**IN THE INCOME TAX APPELLATE TRIBUNAL**
**"A" BENCH : BANGALORE**

**BEFORE SHRI JASON P BOAZ, ACCOUNTANT MEMBER AND SHRI LALIET KUMAR, JUDICIAL MEMBER**

| ITA No.1101/Bang/2016 |
|---|
| Assessment year : 2010-11 |

| | | |
|---|---|---|
| M/s. Harman Connected Services Corporation India Private Limited, [*formerly known as Symphony Teleca Corporation India Private Limited)*<br>No.3 & 3A, EOIZ Industrial Area, Survey No. 85 & 86, Sadarmangla Village, Krishnarajapuram Hobli, Bangalore – 560 066.<br>**PAN : AABCG 5658 E** | Vs. | Principal Commissioner of Income-tax,<br>Bangalore - 3. |
| APPELLANT | | RESPONDENT |

| | | |
|---|---|---|
| Assessee by | : | Shri. K. R. Vasudevan, Advocate |
| Revenue by | : | Shri. C. H. Sundar Rao, CIT-I |

| | | |
|---|---|---|
| Date of hearing | : | 04.10.2018 |
| Date of Pronouncement | : | .12.2018 |

## O R D E R

***Per Jason P Boaz, Accountant Member***

This appeal by the assessee is directed against the order of the PCIT-3, Bangalore passed u/s 263 of the Income Tax Act, 1961 (in short 'the Act') dated 30.03.2016 for Assessment Year 2010-11.

2. Briefly stated, the facts of the case are as under:

2.1 The assessee, a company, engaged in software development and related services, filed its return of income for assessment year 2010-11 on 08.10.2010 declaring income of Rs.6,93,52,714/-. The case was selected for scrutiny and the assessment was completed u/s 143(3) of the Act vide order dated 26.03.2014, wherein the assessee's income under the normal provisions was determined at Rs.10,51,78,619/- in view of the following additions/disallowances:

| | | |
|---|---|---|
| (i) Disallowance of Hedging Loss | - | Rs.2,25,31,520/- |
| (ii) Disallowance of depreciation on servers | - | Rs. 2,93,063/- |
| (iii) Disallowance u/s 40(a)(ia) | | |
| (a) Non deduction of Tax at Source on Legal and Professional Fees | - | Rs.70,73,657/- |
| (b) Non deduction of Tax at Source on software | - | Rs. 1,94,642/- |

2.2 Book profits u/s 115JB of the Act were declared at Rs.110,73,45,364/- and accepted as returned by the Assessing Officer ('AO'); without making additions/disallowances therein, as carried out under the normal provisions.

3.1 Subsequently, the PCIT-3, Bangalore, initiated proceedings u/s 263 of the Act as he was of the view that the order of assessment dated 26.03.2014 for Assessment Year 2010-11 is erroneous and prejudicial to the interests of Revenue on the following issues:

*"(a) The assessee's claim of notional Forex loss recognized in respect of outstanding contract pertaining to import/export of goods by applying the year end exchange rate has been allowed while computing the profit u/s 115JB of the Income Tax Act.*

*(b) Provision for doubtful debts and advances debited to P & L account is not added back to profit u/s 115 JB of the Income Tax Act.*

*(c) Prior period expenditure of Rs.16,95,75,000/- being Management Consultancy fees debited to P & L account are not added back to book profit u/s 115JB of the Income Tax Act.*

*(d) The claim of expense on licence fee of USD 1,92,00,000/- to obtain licence of technology from M/s. Symphony Service Corporation USA, which falls under the definition of Royalty as per IT Act and DTAA was allowed, though TDS was not made on the payment as required u/s 195 of the IT Act."*

3.2 In response to the show cause notice u/s 263 of the Act, the assessee filed its written submissions before the CIT. The CIT, after considering the assessee's submissions, concluded the proceedings u/s 263 of the Act vide order dated 30.03.2016 setting aside the order of assessment dated 26.03.2014 for Assessment Year 2010-11, with the following directions to the AO:

*"(i) To add back the unrealized market to market losses and prior period expenses to the Book profits u/s 115JB of the Income Tax Act.*

*(i) To verify if the amount of Rs.21,24,398/- are actual debts that are written off as bad. If it pertains to provisions for bad and doubtful debts then it has to be added back while computing Book profits u/s 115JB of the Income Tax Act. If this amount is already included in the amount of Rs.1,91,72,285/- claimed as deduction from the profits on account of bad debts written off, then it is to be added back while computing the Book profits u/s 115JB of the Income Tax Act.*

*(ii) To verify whether the amount paid of USD $19,200,000/- has been debited to the P & L account or is capitalized in the books and accordingly disallow either the payment made or the depreciation claimed u/s 40 (a) (i) of the Income Tax Act."*

4. Aggrieved by the order u/s 263 of the Act dated 30.03.2016 for Assessment Year 2010-11, the assessee has preferred this appeal before the Tribunal raising the following grounds:

***I. Initiation of proceeding under 263 of the Act***

1. *The learned Principal Commissioner of Income-tax Bengaluru — 3 ["Pr. CIT"] has erred in initiating proceedings under section 263 of the Act without appreciating that the order of the learned assessing officer ["AO"] is not erroneous and prejudicial to the interest of revenue.*

2. *The learned Pr. CIT has erred in invoking provisions under section 263 of the Act merely because there is another view possible as against the view adopted by the learned AO.*

3. *The learned Pr. CIT has erred in invoking provisions under section 263 of the Act without appreciating that Hon'ble Supreme Court/ Hon'ble Bangalore Income Tax Appellate Tribunal ["ITAT"] has already ruled in favour of Assessee on similar issues covered under the order of the learned Pr. CIT.*

***II. Without prejudice to the above***

***A. Addition of Mark to Market loss ["MTM loss"] to book profits***

1. *The learned Pr. CIT has erred in directing the learned AO to add MTM loss in computation of book profits on the contention that the same is not an ascertained liability.*

2. *The learned Pr. CIT has erred in not appreciating that the Appellant has followed Accounting Standard 11 ["AS -11"] [The Effect of Changes in foreign exchange rates] in computing MTM loss and hence the same cannot be said to be in the nature of other than ascertained liability.*

3. *The learned Pr. CIT has erred in relying on instruction no. 03/2010 dated 23 March 2010 issued by Central Board of Direct Taxes ["CBDT"] wherein it has been held that MTM loss on forex derivatives is notional loss and contingent in nature without appreciating the facts laid down by judicial precedents in this context, concluding that MTM losses are not notional or contingent in nature.*

*The learned Pr. CIT has erred in not relying on the decision of the Hon'ble Supreme Court in case of* ***Apollo Tyres Limited vs. CIT [122 Taxmann.com 562]*** *wherein it has held that the AO has to*

*accept the authenticity of the accounts with reference to the provisions of the Companies Act as certified by statutory auditors and has no authority under the Income-tax Act to probe into the accounts accepted by the authorities under the Companies Act.*

5. *Notwithstanding the above, should MTM loss be added to book profits, then the learned AO be directed to reduce the same from book profits on reversal of losses in subsequent year(s).*

***B. Addition of prior period expenses to book profits***

1. *The learned Pr. CIT has erred in directing the learned AO to add prior period expense in computation of book profits on the contention that the same is not contemplated to be allowed under section 115JB of the Act.*

2. *The learned Pr. CIT ought to have appreciated that the provisions of section 115JB of the Act is a complete code by itself and no other adjustments can be carried out to the book profits.*

3. *The learned Pr. CIT has failed to appreciate that section 115JB of the Act does not provide specifically for addition of prior period expenses to the net profit/ loss as disclosed in the financial statements.*

4. *The learned Pr. CIT has erred in not relying on the decision of the Hon'ble Supreme Court in case of* ***Apollo Tyres Limited vs. CIT [122*** *Taxmann.com 5621****,*** *wherein it has held that the AO has to accept the authenticity of the accounts with reference to the provisions of the Companies Act as certified by statutory auditors and has no authority under the Income-tax Act to probe into the accounts accepted by the authorities under the Companies Act.*

***C. Disallowance of depreciation claimed on outright purchase of software under section 40(a)(i) for non-deduction of taxes at source***

1. *The learned Pr. CIT has erred in concluding that tax is required to be deducted under section 195 of the Act on payments made to Symphony Services Corporations, USA for outright purchase of software.*

2. *The learned Pr. CIT has erred in concluding that the said payment falls within the meaning of royalty as per section 9 of the Act and India - USA double taxation avoidance agreement*

3. *The learned Pr. CIT failed to appreciate that the taxability of the aforesaid transaction is already pending before the Authority of*

*Advance Ruling, the outcome of which is binding on the Revenue Authorities.*

4. *Notwithstanding the above, the learned CIT has failed to appreciate that depreciation being a statutory allowance cannot be disallowed under section 40(a)(i) of the Act.*

5. Before us, the learned AR for the assessee was heard in support of the grounds raised. The learned AR assailed the jurisdiction of the CIT in invoking the provisions of section 263 of the Act and also the additions/disallowances directed to be made by the CIT. It was submitted that revision u/s 263 of the Act is permitted only if the order passed by the AO is erroneous and prejudicial to the interests of Revenue as section 263 of the Act postulates the satisfaction of twin conditions/requirements; namely (i) the order of the AO sought to be revised is erroneous; and (ii) prejudicial to the interests of Revenue. If one of them is absent, i.e., if the order of the AO is erroneous but not prejudicial to the interests of Revenue OR if it is not erroneous but is prejudicial to the interest of Revenue, recourse cannot be had to section 263(1) of the Act. It is contended that the phrase 'prejudicial to the interest of revenue' has to be read in conjunction with an erroneous order passed by the AO. In support of the aforesaid contentions, reliance was, *inter alia*, placed on the decision of the Hon'ble Apex Court in the case of Malabar Industrial Co. ltd., v CIT (2000) 243 ITR 83 (SC), copies of which have been filed in an Index of case laws (pages 1 to 370).

5.2 It was also submitted that this was not a case of "lack of enquiry", where the CIT may assume jurisdiction u/s 263 of the Act. According to the learned AR, the AO has made enquiries and made additions under certain heads, under the normal provisions, and the objections of the CIT were that the AO did not make similar additions while computing the book profits u/s 115JB of the Act. It is contended that such additions/disallowances under MAT provisions are anyhow not permissible and are legally untenable and therefore the question of the said order of assessment for Assessment Year 2010-11 being erroneous and prejudicial to the interests of Revenue does not arise at all.

5.3 The learned AR further submitted that the impugned order u/s 263 of the Act does not demonstrate as to how the order passed u/s 143(3) of the Act dated 26.03.2014 for Assessment Year 2010-11 was erroneous and prejudicial to the interests of Revenue. It was also submitted that as the CIT has given specific directions on each of the issues and has not remanded the matter for fresh examination, the merits of the issues need to be adjudicated to decide the correctness of the CIT's action in invoking the provisions of Section 263 of the Act. In this regard, the learned AR proceeded to go through the facts of each of the issues to support his contentions which are as under:

**5.4 <u>Unrealized Mark to Market losses</u>**

5.4.1 According to the learned AR, the revision u/s 263 of the Act on this issue has been resorted to only because disallowance under this head was not made under MAT provisions, while computing the profits u/s 115JB of the Act. It was pointed out that the AO has examined this issue and made disallowance under this head under normal provisions. The learned AR argued that even though there are several judicial pronouncements wherein it has been held that provisions made towards Forex losses due to unrealized Mark to Market losses on outstanding forward contracts is an allowable expenditure, copies of which are submitted in the index of case law book, the limited issue in this appeal is whether such a disallowance can be made u/s 115 JB of the Act.

5.4.2 On being specifically asked at the Bar, the learned AR of the assessee confirmed that the addition on this issue made under normal provisions has been carried in appeal by the assessee and is pending before the Tribunal.

5.4.3. According to the learned AR, section 115 JB of the Act provides for specified items of additions and deductions for the purpose of computing 'book profits'. Section 115 JB of the Act is a complete code by itself and no adjustments, other than those prescribed therein, can be made to the book profits. It is contended that there is no provision u/s 115 JB of the Act for making addition of Forex losses as referred to above and therefore it cannot be added back to the profits computing 'book profits' for the purposes of section 115JB of the Act. In this regard, the learned AR referred to the decision of the Hon'ble Karnataka High Court in the case of Sansera Engineering (P.) Ltd., (2017) 80 taxmann.com 248 (Karnataka), wherein at para 6 thereof it was held as under:

*"6. ……. ……For the purpose of section 115JB, the book profit is the profit disclosed as per P&L a/c prepared in accordance with the provisions of Part-II and Part-III of Schedule VI of the Company's Act, 1956, laid before the company in its AGM. The adjustment to that profit can only be made qua, the items provided in Explanation-1 to section 115JB i.e., a to f. On perusal of clause a to f, under explanation-1, we find that no adjustment on account of prior period expenses is to be made. The Hon'ble Supreme Court in the case of Apollo Tyres has observed that except the adjustment provided in Explanation-1 to section 115JB (2), the Assessing Officer cannot tinker with the book profit computed by the assessee and approved in the AGM. The learned CIT(A) has held that this type of expenditure cannot be adjusted. We are of the view that such type of rectification is neither permissible u/s 154; nor u/s 115JB (Exp-1), therefore, the CIT(A) has rightly deleted this addition from the book profit. "*

5.4.4 The learned AR also submitted that the CIT was factually incorrect in stating that the decision of the Hon'ble Apex Court in the case of Apollo Tyres Ltd., V. CIT (2202) 255 ITR 273 (SC) has been referred to a larger bench and therefore this decision of the Hon'ble Apex Court still holds the ground.

**5.5 Provision for doubtful debts**

5.5.1 The learned AR submitted that though no specific grounds have been raised on this issue in the grounds of appeal, the action of the CIT in resorting to section 263 of the Act to examine details of this issue is wrong and without jurisdiction. It was submitted that the details of the provisions made, the amount of bad debts written off out of the provisions were all there on record in the details filed before the AO. Though this point was brought to the notice of the CIT, he disregarded the same. It is submitted that all necessary details were filed and available with the AO and he allowed the same after examination. It is contended that this is not a case of "no enquiry" OR "lack of enquiry" and therefore the action of the CIT was erroneous.

5.5.2 On being specifically queried by the Bench, the learned AR submitted that pursuant to the order u/s 263 of the Act, the AO has allowed the same after due verification and submitted that there was neither any error in the order of assessment nor was there any prejudice to the interest of Revenue.

**5.6 Prior Period Expenditure**

5.6.1 The learned AR of the assessee submitted that the revision u/s 263 of the Act on this issue has been resorted to only because disallowance under this head was not made under MAT provisions, while computing the 'book profits' u/s 115 JB of the Act. It was pointed out that the assessee itself has disallowed the expenditure while computing income under normal provisions and therefore the limited issue for consideration is whether such a disallowance can be done u/s 115JB of the Act.

5.6.2 It was submitted by the learned AR that section 115 JB of the Act provides for specified items of additions and deductions for the purpose of computing 'book profits' u/s 115 JB of the Act and is a complete code by itself. No adjustments other

than those which are prescribed in section 115JB of the Act can be made to the 'book profits'. It is submitted that there is no provision u/s 115JB of the Act for making addition of prior period expenditure and therefore it cannot be added back to profits while computing 'book profits' for the purposes of section 115 JB of the Act. The learned AR reiterated the arguments here as advanced for the issue of Forex losses and the same judicial pronouncements were cited and placed reliance upon.

**5.7 <u>Licence payments to be treated as Royalty and subject to TDS</u>**

5.7.1 According to the learned AR, the CIT had erroneously held that the payments made for purchase of software is in the nature of royalty and hence tax is liable to be deducted at source thereon. It was also submitted that the assessee had filed an application before the Authority for Advance Ruling (AAR) on the issue of applicability of withholding tax on the said payments for purchase of software; which has been admitted by the AAR and is pending hearing/disposal. This fact was on record before the AO and he has correctly not made any addition on this count, as the application before the AAR on this issue is pending disposal. The learned AR submits that in terms of the provisions of section 245 RR of the Act, no Income Tax authority can proceed to decide an issue on which an application is pending before the AAR and the decision of the CIT in directing the AO to decide this issue is against the provisions of law.

5.8 Per contra, the learned DR for Revenue supported the order of the CIT and submitted that those items which the assessee itself disallowed or the disallowances that have been accepted and not challenged in appeal are liable to be disallowed u/s 115JB of the Act as well.

5.9.1 We have considered the rival contentions and submissions and perused and considered the material on record; including the judicial pronouncements cited. As

per the provisions of section 263 of the Act, the PCIT/CIT may call for and examine the record of any proceeding under this Act and pass an order thereunder; only if the following twin conditions are satisfied:

(i) any order passed by the AO is erroneous; and
(ii) prejudicial to the interests of Revenue.

5.9.2 The Hon'ble Apex Court in the case of Malabar Industrial Co. Ltd., Vs. CIT (2000), 243 ITR 83 (SC) has held that 'both' the above conditions have to be satisfied. In this regard, their Lordships, at para 9 thereof, have held/observed as under:

*"9. The phrase 'prejudicial to the interests of the revenue' has to be read in conjunction with an erroneous order passed by the Assessing Officer. Every loss of revenue as a consequence of an order of the Assessing Officer cannot be treated as prejudicial to the interests of the revenue, for example, when an ITO adopted one of the courses permissible in law and it has resulted in loss of revenue; or where two views are possible and the ITO has taken one view with which the Commissioner does not agree, it cannot be treated as an erroneous order prejudicial to the interests of the revenue unless the view taken by the ITO is unsustainable in law. It has been held by this Court that where a sum not earned by a person is assessed as income in his hands on his so offering, the order passed by the Assessing Officer accepting the same as such will be erroneous and prejudicial to the interests of the revenue. Rampyari Devei Saraogi v. CIT [1968] 67 ITR 84 (SC) and in Smt. Tara Devi Aggarwal v. CIT [1973] 88 ITR 323 (SC)."*

Therefore, for invoking the provisions of section 263 of the Act, the twin tests of the order being both 'erroneous' and 'prejudicial to the interests of Revenue' have to be satisfied. If we examine the issues raised by the CIT in the impugned order u/s

263 of the Act and the reasoning given therein, in our view, it is fairly clear that the above two tests are not satisfied in these cases.

5.10.1 As regards the issues related to **'Forex Loss due to Mark to Market Losses'** and **'Prior Period Expenditure'** are concerned, the grievance of the CIT is that these are not disallowed while computing 'Book Profits' u/s 115JB of the Act. The law in this regard has been laid down by the Hon'ble Apex Court in the case of Apollo Tyres Ltd., (2002) 255 ITR 273 (SC); wherein at para 5 thereof held as under:

*"5. ……..*
*……Therefore, we are of the opinion that the Assessing Officer while computing the income under section 115J has only the power of examining whether the books of account are certified by the authorities under the Companies Act as having been properly maintained in accordance with the Companies Act. The Assessing Officer thereafter has the limited power of making increase and reductions as provided for in the Explanation to the said section. To put it differently, the Assessing Officer does not have the jurisdiction to go behind the net profit shown in the profit and loss account except to the extent provided in the Explanation to section 115J."*

5.10.2 Since there is no provision u/s 115 JB of the Act for addition of "Forex Losses" OR "Prior Period Expenditure", such disallowances/additions are not tenable under the law and the CIT cannot issue directions to make additions/disallowances which are not allowed under the law. In our considered view, as the twin conditions of an erroneous order and prejudicial to the interest of Revenue are not satisfied on both disallowances in respect of "Forex Losses" and "Prior Period Expenditure", therefore the impugned order of the CIT was wrong.

5.11.1 In respect of the issue of **'non-deduction of tax at source on payments for purchase of software'**, the fact that this issue has been taken up before the AAR

and the application has been admitted is borne out by the details on record. As per the provisions of section 245RR of the Act, no Income Tax authority or Appellate Tribunal can proceed to decide any issue in respect of which an application has been made before the AAR u/s 245Q (1) of the Act. This applies to and includes, *inter alia,* both AO and the CIT. This being the case, in our considered view, the CIT's action in directing the AO to decide the issue in a particular manner is not in accordance with law.

5.12.1 As regards the issue of verification of **"provision for doubtful debts and advances"** and the quantum of bad debts written off, evidently, the details thereof are on record and reflected in the financial statements and computation of income. The CIT has not made out a case to demonstrate that the AO has not conducted any enquiry and as the details were available on the face of the return of income, the conclusion can be that the AO has examined the issue and accepted the details filed by the assessee. It is settled legal principle that the assessee can write off its debts in any year of its choice, provided that the said amounts were offered to tax earlier and if such amounts or part thereof are recovered at a subsequent date, it shall be offered to tax in that year. We also observe that the AO in order u/s 143(3) r.w.s. 263 of the Act dated 19.12.2016, giving effect to the directions issued by the CIT in the impugned order for computing the book profits u/s 115JB of the Act, has examined the issue again and allowed the deductions claimed by the assessee. In that view of the matter, the twin conditions precedent; of the order being erroneous and prejudicial to interests of Revenue have not been satisfied.

6. Taking into account the facts and legal circumstances of the case, as discussed above, we find that the issues on which the CIT has invoked the revisionary jurisdiction u/s 263 of the Act is untenable in the eyes of law as in our view no case has been made out that the order of assessment passed u/s 143(3) of the Act dated 26.03.2014 for Assessment Year 2010-11 is erroneous and prejudicial to the interest

of Revenue on any of the issues raised by the CIT in the impugned order. In this view of the matter, we hold that the action of the CIT in invoking the provisions of section 263 of the Act to be untenable and therefore cancel the impugned order of the CIT passed u/s 263 of the Act on 30.03.2016 for Assessment Year 2010-11.

7. In the result, the assessee's appeal for assessment year 2010-11 is allowed.

*Order pronounced in the open court on this 5th day of December, 2018.*

| Sd/- | Sd/- |
|---|---|
| **(LALIET KUMAR)** | **(JASON P BOAZ)** |
| **Judicial Member** | **Accountant Member** |

Bangalore.
Dated: 5th December, 2018.
/NS/*

Copy to:

| | |
|---|---|
| 1. Appellants | 2. Respondent |
| 3. CIT | 4. CIT(A) |
| 5. DR | 6. Guard file |

By order

Assistant Registrar,
ITAT, Bangalore.