to why the foreign tax credit not be restricted to this amount, the assessee clarified that the gross receipts, which is what are material for the purpose of computing the tax credit even if the ratio of foreign receipts to the overall receipts are to be taken into account, are Rs 90,58,514. The assessee then referred to article 23 of India Indonesia Double Taxation Avoidance Agreement [India- Indonesia tax treaty, in short; (1988) 171 ITR (Stat) 27] and article 25 of India Singapore Double Taxation Avoidance Agreement [Indo Singapore tax treaty, in short; (1994) 231 ITR St 1]. It was contended by the assessee that ñthe tax credit is available in respect of ópofit or incomeôwhich is taxed in both the countries as a result of resident country will allow tax credit which should not exceed the tax of Indian taxò It was also pointed out that none of these tax treaties prescribe the manner, as adopted by the Assessing Officer, of deriving the net income, or, for that purpose, any metjod of computing the net income. It was also submitted that the related article state that tax credit will be available for ñprofit or incomeò which has been subjected to tax in both the countries, and that the profit, in this context, denotes income less all related allowable expenditure. The assessee the briefly set out the well settled principles governing interpretation of tax treaties and contended that ñentire receipt should be considered as doubly taxed, looking to the intention and scheme of the tax treatiesò None of these submissions impressed the Assessing Officer. The only change he made in his computation of admissible tax credit was that instead of net receipts of Rs 79,45,607, he adopted the gross receipts at Rs 90,58,514. The mechanism of computing the foreign tax credit, however, remained the same. The admissible tax credit was thus marginally enhanced, and it was finally computed at Rs 86,571. Aggrieved, assessee carried the matter in appeal before the CIT(A) but without any success. While confirming the stand of the Assessing Officer, learned CIT(A), inter alia, observed as follows:

> **I have carefully considered the facts of the case, the assessment order and the written submission of the appellant. The appellant has some receipts from the contract in Singapore and Indonesia. As per the rules of the income tax in those countries the withholding tax has been deducted on the payment. The appellant has claimed the deduction on account of tax paid in those countries from the income tax payable on the income in India. The AO after examining the provisions of section 90 and the relevant clauses of DTAA with Singapore and Indonesia, allowed**

only part of the tax paid as against full credit of foreign tax deducted claimed by the appellant. For this purpose he computed proportionate profit on the receipts from these countries and calculated the income which was being taxed again in India or the doubly taxed income. For calculating the credit of foreign fax deducted he calculated the tax payable on that proportionate income and allowed the credit off the proportionate tax out of the FTC. The appellant on the other hand has submitted that it was not claiming any refund. The method adopted by the AO was not proper. The appellant also gave a separate calculation of the income earned out of those transactions in Singapore and Indonesia and submitted that the income no calculated should be taken for proportionate deduction. The treaties need to be interpreted liberally and required to be interpreted through technological approach to certain the object and purpose of the treaty. The treaties entered by foreign diplomats who are not experts in drafting and, hence, wherever there is anomaly harmonious interpretation would be warranted.

On a careful consideration of all the facts and circumstances of the issue involved, it is noted that the provisions of DTAA and the provisions of section 90 of the Income Tax Act are very clear. For the sake of clarity the provisions of the relevant clauses of DTAA with Singapore and Indonesia are reproduced here under: - .

> **Para 2 of Article 25 - Avoidance of double taxation of DTAA between India and Singapore: -**
>
> **"Where a resident of India derives income which, in, accordance with the provisions of this Agreement may be taxed in Singapore, India shall allow as a deduction from the tax on the income of that resident an amount equal to the Singapore tax paid, whether directly or by deduction. Where the income is a dividend paid by a company which is a resident of Singapore to a company which is a resident of India and which owns directly or indirectly not less than 25 per cent of the share capital of the company paying the dividend, the deduction shall take into account the Singapore tax paid in respect of the profits out of which the dividend is paid. Such deduction in either case shall not, however, exceed that part of the tax (as computed before the deduction is given) which is attributable of the income which may be faxed in Singapore."**
>
> **Para 2 of Article 23 - Elimination of double taxation of DTAA between India and Indonesia: -**
>
> **"The amount of Indonesian fax payable, under the laws of Indonesia and in accordance with the provisions of this Agreement, whether directly or by deduction, by a resident of India, in respect of profits or income arising in Indonesia, which have been subjected to fax both in India and in Indonesia, shall be**

allowed as a credit against the Indian tax payable in respect of such profits or income provided that such credit shall not exceed the Indian tax (as computed before allowing any such credit) which is appropriate to the profits or income arising in Indonesia."

Section 90 of the Income Tax Act provides that the relief in respect of the income on which taxes have been paid under the Indian income Tax Act and the income tax Act of the other country are to be governed by their agreement between the Indian government and that country, A perusal of the above clauses of DTAA with Indonesia and Singapore clearly show that the amount of fax payable in respect of profit or income arising in that country and subjected to fax both in India and the other country shall be allowed as a credit against Indian tax payable in respect of such profits or income in such manner that the credit should not exceed the Indian tax which is appropriate to the profit or income arising in the other country. The relevant clauses are similar for Indonesia and Singapore. The provisions clearly show that the credit shall be allowed, which is proportionate to the profit or income arising in that country. Therefore, in my opinion the approach and method of giving the credit adopted by the AO in respect of the tax deducted in Indonesia and Singapore is justified and his in order. The submission of the appellant that the treaties are drafted by diplomats and politicians the interpretations should be done for helping the commercial relations is not acceptable. The provisions of the relevant clauses read with section 90 of the Income tax Act are very clear. In my opinion, there is no ambiguity in the provisions and this cannot be any other interpretation of the relevant clauses. The use of word "appropriate" in the treaty with Indonesia and the word "attributable" clarifies everything.

The appellant has also given a working indicating the profitability of the transactions on which the tax has been deducted. The working given by the appellant has been carefully perused and examined by me. The same cannot be accepted as the overall profit margin of the enterprise has been seen for allowing the credit. The appellant has claimed that the transactions were renewal of software license and sale of software license on which no expenditure has been incurred in the current year as all expenses were incurred during the phases of development and the same have been charged in earlier year. The submission is not acceptable when the company is taking of several projects at a time and it is not keeping separate accounting in respect of each product project and the profitability is not worked out in respect of each project or product the global profitability has to be adopted for computing the proportionate profit. In view of these facts and circumstances the contentions of the appellant cannot be accepted.

The working of foreign tax credit adopted by the AO is therefore, in order and the same is upheld.

5. The assessee is not satisfied and is in second appeal before us.

6. We have heard the rival contentions, perused the material on record and duly considered facts of the case in the light of the applicable legal position.

7 We find that there are two aspects of the matter, on which there is apparently no meeting ground between the stand of the assessee and the stand of the revenue authorities, and which, therefore, need to be decided by us- first, the manner in which the quantum of income eligible which is required to be treated as taxed in both the countries, and second, the manner in which the eligible tax credit is to be computed. Before we address ourselves to these aspects, let us take a look at the relevant provisions in the related tax treaties:

India Indonesia tax treaty

ARTICLE 23 - METHODS FOR ELIMINATION OF DOUBLE TAXATION

1. Where a resident of a Contracting State derives income which, in accordance with the provisions of this Agreement, may be taxed in the other Contracting State, the first-mentioned State shall allow as deduction from the tax on the income of that resident an amount equal to the income tax paid in that other State. Such deduction shall not, however, exceed the part of the income tax as computed before the deduction is given, which is attributable as the case may be, to the income which may be taxed in that other State.

….. not relevant for our purposes

India Singapore tax treaty

ARTICLE 25- AVOIDANCE OF DOUBLE TAXATION

2. Where a resident of India derives income which, in accordance with the provisions of this Agreement, may be taxed in Singapore, India shall allow as a deduction from the tax on the income of that resident an amount equal to the Singapore tax paid, whether directly or by deduction. Where the income is a dividend paid by a company which is a resident of Singapore to a company which is a resident of India and which owns directly or indirectly not less than 25 per cent of the share capital of the company paying the dividend, the deduction shall take into account the Singapore tax paid in respect of the profits out of which the dividend is paid. Such deduction in either case shall not, however, exceed that part of the tax (as computed before the deduction is given) which is attributable to the income which may be taxed in Singapore.

é é é .. *not relevant for our purposes*

8. So far as the first issue that we have identified for adjudication, i.e. the manner in which the quantum of income eligible which is required to be treated as taxed in both the countries ,is concerned, there is no guidance available in the

treaties. All that both the treaties state is that the foreign tax credit shall not exceed the part of the income tax as computed before the deduction is given, ñwhich is attributable as the case may be, to the income which may be taxed in that other Stateò but there is little guidance on how to compute such income. However, quite clearly, as the expression used is óincomeô, which essentially implied óincomeô embedded in the gross receipt, and not the ógross receiptô itself. This approach is reflected in the UN Model Convention Commentary as well, which, in turn, follows the approach in OECD Model Convention Commentary in this regard. **UN Model Convention Commentary** (2011 update @ page 333) states that ñ**Normally the basis of calculation of income tax is total net income, *i.e. gross income less allowable deductions*. Therefore, it is the gross income derived from the source state less any allowable deductions *(specific or proportional)* connected with such income which is to be exempted**ò It is, therefore, not really the right approach to take into account the gross receipts, as was contended by the assessee, for the purpose of computing admissible tax credit. The case before us is, however, somewhat unique in the sense that the main business is carried on in India and only some isolated transactions have taken place in Singapore and Indonesia. So far as the first two transactions are concerned, these are only for release of margin money and addition of a separate user- things which donot require any activity on the part of the assessee. In a way, therefore, these earnings are, so far as the present year is concerned, are passive earnings, and no part of the costs incurred in India can be allocated to earnings from Singapore and Indonesia. As regards earnings from maintenance contract, the assessee has allocated the costs on a proportionate basis and no defects are pointed out in the allocation so made by the assessee. However, there seems to be no logic in allocating a share, in proportion of turnover, of all the costs borne by the assessee to these earnings- as has been done by the Assessing Officer. When the income in respect of such foreign operations is not separately computed, it is to be done on a reasonable basis, and what would constitute reasonable basis will be the basis which is based on sound reasoning. The concept of averaging on the basis of overall revenues and profits of the assessee, or on the basis of some other ratio analysis, can only come into play when the income element cannot be worked out on some other reasonable basis on the facts of a particular case. So far as the facts of the present case are concerned, we have also noted that the assessee has, during the course of the assessment proceedings, given the working on the computation of income- a copy of which is placed at page 79 of the paper-book filed before us. This computation is as follows:

Customer Name	Country of customer	Transaction	Details	Income (Rs.)	Expense (Rs.)	Net Profit (Rs.)
IBM Singapore	Singapore	Sale of Software License	The contract was awarded to the appellant in FY 2006-07. On perusal of Purchase Order, it is evident that 85% payment was on delivery of software in FY 2006-07 and balance 15% was after validation of software. It is pertinent to note that the company had incurred expenses at the time of supply of software in FY 2006-07 and no expenses have been incurred for the balance 15% of the amount received in the year under consideration.	5,323,085	-	5,323,085
PT Tech Mahindra	Indonesia	Sale of Incremental Software License	PT Tech Mahindra had purchased software from the appellant in FY 2005-06. The payment received is for the increase in the number of users in accordance with the terms of the agreement dated 17th February, 2006. The appellant did not have to incur any cost for the same in the year of consideration.	3,161,369	-	3,161,369
PT Tech Mahindra	Indonesia	AMC for Software	PT Tech Mahindra had awarded Annual Maintenance Contract for the software to the appellant. The appellant has a dedicated team which manages AMC and warranty projects. The cost for the same is apportioned and deducted from the gross receipts of the appellant.	574,060	149,251	424,809
Total				**9,058,514**		**8,909,263**

9. We see no infirmities in this computation showing the element of income embedded in the receipts which have been taxed abroad as well. These details were duly furnished to the Assessing Officer vide letter dated 20th March 2013, a copy of which was also placed before us at pages 69 onward of the paper-book. On a perusal of these details, we find that as far as release of retention money of Rs 53,23,085, released after validation of software by IBM Singapore, is concerned, we find that it is uncontroverted claim of the assessee that entire related expenses have been incurred in the earlier years as the software supply was completed in financial year 2006-07. There cannot obviously be any incremental cost at the point of time when retention money of 15% of total contract value is released. The same is the

position in respect of receipt of Rs 31,61,369 from PT Tech Mahindra is concerned, which is only for additional user of software already supplied to the customer. When an additional user is added by the customer, it does result in revenue to the seller but it does not at all add to his costs. There is thus merit in the plea that entire receipt, as in the case of release of retention money, is in the nature of income in this year. As regards receipt of Rs 5,74,060, this is in respect of annual maintenance fees but then there is a dedicated team for this purpose and the costs relatable to this particular receipt have been computed by apportioning these costs. We see no infirmity in this computation either. In our considered view, therefore, the computation of income element, as given by the assesse, is fair and reasonable and, in any event, the Assessing Officer has not pointed out any specific infirmities in the same. Given this analysis, we see no need to compute the profit element by taking into account the ratio of entire income to entire turnover of the assessee. Such a course, if at all, could have been relevant if the assessee had not furnished a reasonable computation of income embedded in the related receipts of the assessee. That is not the case before us. We, therefore, approve the stand of the assessee on this point. Having said that, we may add that this decision cannot be the authority for the general proposition that only marginal or incremental costs incurred in respect of foreign income should be taken into account and the overheads cannot be allocated thereto. As we have noted earlier, the allocation of proportional deductions can be justified in some situations, such as when business operations are somewhat evenly or even in a significant manner, spread over the residence and source jurisdiction, but thatôs not the case here. Right now, we are dealing with a situation in which a major portion of income, by release of retention money as also by addition of an additional user by the customer, is a somewhat passive income, even though in the nature of business receipt, and as such, to that extent, allocation of all the expenses incurred by the assessee, in respect of such earnings, will not be justified. As regards the income from maintenance contracts, the relates costs have already been allocated and the Assessing Officer has not pointed out any infirmity in the same. In this view of the matter, quantification of income for the purpose of computing admissible tax credit, as done by the assessee and as reproduced earlier, is accepted.

10. We have noted that the tax credit for both the jurisdictions is to be computed separately but in a similar manner, as is provided in the respective treaties. So far as the tax credit in respect of Indonesian receipts is concerned, as noted above and in view of article 23(1) of the applicable tax treaty, it cannot ñexceed the part of the income tax as computed before the deduction is given, which is attributable as the case may be, to the income which may be taxed in that other Stateò. The income tax is, therefore, required to be computed on proportionate basis. What is, therefore, to be computed next is the tax attributable to the income which is so taxed in both the

tax jurisdictions. The tax has been paid, in this case, on book profits. To the best of our understanding, and particularly in the absence of any other method having been pointed out to us, only way in which be so done is by apportioning the actual tax paid under MAT provisions (i.e. Rs 54,13,417), in the same ratio as double taxed profit to the overall profits i.e. 35,86,178**:**4,77,79,403. The amount of tax credit in respect of this income thus comes to Rs 4,06,315, as against the actual deduction of tax aggregating to Rs 5,71,878. The tax credit claim is thus admissible to this extent. As for the tax credit in respect of Singaporean receipts, while the formulae for limitation under article 25(2) of the Indo Singapore tax treaty remains broadly the same as it is provided that the credit shall not exceed tax ñwhich is attributable to the income which may be taxed in Singaporeò but the first variable i.e. income taxed in both the countries would change. The figure of income taxed in Singapore as also India is 53,23,085. The MAT paid, relatable to this income, will be arrived at by dividing the same in the ratio 53,23,085:4,77,79,403 The amount of tax payable in respect of Singapore income, by the same formulae, works out to Rs 6,03,107 which is clearly less than Rs 5,41,029 which was deducted at source in Singapore. The tax credit of Rs 5,41,029 in respect of Singaporean receipts is thus clearly admissible. As against tax credit claim of Rs 11,12,907, the tax credit of Rs 9,47,344 is thus indeed admissible. To this extent, the claim of the assessee is upheld. The case of the assessee, in any event, was not pressed beyond this point.

11. In the result, the appeal is partly allowed in the terms indicated above. Pronounced in the open court today on the 3rd day of January, 2017.

Sd/-
S S Godara
(Judicial Member)

Sd/-
Pramod Kumar
(Accountant Member)

Ahmedabad, the 3rd day of January, 2017

Copies to:
(1) The appellant
(2) The respondent
(3) Commissioner
(4) CIT(A)
(5) Departmental Representative
(6) Guard File

By order

Assistant Registrar
Income Tax Appellate Tribunal
Ahmedabad benches, Ahmedabad