

TAX FLASH NEWS

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Deduction under Section 10A of the Income-tax Act cannot be denied in respect of additional income offered in the modified return in pursuance of APA

Recently, the Pune Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Dar Al Handasah Consultants¹ (the taxpayer) dealt with the issue of availability of deduction under Section 10A of the Income-tax Act, 1961 (the Act) in respect of additional income offered in the modified return in pursuance of Advance Pricing Agreement (APA). The Tribunal held that the taxpayer is entitled to Section 10A deduction on additional income offered in modified tax return filed pursuant to resolution under APA.

Fact of the case

During the Assessment Year 2010-11, the taxpayer reported an international transaction of 'IT enabled Design Engineering Services' (ITeS) with transacted value of INR37.54 crores. The Assessing Officer (AO) made a reference to the Transfer Pricing Officer (TPO) for determining the Arm's Length price (ALP). The TPO made a transfer pricing adjustment by selecting certain comparables whose average PLI of Operating Profit (OP) / Operating Cost (OC) was 26.26%. Pursuant to the directions given by the Dispute Resolution Panel (DRP), the AO made transfer pricing addition of INR2.75 crores in the final assessment order dated 30 January 2015.

In the meantime, the taxpayer entered into an Advance Pricing Agreement (APA) with the CBDT on 24 November 2015 and the APA settled the arm's length margin at not less than 17 per cent covering the APA years and the rollback years including the year under consideration above. In consonance with APA, the taxpayer filed a modified return with 17 per cent operating margin and raised further invoice on its AE on 7 December 2015. The only change which occurred in the modified return was that the taxpayer

increased the profit margin to 17 per cent in consonance with the APA, from the originally declared profit margin of 15 per cent and therefore, this resulted into enhancement of income, which was brought into India in convertible foreign exchange on 23 December 2015 which was within a period of one month from the date of the APA.

The taxpayer claimed a deduction under Section 10A of the Act for the amount equal to the enhanced income. The AO did not accept the claim of deduction under section 10A for the enhanced additional income on the ground that the modification in the return under Section 92CD(1) was permissible only to the extent of stipulation in the APA and the APA did not provide for any such deduction. Further, the AO observed that the Section 10A(3) of the Act provides that the sale proceeds in respect of export of software should be brought into India in convertible foreign exchange within a period of six months from the end of the relevant previous year. However, the enhancement in the amount of sale value was brought into India in convertible foreign exchange after such period. Thus, the AO held that the taxpayer was not entitled to deduction under section 10A of the Act. The Commissioner of Income-tax Act [CIT(A)] upheld the order of the AO.

Tribunal decision

The Tribunal observed that the modified return cannot breach the mandate of the APA, which in turn restricts its scope only to the determination of the ALP and nothing more than that. The crux of the provision dealing with the APA is that the ALP is settled as per the terms of the APA. The manner of determination of such ALP may be by any of the methods referred to in TP provisions [Section 92C(1) of the Act], and the provisions of Section 92C (computation of ALP) and section 92CA (Reference to TPO) shall not apply in respect of the determination of the ALP under the APA.

¹ Dar Al Handasah Consultants v. DCIT (ITA No. 1413/PUN/2019) – Taxsutra.com

The Tribunal observed that on perusal of Section 92CD of the Act, it indicates that once a taxpayer filed modified return under Section 92CD of the Act, the AO is obliged to make/complete the already completed or pending assessment under Section 92CD itself having regard to terms of the APA. Not only that, Section 92CD(5) of the Act also enshrines period of limitation for making/completing such assessments. Therefore, the Act contains separate designated procedure for dealing with assessment pursuant to the APA which also contains distinct time limits.

Whether proviso to Section 92C(4) debars deduction under Section 10A on additional income in assessment under Section 92CD

A close scrutiny of the crucial words in the proviso to sub-section (4) of Sections 92C of the Act decodes that the denial of deduction is permissible only when, there is computation of income under sub-section (4) of Sections 92C/92CA of the Act and the total income is enhanced because of such computation, namely, by virtue of the transfer pricing adjustment made by the TPO/AO. Thus, the proviso restricting the granting of deduction under Section 10A on enhanced income applies only where the computation of income is made under Sections 92C/92CA(4) of the Act. Where the computation of income was neither made under Section 92C nor 92CA, nor transfer pricing addition was made by the AO, then the proviso shall have no application.

The Tribunal observed that deduction under Section 10A of the Act cannot be disallowed in respect of additional income offered in the modified return as it is not transfer pricing addition made by AO, but the additional transfer pricing income offered by the taxpayer is consonance with the APA and CBDT.

Filing of the modified return under Section 92CD of the Act with the income as agreed between the taxpayer and CBDT under the APA is an act of the taxpayer in offering the additional income and not an act of the AO in making the enhancement of the total income. The Tribunal observed that where the taxpayer itself had filed a modified return of income at the mutually agreed rate of 17 per cent under the APA, there cannot be any question of the AO making enhancement in the income as a result of transfer pricing adjustment attracting the proviso to Section 92C(4) of the Act. Thus, the proviso to Section 92C(4) does not debar deduction under Section 10A on additional income in assessment under Section 92CD of the Act.

Whether assessment under section 92CD provides for granting deduction under Section 10A

If the taxpayer is otherwise eligible for deduction under any other appropriate provisions in respect of the income offered in the modified return, there

cannot be embargo on granting deduction under such relevant provision. If the taxpayer is entitled to deduction under Section 10A or any other provision of the Act in respect of income the same cannot be denied.

Whether the taxpayer had satisfied the conditions of deduction under Section 10A

On reference to the APA entered into between the taxpayer and CBDT, it indicates that there was a clause for raising the invoice for the additional amount and also 'realise it' in the month following the month in which the APA was signed. CBDT not only stipulated for raising of the invoice for the additional income but also for the realisation of the additional amount within the month following the month in which the agreement was signed. Thus, APA contains a clause for realising the amount or bringing into India in convertible foreign exchange for the additional amount of invoice within one month's period. The APA has made it mandatory for the taxpayer to bring in convertible foreign exchange in India within one month. Other than for granting the relevant deductions connected with the realisation of convertible foreign exchange in India, there was no purpose to stipulate it in the APA. As the taxpayer brought into India the convertible foreign exchange within the stipulated one month's period, it became entitled to deduction under Section 10A of the Act.

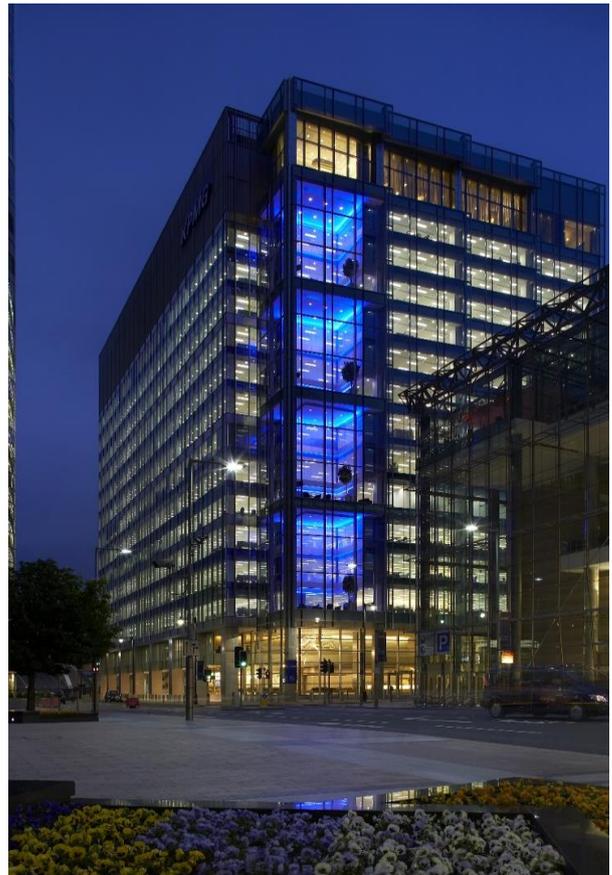
After the increase in the income due to the APA and with the simultaneous claim of deduction under Section 10A, the total income of the taxpayer as declared in the modified return remained at the same level. Thus, it is neither a case of reducing the total income nor increasing the total loss. Consequently, it was held that the taxpayer has satisfied the condition of deduction under Section 10A(3) read with Section 92CD(2) of the Act.

The Tribunal held that the proviso to Section 92C(4) of the Act does not debar deduction under Section 10A on additional income in assessment under Section 92CD of the Act. The assessment under Section 92CD of the Act provides for granting deduction under Section 10A of the Act. The taxpayer has satisfied the requirement of Section 10A(3) read with Section 92CD(2), thereby entitling it to deduction under Section 10A on the additional amount.

Our comments

The Pune Tribunal in the instant decision while dealing with the issue of deduction under Section 10A of the Act in respect of additional income offered in modified return in pursuance of APA, observed that the proviso to Section 92C(4) of the Act does not debar deduction under Section 10A on additional income where assessment is under Section 92CD of the Act. Thus, deduction under Section 10A is available on the additional income offered in the modified tax return in pursuance of APA.

It is pertinent to note that the Pune Tribunal in the case of *Approva Systems Pvt Ltd*² dealt with the issue of allowability of deduction under Section 10A of the Act vis-à-vis proviso to Section 92C(4) of the Act. Even in such a case, the Tribunal observed that the taxpayer is entitled to claim 10A deduction on the additional TP income offered by the taxpayer on its own motion in the return of income. It was observed that it is not the AO or TPO who has determined the additional income on account of transfer pricing provisions under section 92C or 92CA of the Act.



² *Approva Systems Pvt Ltd v. DCIT (ITA No.1051/PUN/2015)*

home.kpmg/in

Ahmedabad

Commerce House V, 9th Floor,
902, Near Vodafone House,
Corporate Road,
Pralhad Nagar,
Ahmedabad – 380 051.
Tel: +91 79 4040 2200

Bengaluru

Embassy Golf Links Business Park,
Pebble Beach, 'B' Block,
1st & 2nd Floor,
Off Intermediate Ring Road,
Bengaluru – 560071
Tel: +91 80 6833 5000

Chandigarh

SCO 22-23 (1st Floor),
Sector 8C, Madhya Marg,
Chandigarh – 160 009.
Tel: +91 172 664 4000

Chennai

KRM Towers, Ground Floor,
1, 2 & 3 Floor, Harrington Road,
Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

Gurugram

Building No.10, 8th Floor,
DLF Cyber City, Phase II,
Gurugram, Haryana – 122 002.
Tel: +91 124 307 4000

Hyderabad

Salarpuria Knowledge City,
6th Floor, Unit 3, Phase III,
Sy No. 83/1, Plot No 2,
Serilingampally Mandal,
Ranga Reddy District,
Hyderabad – 500 081.
Tel: +91 40 6111 6000

Jaipur

Regus Radiant Centre Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road,
Jaipur – 302 018.
Tel: +91 141 - 7103224

Kochi

Syama Business Centre,
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682 019.
Tel: +91 484 302 5600

Kolkata

Unit No. 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091.
Tel: +91 33 4403 4000

Mumbai

1st Floor, Lodha Excelus,
Apollo Mills,
N. M. Joshi Marg,
Mahalaxmi,
Mumbai – 400 011.
Tel: +91 22 3989 6000

Noida

Unit No. 501, 5th Floor,
Advant Navis Business Park,
Tower-A, Plot# 7, Sector 142,
Expressway Noida,
Gautam Budh Nagar,
Noida – 201 305.
Tel: +91 0120 386 8000

Pune

9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex,
Mundhwa Road, Ghorpadi,
Pune – 411 001.
Tel: +91 20 6747 7000

Vadodara

Ocean Building, 303, 3rd Floor,
Beside Center Square Mall,
Opp. Vadodara Central Mall,
Dr. Vikram Sarabhai Marg,
Vadodara – 390 023.
Tel: +91 265 619 4200

Vijayawada

Door No. 54-15-18E,
Sai Odyssey,
Gurunanak Nagar Road, NH 5,
Opp. Executive Club, Vijayawada,
Krishna District,
Andhra Pradesh – 520 008.
Tel: +91 0866 669 1000

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