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TAX REVIEW INTERNATIONAL
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Editor-in-Chief
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CASE LAWS

Foreign:

CIT, Coimbatore
v.
M/s Textool Co. Ltd.

Bhoruka Engineering Inds. Ltd.
v.
DCIT

ITA No.7140/Mum/2012
(Assessment year: 2007-08) &
ITA No. 7097/Mum/2012
(Assessment year: 2007-08)

ITA No.3598/Mum/2010
(Assessment Year :2007-2008)

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TAX NEWS

OECD reports to G8 on global system of automatic exchange of tax information

Think Tank Calls On UK To 'Embrace' Tax Havens

Sri Lanka imposes new gold import tax

Kind regards

Mrs. Huzaima Bukhari
Editor

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OECD

OECD reports to G8 on global system of automatic exchange of tax information

On 18 June 2013, the OECD published a new report A Step Change in Tax Transparency (http://www.oecd.org/ctp/exchange-of-tax-information/taxtransparency_G8report.pdf) prepared at the request of the G8 for the Lough Erne Summit (Northern Ireland), outlining four concrete steps needed to put in place a global, secure and cost effective model of automatic exchange of information. The report says because tax evasion is a global issue, the model needs to have worldwide reach to avoid merely relocating the problem elsewhere. The process also needs to be standardized to minimise costs for businesses and governments and to improve effectiveness.

A major breakthrough towards more transparency was accomplished in 2009 with information exchange upon request becoming the international standard and the restructured Global Forum on Exchange of Information and Transparency for Tax Purposes starting to monitor the implementation of the standard through peer reviews. In April 2013, the G20 Finance Minister's endorsed automatic exchange of information for tax purposes as the expected new standard.

The report, prepared under the authority of the OECD Secretary General, sets out the key success factors for an effective model for automatic exchange, provides relevant background and outlines four concrete steps needed to put such a model into practice:

- enacting broad framework legislation to facilitate the expansion of a country's network of partner jurisdictions;
- selecting (or where necessary entering into) a legal basis for the exchange of information;
- adapting the scope of reporting and due diligence requirements and coordinating guidance; and
- developing common or compatible IT standards.

The report also provides potential timeframes for each of the action items.

Key features of a standardised multilateral automatic exchange model on financial information

As a general matter, for a model for automatic exchange of financial information to be effective it must be specifically designed with residence jurisdictions' tax compliance in mind rather than be a by - product of domestic reporting. Further, it needs to be standardized so as to benefit the maximum number of residence jurisdictions and financial institutions while recognising that certain issues remain to be decided by local implementation. The advantage of standardisation is process simplification, higher effectiveness and lower costs for all stakeholders concerned. In 2012, the OECD delivered to the G20 the report Automatic Exchange of Information: What it is, How it works, Benefits, What remains to be done, which summarizes the key features of an effective model for automatic exchange. The main success factors for effective automatic exchange are:

– A common agreement on the scope of reporting and exchange and related due diligence procedures.

  An effective model for automatic exchange of information requires an agreement on the scope of the information to be reported by domestic financial institutions and exchanged with residence jurisdictions. This will ensure that the reporting by financial institutions is aligned with the interests of the residence country. It will also increase the quality and predictability of the information that is being exchanged. The result will be significant opportunities for the residence country to enhance compliance and make optimal use of the information (e.g. through automatic matching with domestic compliance information and data analysis).

– A legal basis for the domestic reporting and international exchange of information.

  A standardised multilateral automatic exchange model requires a legal basis for: (i) the domestic reporting obligation and (ii) the exchange of the information. The reporting obligations will typically be included in domestic tax legislation, with due diligence procedures to ensure the quality of the data set out in regulations or guidance. There are different legal bases upon which automatic exchange could take place, and which already exist, including a bilateral treaty with a provision based on article 26 of the OECD Model (2010). The Nordic Convention also provides such a basis and within the European Union, Directives provide a specific legal framework for automatic exchange on interest income and certain other types of information between its 27 (soon 28) members.

– Common technical solutions.

The development of common technical solutions for reporting and exchange of information is a critical element in a standardised exchange system - especially one that will be used by a large number of countries and financial institutions. Standardisation will reduce the overall costs for governments and financial institutions.

Implementing a model into practice

Key developments are already under way. Five European countries, each an OECD and EU member (France, Germany, Italy, Spain and the United Kingdom), developed with the United States the Model 1 IGA. The Model 1 IGA provides for reporting by financial institutions to their local tax authorities, which then exchange the information on an automatic basis with the residence jurisdiction tax authorities. This approach is consistent with the general architecture of automatic information exchange that is also used in the EU context, for instance for the Savings Directive (2003/48).

The Model 1 IGA contains a number of key features of an effective automatic exchange model. This, along with the fact that governments and financial institutions around the world are already investing to implement it, makes the Model 1 IGA a logical basis on which to build.

These developments offer an opportunity to move towards a standardised model of automatic exchange of information and avoid the possibility of a fragmentation of standards, which would impose significantly higher costs on financial institutions and governments. Four steps can now be taken (a number of them are already ongoing at the OECD) to implement a standardised multilateral model of automatic exchange:

Step 1. Enact broad framework legislation

Most jurisdictions will need to adopt legislation to implement the Model 1 IGA and in particular the domestic reporting obligations. This presents an opportunity to create in one step a broader framework legislation facilitating the subsequent expansion of a country’s network of partner jurisdictions. The framework legislation could allow the executive to expand reporting to accountholders that are residents of other jurisdictions by way of regulation and/or administrative guidance, provided relevant conditions are met.

Step 2. Select a legal basis for the exchange of information

Different legal bases for automatic exchanges of information reported under a comprehensive reporting regime (i.e., covering different types of investment income and financial information, applying to individuals and certain entities, and covering a wide range of financial institutions) already exist. While bilateral treaties such as those based on article 26 of the OECD Model (2010) permit such exchanges, it may be more efficient to establish automatic exchange relationships through a multilateral information exchange instrument. The multilateral Convention on Mutual Administrative Assistance in Tax Matters (the Convention), as amended in 2011, is such an instrument. It provides for all possible forms of administrative co-operation between States, contains strict rules on confidentiality and proper use, and permits automatic exchange of information. One of its main advantages is its global reach: more than 60 countries, including all G20 countries, have either signed the Convention or committed to do so with further signatures expected before the September 2013 G20 Summit in St. Petersburg.

Step 3. Adapt the scope of the reporting and due diligence requirements and coordinate guidance to ensure consistency and reduce cost

Developing a standardised model for automatic exchange can draw on the Model 1 IGA, with amendments required to support a standardised multilateral model that addresses the needs of all participating jurisdictions and remains administrable for both financial institutions and participating jurisdictions. These changes include simplifying the rules by removing U.S. specificities that are not needed or feasible for a multilateral approach, dealing with any different effective dates from those used for the Model 1 IGA itself and building on what already exists for instance in the EU context and in the area of anti-money laundering standards. Work in this area started at the OECD in 2012 and is progressing rapidly. OECD and G20 countries discussed draft proposals at their last meeting in March 2013 and the next meeting is scheduled for June. For the purposes of illustration, examples of areas where such changes are needed include: thresholds, exceptions to reportable accountholders, due diligence procedures and exceptions to reporting financial institutions.

Step 4. Develop common or compatible IT standards

(a) The reporting format

A standard format for the exchange of information is essential to ensure the model remains effective and administrable. The OECD has brought together its member countries, the EU, and representatives of the business community to assist in the development of a reporting format ("schema") for implementing FATCA which is based on STF (Standard Transmission Format - standard format for automatic exchange of tax information which was developed by the OECD and uses XML language) and incorporates many elements of FISC 153 (standard that is used for the Savings Directive (2003/48)). It is expected that this will be flexible enough to be used for reporting and exchange under a multilateral exchange model, subject to minor amendments.

(b) Compatible transmission methods and agreed levels of encryption

Already a number of jurisdictions have experience in exchanging tax information through electronic means and using agreed encryption standards. In its effort to prepare for FATCA implementation, the United States is working to develop a secure data exchange process that intends to allow jurisdictions to exchange data securely based on agreed encryption protocols and software compatibility solutions. This process could potentially be used by interested jurisdictions not only for exchange but also for data collection.

United Kingdom

Think Tank Calls On UK To 'Embrace' Tax Havens

The Institute of Economic Affairs has claimed that so-called "tax havens" are essential to the maintenance of a healthy economy, help to limit the overall tax burden, and improve efficiency in financial markets.

The free market think tank has published a new report that urges governments to recognize the benefits of tax havens. According to the author Jamie Collier, a lack of understanding characterizes the increasing vilification of the tax practices of multinational corporations. Worse still, the pronouncements of governments on this issue are labelled as hypocritical. In the case of the UK Government, Collier recommends that it "stop simultaneously talking about the need to encourage business whilst also deriding tax havens and companies that use existing tax rules to minimise their tax bill."

Among the report's conclusions is that big businesses would be forced to move away from the UK if tax havens were no longer available. A single rate of corporate tax would need to be set, and, if lowered too far, could cause the overall tax take to fall. If the rate was too high, on the other hand, businesses would simply head overseas.

The report contends that the UK has in fact done rather well through the existence of tax havens. They allow the UK to make the most of its financial services regime, by preventing incidences of double or triple taxation on investment returns. Both wealth and job creation have followed, as tax havens, together with a high mobility of capital, have meant that governments are constrained in the tax rates they could otherwise apply.

Commenting on the research, Professor Philip Booth, Editorial Director at the Institute of Economic Affairs, said: "The present furore about tax havens has generated more heat than light. Politicians of all stripes are playing a dangerous game vilifying businesses for taking advantage of the tax systems that they themselves designed. British politicians can therefore hardly complain when other countries do the same and when businesses take advantage of those rules."

Sri Lanka imposes new gold import tax

Sri Lanka announced a 10 percent tax on gold imports Friday in what observers said was a bid to curb smuggling to India as global markets trading in the precious metal reported sharp price drops to 2010 levels. Earlier this week India - the world's largest consumer of gold - hiked import duty on the precious metal to eight percent to stem surging demand and reduce the country's ballooning current account deficit, as consumers sought to exploit the fall in prices.

2013 TRI 1292 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
MUMBAI "K" BENCH, MUMBAI

Rajendra Singh, Accountant Member and Vivek Varma, Judicial Member

FACTS/HELD

Transfer Pricing: "High End" Cos in ITES/BPO sector comparable to "Low End" ones

1. The assessee raised three contentions in support of the contention that its charges were at ALP: (i) that the assessee was engaged in the "low end" activity of "voice based call centre" and that the comparables chosen by the TPO were not functionally comparable as they were engaged in the "high end" activity of "knowledge process outsourcing (KPO)", "software development" etc, (ii) that the margin has to be computed on the basis of return on asset employed (ROA) or on capital employed (ROCE) and not on the basis of operating cost & (iii) that as its income was exempt u/s 10A, there was no 'tax avoidance' and the transfer pricing provisions could not apply. HELD by the Tribunal:

   (i) The argument that the ITES/BPO industry has several segments starting from low end segment such 'call centre', 'customer care' to high end segments such as 'KPO', 'content development' etc. in which there is wide variation in the billing rates and that high end services are not comparable to the low end services is not acceptable because under Rule 10B(2) the comparability of an international transaction with an uncontrolled transaction has to be judged with the reference to the services provided, functions performed, asset employed and risk assumed. All companies which are in the ITES segment are providing similar services and difference is in the internal working which is reflected through difference in qualifications and skills of the employees. The difference in skill/ qualification of the employees and their payment structure and the difference in billing rate does not affect the comparability in any significant manner under TNMM;

(ii) Though Rule 10B(1)(e) gives the option of computing the margin in relation to asset employed (ROA or ROCE), the OECD and the United Nations TP manual provide that ROCA/ROA are suitable only for manufacturing and other capital or asset intensive industries and not for the service sector. In the case of service companies, the main asset is employees which is not reflected in the balance sheet and, therefore, ROCA/ROA will not be an appropriate method for the purpose of computation of margin;

(iii) The argument that as the assessee's income is exempt u/s 10A, there was no tax avoidance in transferring profit to a low tax jurisdiction is not acceptable because the law has to be applied as enacted. There is no provision in the transfer pricing regulations that for applying the said provisions the revenue has to prove tax avoidance. Once there is a international transaction, the ALP has to be computed as per the prescribed methods.

Appeals partly allowed.

ITA No.7140/Mum/2012 (Assessment year: 2007-08) & ITA No. 7097/Mum/2012 (Assessment year: 2007-08).

Heard on: 8th April, 2013.

Decided on: 26th April, 2013.

Present at hearing: Yogesh Thar, for Appellant. Ajit Kumar Jain, for Respondent in ITA No.7140 /Mum/2012. Ajit Kumar Jain, for Appellant. Yogesh Thar, for Respondent in ITA No. 7097/Mum/2012.

JUDGMENT

Per Rajendra Singh:– (Accountant Member)

These cross appeals are directed against the order dated 11.9.2012 of CIT (A) for the assessment year 2007-08. The disputes raised by the parties in these appeals relate to transfer pricing adjustment made by the Assessing Officer (AO) on account of international transactions entered into by the assessee with associated enterprise, (AE).

2. The facts in brief are that the assessee who was engaged in the business of providing voice based call centre services, had provided such

services to its holding company i.e. Hutchison Call Centre Holding Limited for which the assessee had received payment of Rs. 2925441490 during the year. Since the assessee had entered into international transaction with an associate enterprise, the Assessing Officer called for the necessary information/details for application of transfer pricing provisions. The assessee conducted its transfer pricing study in which TNMM method was used for bench marking the international transaction. The assessee in the TP study identified 39 comparables out of which 9 companies were selected as per details given below:–

Sl No.	Name of the company	Operating Cost	PBIT	%of PBIT
1	Allsec Technologies Limited	88.60	24.79	27.98%
2	Ask Me Info Hub. Ltd.	2.98	0.01	0.34%
3	Godrej Upstream Ltd.	17.97	0.46	2.56%
4	NIIT Smartserve Ltd.	53.85	2.21	4.10%
5	Nipuna Services Ltd.	172.57	0.59	0.34%
6	Optimus Global Services ltd.	33.07	(1.42)	-4.29%
7	Transwork Information Services Ltd.	176.03	21.12	12.00%
8	Sparsh BPO Services Ltd.	81.70	5.76	7.05%
9	HTMT Global Solution Ltd.	253.16	12.32	4.87%
Arithmetic Mean				6.10%

3. The assessee submitted that the price charged by the assessee from the AE was cost plus 7% mark up. It was pointed out that margin on operating cost in case of comparables selected by it was 6.10%. The assessee also submitted that certain costs such as linked cost and equipment cost had been incurred by the AE on behalf of the assessee and therefore in case the adjustments were made in relation to such costs, the margin of the assessee on operating cost would be 15.16%. The TPO however conducted his own search and identified 25 comparables providing Information Technology Enabled Services (ITES) as per details given below:–

S. No.	Name of the Comparable Company	Turnover	NCP%
1	Accentia Technologies Ltd	16.57	38.26
2	Aditya Birla Minacs Worldwide Ltd.	197.06	11.98
3	Allsec Technologies Ltd.	113.28	27.31
4	Apex Knowledge Solutions Pvt. Ltd.	4.92	20.48
5	Appollo Healthstreet Ltd.	47.84	-13.55

6	Asit C. Mehta Financial Services Ltd.	6.09	24.21
7	Bodhtree Consulting Ltd.	(Seg).	2.94 29.58
8	Caliber Point Business Solutions Ltd.	39.3	21.26
9	Cosmic Global Ltd.	4.28	12.4
10	Datamatic Financial services ltd. (Seg)	2.92	5.07
11	Eclerx Services Ltd.	86.12	103.72
12	Flextronics Software Systems Ltd. (Seg)	21.41	14.54
13	Genesys International Corporation Ltd.	19.17	13.53
14	HCL Comnet Systems & services Ltd.	260.18	44.99
15	ICRA Techno Analytics ltd. (Seg).	7.23	12.24
16	Informed Technologies India ltd.	4.08	35.56
17	Infosys BPO Ltd.	649.56	66.14
18	IServices India Pvt Ltd.	16.29	50.27
19	Maple Solutions Ltd.	12.21	34.05
20	Mold-Tek Technologies Ltd.	11.4	113.49
21	R. Systems International Ltd.	17.34	20.18
22	Spanco Ltd. (Seg)	35	25.81
23	Triton Corp Ltd.	53.37	34.93
24	Vishal Information Technologies Ltd.	30.6	51.19
25	Wipro Ltd. (Seg)	939.78	29.7
Arithmetic Mean			33.09%

4. In response to the new comparables selected by TPO, the assessee submitted that Allsec Technologies and Transwork Information Ltd., were already selected by assessee in its comparables. The assessee also submitted that Spanco was comparable to the case of assessee. In respect of the other companies, it was submitted that quite a few of them were in the field of computer software and other companies which were in ITES/BPO segment were doing high end job, and therefore, these companies were not functionally comparable. The assessee referred to the comparative billing rates as per NASSCOM report 2003-04 as per which the billing rates in respect of high end services such as content development and knowledge process outsourcing (KPO),which were very high. In relation to Maple E solution Ltd., it was submitted that business operations of this company were controlled by Triton and, therefore, it was submitted that this company should be excluded on the ground of related party transactions. The assessee also requested for working

capital adjustments and submitted that after making such adjustments, the margin in case of the assessee would be 8.86 after including Spanco limited which was comparable to the assessee. It was also submitted that in case the adjustment was made on account of cost incurred by the AE, the margin would be 17.04%. The Assessing Officer, however, did not accept the contentions raised. It was observed by him that transaction of Maple (E) Solution Ltd. with Triniton were only on capital account and, therefore, it will not have any impact on the revenue stream. As regards, Wipro it was pointed out that the assessee itself had selected it as one of the comparables in the last year. TPO also observed that the assessee had not pointed out functional differences with respect to the companies selected by TPO as the assessee had conceded that most of the companies were in the ITES sector. The main objection of the assessee was that these companies were rendering high end activities in which charges per hour was very high. The TPO further observed that in such cases of high end companies, employees cost will also be high and therefore margins would not be impacted much. In relation to the comparables selected by the assessee, TPO observed that M/s Optimus Global Services was incurring persistent losses for the last three years. The TPO therefore excluded this company from the list of comparable cases. TPO thus finally selected thirty one comparables, eight from the list of comparables selected by assessee and twenty three new comparable selected by him (excluding two common comparables) and computed the mean margin of these thirty one comparables at 25.25% as per details given below:–

1	Allsec Technologies Ltd.	27.98%
2	Ask Me Info Hub Ltd.	0.34%
3	Godrej Upstream Ltd.	2.56%
4	NIIT smartserve Ltd.	4.10%
5	Nipuna Services Ltd.	0.34%
6.	Transworks Information Services Ltd.	12.00%
7.	Sparsh BPO Services Ltd.	7.05%
8.	HTMT Global Solution Ltd.	4.87%
9	Accentual Technologies	38.26%
10	Apex Knowledge Solutions Pvt. Ltd.	12.83%
11	Apollo Healthcare Ltd.	-13.55%
12	Asit C. Mehta Financial Services Ltd.	24.21%
13	Caliber Point Business Solutions Ltd	21.26%
14	Cosmic Global Ltd.	12.40%
15	Datamatics Financial Services Ltd. (Seg).	5.07%
16	Exclerx Services Ltd.	90.43%

17	Flextronics Software Systems Ltd. (Seg)	14.54%
18	Genesys International Corporation Ltd.	13.35%
19	HCL Comnet Systems & Services Ltd.	44.99%
20	Informed Technologies India Ltd.	35.56%
21	IServices India Pvt. Ltd.	50.27%
22	Mold Tek Technlogies Ltd.	113.49%
23	R Systems International Ltd. (Seg).	20.18%
24	Spanco Ltd. (Seg.)	25.81%
25	Vishal Information Technologies Ltd.	51.19%
26	Bodhtree Consulting Ltd. (Seg).	29.58%
27	ICRA Techno Analytics Ltd. (Seg)	12.24%
28	Infosys BPO Ltd.	28.78%
29	Maple E Solutions Ltd.	34.05%
30	Triton Corp. Ltd.	34.93%
31	Wipro Ltd. (Seg).	29.70%
	Arithmetic Mean	25.25

5. The TPO accordingly made adjustment on account of transfer pricing at Rs. 502236923 on the basis of mean margin 25.25%. The Assessing Officer, thus, in the assessment order passed made an addition of Rs. 502236923 to the total income.

6. The assessee disputed the decision of the Assessing Officer making adjustment on account of transfer pricing and raised several objections before CIT(A). The first objection was regarding applicability of transfer pricing provision in case of the assessee whose income was exempt u/s 10 A of the Income Tax Act. It was submitted that the assessee had no advantage in transferring profit to low tax jurisdiction as the income of the assessee was exempt. The assessee placed reliance on the decision of Tribunal of Bangalore bench in case of *Phillips Software Centre (P) Ltd.* (26 SOT 226), in which it was held that in case the income of the assessee was exempt u/s10 A, the transfer pricing provision would not be applicable. The Assessing Officer, however, did not accept the contentions raised. It was observed by him that in case the assessee had entered into international transactions and the transfer pricing provisions were applicable, then adjustment had to made as per law and it was not necessary to go to intentions behind the regulations and the Assessing Officer was not required to prove that there was any manipulation by the assessee in shifting the profit outside India. CIT (A) also observed that decision of Bangalore Bench of Tribunal in case of Phillips Software Centre (P) Ltd. (Supra) had been stayed by Hon'ble High Court of

Karnataka in ITA 49/2008, CIT(A), therefore, rejected the argument advanced by the assessee.

7. The assessee also objected to the exclusion of Optimus Global Services Ltd, the comparable selected by the assessee on account of losses. It was submitted that the said company had been set up in the year 2002 which was around the same time when the assessee company had been set up. It was pointed out that it was natural to make losses in the initial few years and that the company had made profit of Rs. 0.58 Lakh in assessment year 2008-09. The assessee referred to several decisions of Tribunal in support of the propositions that the comparables could not be excluded only on the ground of losses. CIT (A) however, did not accept the arguments advanced. It was observed by him that consistent losses could be only on account of some extraordinary factors and therefore, such losses could not be considered as incurred during normal course of business. CIT(A) also observed that for making comparison only the data for past two years could be considered as per rule and not the data of subsequent year, and therefore, profit made by the Optimus Global Services ltd. in assessment year 2008-09 was not relevant. CIT (A) accordingly upheld the order of Assessing Officer excluding the said comparable.

8. The assessee also raised objection to the four comparables selected by TPO on the ground that these were cases of exceptionally high profit margins as per details given below, reproduced from page 10 of CIT (A).

Sl. No.	Name of the Company	Operating Profit (%)
1.	Eclerx Services Ltd.	90.34%
2.	Iservices India Private Ltd.	50.27%
3.	Mold0tek Technologies Limited	113.49%
4.	Vishal Information Technologies Ltd.	51.19%

8.1 The assessee requested that the above exceptionally high profit cases should be excluded. The assessee placed reliance on several decisions of Tribunal in support of the said proposition. CIT (A) however, did not accept the contentions raised. It was observed by him that the high/low profit alone was not a **factor** for excluding the comparables and only in cases where such high/low profit was on account of factors affecting to the comparability of the companies, these cases could be excluded. CIT(A) placed reliance on the decision of Mumbai Bench of Tribunal in case of DCIT Vs. BP India Services (P) Ltd. in ITA 4425/Mum/2013. CIT (A), accordingly, rejected the plea of the assessee to exclude the above four comparables on the ground of high profit margin alone.

9. The assessee also raised objections on the ground of functional comparability. It was submitted that out of the twenty three companies

selected by TPO, 21 were functionally not comparable with the assessee as they were not engaged in voice based call centre. These were providing high end services such as Knowledge Process Outsourcing (KPO), Software Development etc. It was argued that the assessee was operating in the lowest strata of various ITES services as the nature of work was similar to customer care centre. The assessee referred to the billing rates per hour given in the NASSCOM report in relation to different sections of ITES services to point out that there was steep difference in the billing rate between the low end services and high end services. In this regard, the statistics from the NASSCOM strategic review 2005 was given as under;–

Sl. No.	Type of Service	Billing Rate per Hour
1	Customer Care	10-14$
2.	Payment services	12-15$
3.	Finance	12-15$
4	Admin	12-15$
5	Human Resource	15-17$
6	Content Development	18-24$
7	Knowledge Process Outsourcing (“KPO”)	30-34$

9.1 The assessee further submitted that the candidates employed by the assessee were graduates/under graduates with English speaking skills as nature of work handled by them did not require any special skills like those possessed by software professionals, technical consultants, accountants etc. It was pointed out that ITES/BPO had a wide network of services such as high end services like content development, finance and account, HR etc, which required specialized skills. It was also pointed out that several companies selected by TPO were engaged in content development and knowledge process outsourcing and other high end segments and, therefore, these companies were functionally not comparable. The assessee placed reliance on some decisions of Tribunal in support of the plea that these companies were not comparable.

9.2 The CIT (A) after considering the submissions of assessee observed that the assessee had itself mentioned that several companies selected by the TPO were in ITES/BPO segment and therefore these were functionally comparable. CIT (A) also observed that the assessee had submitted functional details of the companies on the basis of the details available on the web site which was not correct as details only from audited accounts should be taken. After considering the details as per audited accounts, CIT (A) observed that in many cases functions of the company had been mentioned as computer software but in fact these were not in development of computer software. He referred to Accentia Technologies Ltd. which had most of the revenue from medical transcriptions and therefore it was not a software company. Similarly Apex Knowledge Solution Ltd. was engaged in contact management and not providing any computer software services. The assessee had mentioned that Genesys International Corporation Ltd. was providing computer software services but actually the company was helping in the management of information creation flow and analysis through information technology and therefore the function was similar to an ITES company. Other companies were operating in the field of BPO/KPO, Medical Transcription, whose functions were similar. CIT (A) further observed that though billing rate in case of high end ITES services was high, corresponding expenses on employees were also high and, therefore, it did not impact the margins much. Since, the functions of these companies were similar, CIT (A) observed that these could not be excluded.

10. CIT (A) accordingly rejected most of the functional objections raised by the assessee and agreed that only in six cases there were functional differences and therefore held that only these comparables should be excluded. The details of these six comparables and the reasons given by CIT (A) for exclusion are given below:–

Sl. No.	Name of the Company	Reasons for exclusion
1	Bodhtree Consulting Ltd. (Seg).	Company engaged mainly in software development and therefore functionally not comparable
2.	ICRA Techno Analytics Ltd. (Seg).	The company helps in identifying, designing, billing and maintaining solutions that are continually comparatible with business and technology strategies. The function are therefore not comparable to that of the assessee.
3.	Infosys BPO Ltd.	This company is an ITES/BPO company but it has grand value and incurs heavy marketing and selling expenses and cost on software package for own use and therefore not comparable.
4.	Wipro Ltd.	Reasons for exclusion are same as above.

5.	Triton Corp. Ltd.	The annual report of the company shows that the company was engaged in trading of ITES Peripherals and had incurred 14.07% of total expenses on account of purchases and disclosed inventory of stores in the financials. The company has single segment i.e. IT and ITES. There is no separate ITES segment, and, therefore, not comparable.
6.	Maple (E) Solutions Ltd.	This company was acquired by Triton Corp Ltd. w.e.f 1.1.2007. Therefore non comparable on the same ground on which Triton Corp Ltd. was excluded. Thus this company was also to be excluded from the comparables.

11. The assessee also pointed out errors in the margin of comparables computed by the TPO. It was pointed out that based on date available in the public domain, margins were found to be different than those computed by TPO on the basis of information obtained u/s 133 (6) in case of four companies i.e. Flextronics Software (Seg), HCL Comnet (Seg), Moldtek Technologies Ltd and R. Systems International ltd. It was pointed that in case correct margin was taken the mean margin of comparables would come to 29.26 against 30.75% computed by TPO.

11.1 CIT (A) after considering the submissions of the assessee directed the TPO to look into the margin computation given by assessee and rectify the same if required at the time of giving effect to the appellate order.

12. The assessee also requested that adjustment may be allowed on account of working capital and linked cost and other costs incurred by the AE on behalf of the assessee. It was pointed out that after making these adjustments, the margin in the case of assessee would come to 17.04%. The assessee pointed out that rule 10B (3) (ii) and Rule10 C (2)(e) permitted adjustment to eliminate material defects of the difference between the assessee and comparables. The assessee also referred to the decision of Tribunal in the assessee's own case in assessment year 2005-06 in which the same issue had been restored by the Tribunal to the file of Assessing Officer. CIT (A) however did not accept the contentions raised. He referred to the rule 10B (1) (e) (iii) as per which net profit margin of the comparable uncontrolled transaction is required to be adjusted to take into account the difference between the international transaction and the comparable uncontrolled transaction. CIT (A) observed that the assessee had not submitted any factual details in

respect of the comparables indicating need for any such adjustment. It was also observed by him that the assessee had not made any such adjustment in the transfer pricing study. The assessee made the claim only when the TPO proposed to exclude certain comparables or to include certain other comparables. Therefore CIT (A) held that claim could not be allowed now as held by the Tribunal in case of Symantec software sales (P) Ltd. As regards the reference by the assessee to the decision of the Tribunal in assessment years 2005-06 and 2006-07, CIT (A) observed that in these orders, ITAT had only set aside the issue and not allowed the claim to the assessee. CIT (A) also observed that no comparables were perfect without any difference or variation and to account for such difference standard deviation of +/- 5%, has been provided in the Act while computing the ALP. CIT (A), therefore, rejected the claim of the adjustment made by assessee.

13. The assessee also claimed the benefit of +/- 5% deviation to the on sale price as provided in the *proviso* to section 92 C (2). The assessee referred to several decisions of Tribunal in support of the claim. CIT (A) however observed that the second *proviso* to section 92 C (2) was amended by the Finance Act 2009 to provide that the standard deviation can be allowed only if the arms length price was within the 5% of the transfer price. It was further clarified by the finance Act 2012 that the said amendment would apply to all assessments and re-assessments pending before the Assessing Officer as on 1.10.2009. Since in this case, the proceedings were pending before AO/TPO as on 1.10.2009 and the ALP determined by the AO exceeded the transfer price by more than 5%, CIT (A) did not allow the claim of the assessee.

14. The assessee further argued before CIT (A) that in TNMM method the net profit margin could be computed in relation to cost incurred, sales affected or asset employed as provided in the Rule 10B (1) (e) (i). It was submitted that though the assessee had computed the margin on the operating cost, it had requested the TPO compute the same on assets employed. It was pointed out that margin of the assessee on the basis of asset employed was 54.04% which was more than the margin of 47.76% of the comparables selected by TPO and margin of 11.37% of the comparables selected by the assessee. It was, therefore, urged that in view of the higher margin on the asset employed, no adjustment was required to be made. After considering the submissions of the assessee. CIT (A) observed that the assessee was a service provider and ran the dedicated call centre which was being remunerated on cost plus basis by the AE. In case of cost plus remuneration, return on asset employed would not adequately capture all the costs associated with functions undertaken and risk assumed. CIT (A) also observed that in case of service industry, the main asset was human resource which was not reflected in the balance-sheet of the company. Therefore in computing return on asset employed the main asset cost will go out of consideration.

CIT (A) thus held that PLI as return on asset employed was not suitable in this case and accordingly rejected the claim.

15 CIT (A) thus directed the Assessing Officer/TPO to re-compute the transfer pricing adjustment in the light of decision taken by him in relation to the comparables and the various claims made by the assessee. Aggrieved by the decision of the CIT (A), the assessee is in appeal before Tribunal objecting to the 15 comparables selected by TPO which had been upheld by CIT (A), exclusion of one comparable selected by the assessee and the rejection of other claims of the assessee on various issues, whereas the revenue is aggrieved by the decision of CIT(A) excluding the six comparables selected by the TPO.

16. We first deal with the various disputed raised by the assessee in the appeal. The first dispute is regarding the selection of comparables and the decision of CIT (A) to uphold the selection of 15 comparables selected by TPO and exclusion of one of the comparables selected by assessee i.e. Optimus Global Services Ltd. The learned AR submitted that 15 comparables selected by TPO and upheld by CIT (A) were operating in different segments of ITES and were not providing services similar to that of the assessee, which was running a voice based call centre. The comparables selected by TPO provided different services such as software services, geographical information service, medical transcription service, knowledge process outsourcing services etc., which were not comparable to the case of the assessee. It was pointed out that under Rule 10B (2) the comparability of international transaction with uncontrolled transaction has to be judged with the reference to characteristics of the services rendered and the functions performed. Since the functions performed and the services rendered were different, these cases were not comparable. It was pointed out that some of the comparables were engaged in high end IT enabled services such as KPO, medical transcription, etc., requiring skilled employees and therefore, these were not comparable to the case of the assessee and should be excluded. It was also argued that certain comparables selected by the TPO had super normal profits and therefore these were not comparable and should be excluded. Reliance was placed on some decisions of the Tribunal in support of the plea. In regard to Optimus Global Services Limited., the comparables selected by the assessee which had been excluded by CIT (A), it was submitted that the said company was functionally comparable and had been set up around the same time when the assessee company was set up and therefore, it should not be excluded only on the ground of persistent losses. It was also pointed out that the said company had earned profit in the assessment year 2008-09

17. Learned CIT(DR) on the other hand submitted that the assessee was providing IT enabled services (ITES) as a call centre. It was pointed out that as per the details given by the assessee in para 9.3.1 at page 93 of the paper book. the assessee had made the search based on ITES. He

also referred to the details given by the assessee in para 6 at page 181 of the paper book in which it was mentioned that the assessee belonged to ITES/BPO industry. The learned CIT (DR) also referred to NASSCOM's member directory a copy of which was placed on record as per which the assessee had been characterized as BPO/IT service company. Thus, the assessee was providing the ITES or Back Office Operation (BPO). He referred to the CBDT notification SO 890 (E) 26.9.2000 issued in connection with section 10 A and 10B in which IT enabled product or services were defined to mean:–

(i) Back office operation

(ii) Call centers

(iii) Content development or animation,

(iv) Data processing

(v) Engineering and design

(vi) Geographic Information System services.

(vii) Human Resource services.

(viii) Insurance claim processing.

(ix) Legal database

(x) Medical transcription

(xi) Payroll

(xii) Remote Maintenance

(xiii) Revenue Accounting

(xiv) Support Centers, and

(xv) Web site services."

17.1 The learned CIT (DR) argued that the services provided by the comparables selected by TPO fell in the category of ITES. It was pointed out that in a particular category of service no distinction can be made between high end and low end services as argued by learned AR as in TNMM method which the assessee had followed, standard of comparability was relatively relaxed and broad similarity of function was required. It was also submitted that the comparables selected by TPO broadly performed functions similar to that of the assessee and were part of ITES segments and therefore, these could not be rejected on the ground of high end activity. He referred to the decision of Hyderabad bench of Tribunal in case of Delloite Consultancy India (P) ltd. in ITA 1082/HYD/2010, in which the Tribunal held that " No two comparable companies could be replica of each other". Reference was also made to a decision of Delhi bench of Tribunal in case of ACTIS Advisors in ITA 122/Delhi/2011 in which it was held that it was quite difficult to get accurate comparables and in case the assessee wanted that IT enabled services should be further dissected, there will not be any end to it and it would be a very subjective exercise.

17.2 The learned CIT DR further submitted that even the comparables selected by the assessee were not engaged in activities which were exactly that of the assessee. He referred to the services performed by those comparables which has been given in table below to point out that the services being provided were not identical to that by the assessee:–

S. No.	Name of the Company	Remarks
1.	Allsec Technologies Ltd.	Call centre, customer services, HR and Payroll processing.
2.	Ask Me Infor Hubs	Telemarketing and customer support services
3	Godrej Upstream Ltd	Contact Center Solution in Travel Domain
4.	NIIT Smart Serve Ltd.	Insurance and financial services call centre, web/e-mail based support services, back office processing
5	Nipuna Services Limited	Contact center
6	Optimus Global Services Limited	Comprehensive Portfolio
7	Transwork information Services Ltd	Financial services, Telecom, Technology and hospitality, Call centre, order processing, claims processing, and loan/mortgage processing.
8	Sparsh BPO Services	Business to Business and Business to customer services
9	HTMT Global solutions	HTMT provides consultancy and development services covering business domain knowledge, technology and process in the domains of automotive, insurance, IT, Customer Services banking, finance and telecom

17.3 Learned CIT DR further submitted that high profit margin or low profit margin could not be the basis for exclusion of a particular comparable, if the comparable is functionally comparable to that of the assessee. He therefore, objected to the argument of learned AR to exclude the four comparables having very high profit margin starting from 50.27% to 101.77%. He placed reliance on the latest decision of Tribunal in case of Willis Processing Services India (P) Ltd. in ITA no4547/Mum/2012 for the assessment year 2007-08. The learned CIT (DR) also supported the decision of CIT (A) to exclude the persistent loss making comparable i.e. Optimus Global Services Ltd. He referred to the decision of Hyderabad bench of Tribunal in case of Brigade Global Services (P) Ltd. in which it was held that in case the company was incurring continuous loss year by year it should not be considered as comparable and following the said judgment, the Mumbai Bench of Tribunal in case of Goldman Sach (I) Securities (P) ltd. held that for excluding a comparable the persistent loss has to be for a period of three years. It was also submitted that there was no merit in the contention of the learned AR that age and formation of the company should also be criteria for comparability analysis as held by the Mumbai bench of Tribunal in case of FIRMENICH Aromatics (1) (P) Ltd. in ITA no. 2056/Mum/2006. As regards the argument of the Learned AR that said company had a profit in assessment year 2008-09, it was submitted that for making comparability analysis, data of subsequent year could not be considered under the rules.

18. The details of functions of the 15 comparables of the TPO accepted by CIT (A) as given by the learned AR and the arguments of the department as to why the decision of CIT (A) should be uphold as summarized in the table below:–

Sl. No.	Name of the Company	Functional Difference Pointed out by the AR	Arguments of the Revenue
1	Accentia Technologies Limited	Computer Software, Medical Transcription Billing and Coding and Software Sales	The Profit and Lost Account and the Schedule of Revenue is attached which shows that almost 67% of the revenue of the company is from medical Transcription and Billing and Coding which are ITES activities. Medical Transcription is ITES as per notification no. 890 dated 26.9.2000
2	Apex Knowledge Solutions Ltd.	Computer Softwaredatabase creation services	Annual report of the company shows that the revenue is generated from export of software and related activity Schedule 12 shows exports of software and related ITES activities. There are no segmental available
3	Apollo Healthcare Ltd.	Medical Transcription-Medical BPO	Medical Transcription is ITES as per notification No. 890 dated 26.9.2000

			In Willis Processing Services India Pvt. Limited in Para No.25 this company was excluded by the ITAT for the reason that there are related party transactions of 81% in this company
4	Asit C Mehta (Nucleus Netsoft)	ITES/Portfolio Management Services and Investment	The annual report of the company shows that the income is from ITES Content development is ITES as per notification no. 890 dated 26.09.2000.
5	Caliber Point Business Solutions ltd.	Computer Softwarebusiness process management	Annual report of the company shows that segmental accounts are available and BPO segment's results can be used for the purpose of comparison.
6	Cosmic Global Ltd	Translation Charges-Medical Transcription and consultancy services and Accounts BPO	The annual report of the company shows that the company is deriving income from medical transcription, Translation charges and BPO
			Medical Transcription is ITES as per notification No. 890 ated 26.09.2000 **However the translation charges are not covered in notification No. 890 dated 26.09.2000.**
7	Datamatics Finacial Services Ltd. (Seg).	ITES/BPO-ITES in the field of financial accounting services and internet based research services as per the information collected by the TPO u/s133 (6)	Annual report of the company shows that it is deriving income from Processing and Printing and export of ITES. There are no segmental results available so the margins of ITES cannot be computed.
8	Eclerx Services Ltd.	(i). ITES/BPO-BPO Services	The annual report of the company shows that it is engaged in BPO services.
		(ii) High Profit Margin	**Rely on the discussion in Para No. 34 of Willis Processing Services India Pvt. Ltd in which it was decided that a company cannot be excluded on the basis of high or low margin.**

9	Genesys International Corporation Ltd.	Computer-Software Geographical Information Services	The annual report of this company shows that it is deriving income from GIS activities which is an ITES activity as per Notification No. 890 dated 26.09.2000. Accepted as comparable by ITAT in Willis Processing Services India Pvt. Ltd.
10	HCL Comnet (seg)	Telephonic Communication and ITES-comprising data centre management services, end user computing services, networking services & tools & process consulting services	The annual report of this company shows there are segmental results available for ITES segment which can be used for the purpose of comparison.
11	Informed Technologies India Ltd.	ITES/BPO-KPO services	The annual report of the company shows that the revenue is derived from BPO activities. There is no reference in the annual accounts of the KPO activities.
12	I Services India Pvt. Ltd.	(i). ITES/BPOBPO unit providing back office services. Further as per the information u/s 133 (6) of the Act for AY 2008-09 and AY 2009-10 the company is engaged in providing remote data services and GIS.	The information collected by the TPO for subsequent year cannot be used for the current financial year since the functional profile of the company might change. GIS activities is an ITES activity as per notification no. 890 dated 26.09.2000.
		(ii) High Profit margin company	**Rely on discussion in para No. 34 of Willis Processing Services India Pvt. Ltd. in which it was decided that a company cannot be excluded on the basis of high or low margin.**
13	Mold Tek Technologies Limited	ITES/BPO-KPO Division	The annual report shows that the company has segmental accounts which can be used for the purpose of comparison. In the case of **Willis Processing Services India**

			Pvt. Ltd it is held on page 48 (para 34.5) that KPO is a term given to the branch of BPO
		High Profit Margin	**Rely on discussion in Para no. 34 of Willis Processing Services India Pvt. Ltd in which it was decided that a company cannot be excluded on the basis of high or low margin.**
14	R.Systems International Ltd. (Seg.)	ITES/BPO-sale of software products and software development services	In the annual report the BPO segment is available and the same can be used for the comparison.
15	Vishal Information Technologies Limited	i. ITES-BPODigital Library and Print on Demand	The annual report of the company shows that the income of this company is derived from ITES activities.
		ii High Profit margin company	**Rely on discussion in Para No. 34 Willis Processing Services India Pvt. Limited in which it was decided that a company cannot be excluded on the basis of high or low margin.**

19. The learned AR for the assessee in the reply to the arguments advanced by the learned CIT (DR), submitted that reliance on the classification of IT enabled services in the CBDT notification no.890890 dated 26.9.2000 was misplaced as the said notification was in relation to claim of exemption u/s 10A and 10 B and referred to both products and services and, therefore, these could not be applied only to services. Moreover, the comparability had to be decided on the basis of characteristics of services rendered and functions performed which was not so in all the cases in the list. He referred to engineering and design services, GIS, and content development and animation appearing in the list to point out that these were totally different services involving skilled professionals, which was not so in case of call centre. It was also pointed out that if one were to go by the definition of ITES as per the notification, KPOs and BPOs which did not appear in the list have to be excluded. It was therefore urged that said classification was of no relevance to the issue under consideration. As regards the decision of ITAT in case of Actis Advisors (P) Ltd. (Supra) referred to by learned CIT DR, it was submitted that facts of the case were different as the nature of service was consultancy and advisory. In that case neither assessee nor TPO had gone into the horizontal or vertical functional line within the IT enabled

services. It was under these circumstances that the Tribunal held that comparable could not be rejected as it was operating in a different line but in the same sector. The learned AR also referred to the decision of Tribunal in case of *ITO vs. CRM services (P) Ltd.* (14 Taxmann.com 96) in which it was held that comparables which are non voice based BPO should not be compared with voice based BPO. It was pointed out that the said decision of Tribunal had not been brought to the notice of Tribunal in case of Actis Advisor (P) Ltd. (Supra). In regard to reliance placed by the learned CIT (DR) on the decision of Tribunal in case Willis Processing Services India (P) ltd. (Supra), it was submitted that loss or extreme profit case should be further examined for such extreme results and they can be excluded if these are on account of difference in characteristics of services rendered or functions performed. It was also pointed out that in case of Willis Processing Services India (P). Ltd. (Supra), comparables of HCL Comnet Services Ltd. and R.System International Ltd. had been excluded by the Tribunal on the ground of related party transactions.

19.1 The learned AR further submitted that extraordinary profit in case of Mold Tek Technologies was because in that case KPO division had been rendering engineering services to high rise buildings as was clear from the annual report of the company placed on record and, therefore, the case was not comparable to that of the call centre. Similarly, Eclerx Services Ltd. which had shown extraordinary profit had tremendous goodwill among the customers which was nothing but the asset employed, even if the same was not recorded in the books. Moreover, Eclerx Services Ltd. was operating in the field of KPO which was different from call centre activity as was clear from the activities of the company given in the annual report placed on record. In case of Vishal Information Technologies Ltd. having very high margin it was pointed out that the tTribunal in case of Capital IQ information systems (P) Ltd. in ITA no. 1961/HYD/2011 for assessment year 2007-08 noted that this company outsourced its work to 3rd parties and, therefore, it had different model. Moreover, the said company had employed 75 seats (utilized 60 seats) as was clear from the order in case of Willis Processing Services India (P) Ltd. (Supra) whereas the assessee had 2840 seats. It was pointed out that number of seats was nothing but asset employed and, therefore, because of huge difference in asset employed, the company should be excluded. He also referred to the decision of Tribunal in case of Mersk Global Services Ltd ITA/3774/Mum/11 in which it was held that the company running on its own account cannot be compared to the company that was outsourcing work. It was therefore, submitted that this case was also not comparable. In relation to I Services India (P) Ltd. it was submitted that thought the profit in this year was 50.28% the profit in the next year was 9.66% which showed that there was something extraordinary this year resulting into high profit and therefore it should be excluded. Reliance was placed on the decision of Tribunal in case of Actis Advisors (Supra).

19.2. In regard to exclusion of comparables on account of extraordinary events like merger, demerger, amalgamation, it was submitted that Tribunal in case of Capital IQ (Supra) clearly held that in such cases comparable has to be excluded. The Tribunal in case of Willis Processing Services India (P) Ltd (Supra) had taken the same view but held that in case, because of the merger/demerger, the company become functionally different then it should be excluded. It was pointed out that in addition to functional difference, factors like synergies of operation, change of management, operational efficiencies etc are also to be considered. It was pointed out that this aspect had not been examined and, therefore, it was requested that the case of Accentia Technologies and Mold Tek Technologies should be set aside to AO for examination of these aspects.

19.3 In regard to the submission of learned DR that even activities of comparables selected by the assessee were not exactly the same, the learned AR referring to the relevant portion of annual reports of the companies, pointed out that these companies were largely in the call centre business either exclusively or predominantly. It was pointed out that the other activities listed by the Learned DR may be only incidental activities. The learned AR however admitted that the annual report was not clear on the exact nature of services rendered in case of Transwork Information Services Ltd. However, the assessee being in the same business was aware that the nature of business of the said company was pre-dominantly call centre and other activities were only incidental. In case of NIIT Smart Serve, the learned AR referred to the relevant portion of the annual report to point out the party had operations both in Back Office and Voice processing. It was thus, argued that the comparables selected by the assessee were largely in the same business in which the assessee itself was placed.

20. We have perused the records and considered the rival contentions carefully. The dispute is regarding selection of comparables for bench marking the international transaction entered into by the assessee. The assessee had selected 9 comparables as unrelated parties for comparing the transaction in case of the assessee. The AO further selected 23 more comparables out of which 2 comparables i.e. Spanco and Flextronics (Seg.) were accepted by the assessee as comparable and the 21 comparables were disputed by the assessee. Out of these 21 cases, CIT (A) has accepted the claim of the assessee in six cases holding that these cases are not comparable to the case of the assessee on different grounds. The remaining 15 comparables selected by the TPO have been upheld by the CIT (A) as comparables to the case of assessee The assessee has disputed the said order of CIT (A).

20.1 The assessee has followed TNMM method for making the transfer pricing adjustment in relation to the international transaction entered into by the assessee. Therefore, the arithmetic mean of the margins of the comparables is required to be compared with that of the assessee for the purpose of making TP adjustment. The selection of comparables is important, which must be operating in the same field in order to insure that accurate adjustment as provided under the law is made. The assessee is providing IT enabled services as call centre about which there is no dispute. The assessee conducted the search for companies engaged in ITES which is clear from the note submitted by the assessee before the TPO on TP study in para 3.3.1 at page 193 of the paper book. In para 6 of the note at page 181 of paper book, the assessee has mentioned that it belongs to ITES/BPO industry. The learned DR has also placed on record the NASSCOM member directory, in the relevant portion of which the assessee has been described as ITES/BPO company. It is thus clear that the assessee is providing ITES/BPO services. The case of the assessee that ITES/BPO industry is divided into several segments and, therefore, assessee had selected only those companies which were pre-dominantly engaged in call centre business. It has also been submitted that ITES/BPO industry has several segments starting from low segment such Call centre, Customer Care to high end segments such as KPO, content development etc. in which there is wide variation in the billing rates. NASSCOM report on billing rate for different segments has been placed on record. It has thus, been argued that high end services are not comparable to the case of the assessee.

20.2 The comparability of transaction or the selection of comparables in our view has to be examined in terms of the rules framed in this regard. The Rule 10B (2) provides that the comparability of international transaction with uncontrolled transactions has among other things to be judged with the reference to characteristics of services provided, functions performed, asset employed and risk assumed. It has therefore to be insured that functions of the comparables and characteristics of services rendered are similar. Viewed from this angle, we find that all companies which are in ITES segment are providing similar services and difference is in the internal working which is reflected through difference in qualifications and skills of the employees. In all these cases employees are the main assets who are providing various services using Information Technology (IT). The main difference is the skills/qualification of the employees engaged who are providing the services. The employees are the main assets of these companies and therefore, the difference is mainly in the assets employed. Therefore, we have to examine whether difference in the skill/qualification of the employees or their payment structure is going to affect the comparability in any significant manner. TNMM method is tolerant to minor differences and, therefore, even if there are some differences unless they materially affect the margin, the comparables could not be excluded. This is clearly provided in the Rule 10 B (3) as per which an uncontrolled transaction has to be taken as comparable to the international transaction if none of the differences between the transactions compared or the enterprises entering into such transactions are likely to materially affect the price charged, cost incurred or profit earned and even if there are material differences, the uncontrolled transaction can still be considered as comparable if reasonably accurate adjustments could be made by eliminating the material affects of such differences.

20.3 In this case as we have pointed out earlier that difference in various segments i.e. low end to high end in ITES services is mainly on account of differences in the skill/qualification and pay structure of employees and, therefore, the main point to be considered is whether such differences between employees is going to materially affect the margin of the comparables. The learned AR for the assessee has placed before us the NASSCOM report showing billing rates in different segments of the ITES sector to point out that there is wide variation between low end and high end segments. However only on the basis of billing rates no conclusion could be drawn that margins in different segments of ITES services is also different. This is because if the billing rate is high in the high end services, the cost of the employees who are highly qualified/skilled also goes up steeply and, therefore, the margins are not much affected. Infact, no evidence has been produced before us to show that margins in the high end segments of ITES services is high compared to low end services. Therefore, we are unable to accept the argument advanced by learned AR that the comparables belonging to high end segments such as content development, KPO, Medical Transcription etc. should be excluded from the comparability list on this ground alone. In fact, this view is supported by the latest decision of Mumbai bench of Tribunal in case of M/s Willis Processing Services India (P) Ltd. in ITA no. 4544/Mum/2012 for assessment year 2007-08 dated 1.3.2013 in which the Tribunal after considering the various submissions and decisions of Tribunal relied upon by the assessee held that KPO was a term given to a branch of BPO in which apart from processing data, knowledge is also applied. The Tribunal therefore, held that the KPO could not be excluded from the comparability list. The Tribunal in the case of Actis Advisors (P) Ltd.(Supra) have also held that any further dissections of ITES will not be proper as it would be a very subjective exercise. Even in the case of CRM services (P) Ltd (Supra) on which the assessee has relied, there is no finding that margin in case of high end segment of ITES is higher.

20.4 We also note that even in the case of comparables selected by the assessee details of which have been given in para 3 of the order earlier, there is wide fluctuation in the margins of the companies; the lowest margin i.e. 0.34% in case of Ask Me Info Hub Ltd. and the highest margin as 27.98% in case of Allsec Technologies Ltd. Obviously the cases selected by the assessee are not identical otherwise there would not have been so wide variation Excluding the highest margin and the loss case, the average margin of other comparables of the assessee comes to only

4.5% which is 1/6th of the highest margin. Compared to this, the average margin of the comparables of the TPO is within two times the highest margin in case of the assessee. Thus, if the comparables with 1/6th of the highest margin are acceptable to the assessee then, there is no reason for the assessee to be aggrieved with the comparables of TPO where average margin is within twice the highest margin, case selected by the assessee. The objection of the assessee will be valid only if there is material to show that high margin in case of high end services is because of nature of activities. But as it has been pointed out earlier, no such material had been produced. Therefore, we reject the argument advanced based on low end/high end services in the ITES activities.

21 With broad proposition laid down above we may now proceed to deal with the comparables individually to find out if they are suitable for comparison;–

21.1 ACCENTIA TECHNOLOGIES LTD.

This comparable has been objected to by the assessee on the ground of functional differences. It has been pointed out that in addition to Medical Transcription and Billing and Coding, this company is also involved in software sales. The learned DR has placed on record the profit and loss account of the company for the relevant year which shows that out of total revenue of Rs. 50.2 Crore a sum of Rs. 9.6 Crore is from sale of software and revenue from Medical Transcription is 32.1 Crore, which is about 67%of total revenue. There is no segment wise result available in case of Medical Transcription and billing and coding. It is not known by how much the margin is affected by trading in software. Therefore in our view this company could not be considered as a good comparable. We therefore hold that this company has to be excluded.

21.2 APEX KNOWLEDGE SOLUTIONA LTD.

The assessee has objected to the selection of this comparable on the ground that it is engaged in computer software and data base creation services. The annual report of the company for the relevant year has been placed on record which shows that entire revenue has been generated from export of software and related ITES activities. There is no segment wise result available for ITES activity. This company had also been excluded by the Tribunal in case of Willis Processing Services India (P) Ltd.(Supra). We therefore, hold that this company is not a good comparable and has to be excluded.

21.3 APPOLO HELATH LTD.

This company is also providing IT enabled services. The objection of the assessee is on the ground that the services provided are in the high end segment of ITES i.e. Medical transcription and Medical BPO. In our view, as held earlier, on this ground alone the comparable could not be excluded. However, it has been brought to our notice that 81% of the transactions in case of the company are with related parties. With such high RPT, this comparable could not be considered as a good comparable. This comparable had also been considered by Tribunal in case of Willis Processing Services India (P) Ltd. (Supra) and had been excluded on this ground. We therefore, hold that this comparable has to be excluded.

21.4. ASIT C. MEHTA (NUCLEUS NET SOFT).

The assessee has objected the selection of this comparable on the ground that it is engaged in portfolio management services also, in addition of ITES. The learned DR has placed on record the annual report of the company which shows that the assessee is in the field of content development which is an ITES. It is also to be noted that almost entire revenue i.e. Rs. 6.09 crore is from ITES and only a sum of Rs. 23.26 lakh is from portfolio management service which is insignificant which in our view will not have much impact on the margins. Content development is a high end service but as held earlier on this ground alone it cannot be excluded. As there is no material to show that in case of high end services in ITES industry margins are higher than those in low segment.

21.5 CALIBER POINT BUSINESS SOLUTIONS LTD.

The assessee has argued that company is not comparable as it is engaged in business process management and other activities. The learned DR has placed on record the annual report of the company which shows that segmental accounts are available in case of BPO segment. The AO/TPO have taken the entire revenue for the purpose of comparison which in our view will not be appropriate. We therefore, direct that the results of only BPO segment have to be considered for the purpose of comparability and subject to the above, the inclusion of this comparable is upheld. Argument based on high segment as held earlier has to be rejected.

21.6 COSMIC GLOBAL LTD.

The assessee has objected to the inclusion of this comparable on the ground that the company is not comparable as it is mainly engaged in translation business in addition to medical transcription, accounts BPO and consultancy. The learned DR has placed on record the annual report of the company which shows that the main revenue i.e. 4.05 crore is from translation business where as revenue from medical transcription is only 9.72 lakh and from BPO at Rs. 12.41 lakh. The translation business is not comparable to the case of the assessee. Therefore, in our view, this company has to be excluded from the list of comparables. We accordingly direct the Assessing Officer to exclude this comparable.

21.7 DATAMATIC FINANCIAL SERVICES LTD. (SEG).

The assessee has objected to this comparable on the ground that functions are different. The perusal of annual report of the company placed on record shows that this company is deriving substantial revenue from processing and printing and export of ITES. About 50% of the revenue is from printing services. The segment wise result from ITES services is not available. Therefore in our view, this company could not be considered as a good comparable and accordingly we direct the AO to exclude this company from the list of comparables.

21.8. ECLERX SERVICES LTD.

This company is engaged in the BPO business which is an IT enabled service. The learned AR for the assessee has argued against the company on the ground of super profit margins, which according to him makes the company non comparable. He has placed reliance on the decision of the Tribunal in case of Capital IQ Information System India in ITA no. ITA/1961/HYD/11. In the said order, the Tribunal held that super normal profit cases should be excluded as not comparable. However as pointed by the learned DR the same comparable was considered in the latest decision of the Tribunal in case of Willis Processing Services India (P) Ltd (Supra) in which the Tribunal after considering the decision in case of Capital IQ (Supra) held that the comparable could not be excluded only on the ground of high profit margin. The Tribunal observed that inclusion or exclusion of a comparable could not be decided on the basis of factors other than the factors specified in Rule 10B which does not include the margin or loss. Similarly, as held earlier high end or low end segment of ITES could also not be a ground for exclusion or inclusion of a comparable. It has also been argued that the company had high goodwill with customers which is an asset which gave better margins. No doubt good will is an asset which can bring more customers and can increase turnover but as we have discussed in the subsequent part of this order (para 24.3.3), there is no linear relationship between margin and turnover and that the concept of economy of scale is not relevant in case of service companies. The argument thus, has no merit and has to be rejected. Therefore, in our view, this comparable has to be included and accordingly we uphold its selection.

21.9. GENESYS INTERNATIONAL CORPORATION LTD.

The assessee has objected to the selection of this comparable on the ground that it is engaged in high end ITES services i.e. Geographical Information Service (GIS). As we have held earlier, only on the ground of high end or low end segment, comparable could not be excluded or included. GIS is an IT enabled service. The entire revenue of the company as per the annual report placed on record is from GIS activities. We also note that the Tribunal in case of Willis Processing Services India (P) Ltd. (Supra) has accepted this company as a good comparable. We therefore uphold the inclusion of this company.

21.10 HCL COMNET SYSTEMS & SERVICES LTD.

The assessee has objected to this company on the ground that it is engaged in activities different from that of the assessee i.e. telephone communication in addition to ITES. The learned DR has placed on record the annual report of the company to point out that segment wise result for ITES is available, which has been used by the TPO for the purpose of comparison. The Learned AR for the assessee however, pointed out that company had related party transaction up to 21.52% and on this ground this company had been excluded in case of Willis Processing Services India (P) Ltd. (Supra). We agree that related party transaction affect the comparability and in case of high RPT the company could not be really considered as independent unrelated party. In case of Willis Processing Services India (P) Ltd. (Supra) the Tribunal held that related party transaction can be accepted only up to 15%. We therefore accept the plea of the assessee to exclude this comparable.

21.11 <u>INFORMED TECHNOLOGIES INDIA LTD.</u>

The assessee has objected to this comparable on the ground that it is engaged in high end ITES segment i.e. KPO. The Learned DR, however, placed on record the annual report of the company to point out that revenue is derived from BPO activities and there is no reference to KPO activities in the annual accounts. We also find from perusal of accounts that BPO is only reportable segment and the entire revenue is from BPO activities. We have also held earlier that a comparable could not be excluded only on the ground of high end /low end activities. Therefore, we uphold the selection of this company as a comparable.

21.12. <u>I SERVICES INDIA PVT. LTD.</u>

The assessee has objected to the inclusion of this company on the ground that it has a BPO unit providing back office operation. It has also been submitted that as per the information provided u/s 133 (6) for assessment year 2008-09 and 09-10, the company is also engaged in the business of providing remote data entry services and GIS. The learned DR has pointed out that the subsequent year report could not considered for the purpose of comparability as the activity could change in the subsequent year. Moreover, GIS is an IT enabled service. In our view the annual, accounts of the current year i.e. assessment year 2007-08 are required to be seen to find out whether in the relevant year, the assessee was providing services as comparable to the case of assessee. The learned AR has also raised objection on the ground of high profit margin. We have held earlier that a company could not be excluded only on the ground of high profit margins. The same view has also been taken in case of Willis Processing Services India (P) Ltd. (Supra). It has been pointed out that the margin in the immediate succeeding year year was only 9.66% which showed that the margin this year was exceptional. We do not find the argument convincing. It is clear from the rules that for the purpose of comparability, data of current year and upto past two years in certain circumstances can only be considered and not the data of the subsequent year. It has not been shown before us that profit this year was exceptionally high compared to last year due to some extraordinary factor, which affected the comparability. The argument raised is therefore rejected. With these observations we direct the TPO/AO to verify the actual activities of the company from the annual account of the relevant year and include the same if it is found to be engaged in ITES activities.

21.13 <u>MOLD TEK TECHNOLOGY LTD.</u>

The company has a separate IT division in which it is providing Knowledge process outsourcing (KPO) services for which segmental results are available and which had been compared by the TPO with the case of the assessee. The assessee has objected to this comparable on the ground that it is working in the high end segment of ITES which involves highly skilled employees and, therefore, is not comparable to the assessee. Objections have also been raised on the ground of very high profit margin of the assessee. Learned AR has referred to the annual report of the company placed on record in which it has been pointed out that the assessee during the year started engineering services to high rise buildings for clients in US and Canada which offered excellent growth prospects. It was pointed out profit during the year of KPO division registered an increase of 260% compared to the 204% rise in the turnover. We find that the margins have slightly improved this year and there is nothing extraordinary about it. We have already examined both the aspect i.e. offer of high end ITES services and super normal profit and have held that on these grounds alone, a company could not be held as not comparable. We also find that this company had also been considered by the Tribunal in case of Willis Processing Services India (P) Ltd in which all the aspects were considered and the Tribunal held that the IT division of the company was in the nature of KPO which was operating in the ITES segment and has therefore to be considered as comparable to the case of the assessee. The Tribunal also rejected the ground of super normal profit for excluding the comparable. It was also noted that this company had been found to be a good comparable by the Tribunal in case of Actis Advisors (P) Ltd. (Supra). The Tribunal also noted the argument advanced on the ground of merger during the year as recorded by the Tribunal in case of Capital IQ Information (Supra). The Tribunal held that only on the ground of merger/amalgamation the comparable could not be excluded unless it was held that the resulting company was functionally different. The Tribunal restored the merger aspect to the AO/TPO for verification and for fresh decision. Facts in this year are identical. Therefore following the decision of Tribunal in case of Willis Processing Services India (P) Ltd (Supra), it is held that the company is a good comparable subject to the verification of merger aspect and its impact on functional comparability.

21.14. <u>R SYSTEMS INTERNATIONAL LTD. (SEG.)</u>

The assessee has objected to the inclusion of this comparable on the ground that the company is engaged in sale of software products and in software development services which are functionally different and, therefore, not comparable to the assessee company. However, before us, the learned CIT (DR) has placed on record the relevant portion of the annual report of the company which shows that the assessee has also a BPO division for which segmental results are available. The TPO has also taken only BPO segment for the purpose of comparability. We have already held that the company could not be excluded only on the ground of high end services. Therefore, following our decision in earlier part of this order, we hold that this company has to be included as a good comparable and accordingly uphold the order of CIT (A) on this point.

21.15. VISHAL INFORMATION TECHNOLOGIES LTD.

The assessee has objected to the inclusion of this comparable on the ground that the company is engaged in high end BPO services and other functions such as digital library and print on demand. It has also been argued that the company should be excluded on the ground of high profit margin and high turnover as the assessee had 2840 seats compared to 75 seats held by that company. The learned CIT (DR) has however placed on record the annual report of the company for the relevant year which shows that it is a 100% ITES company. The learned CIT (DR) pointed out that digitizing the books was an IT enabled service and so was the print on demand, which was the reason for classifying the company as an ITES company in the annual report. We agree that being an ITES company, it is comparable to the case of the assessee. However, as we have held earlier, supernormal profit or high margin is not a valid ground for exclusion of a comparable. As regards the high number of seats it will mean more employees and more turnover, but as we have discussed in subsequent part of this order at para (24.3.3), there is no linear relationship between margin and turnover and that the concept of economy of scale is not relevant to the service companies. Following the reasoning given therein, we reject the arguments advanced. The learned AR for the assessee, has also sought exclusion of the company on the ground of substantial outsourcing of work. We find that this argument has already been considered by the Tribunal in case of Willis Processing Services India (P) Ltd (Supra). In that case, the Tribunal had considered the argument of the learned DR that the company had seating capacity of 75 out of which 60 had been utilized by the company and, therefore, it was pointed out that the argument that the company was outsourcing work was not correct. The Tribunal further noted the argument of the learned AR that the said information which had been obtained by the learned DR u/s 133 (6) was not addressed to the TPO. The Tribunal, therefore, restored the issue of outsourcing to AO/TPO for fresh examination of relevant facts. The facts in the present case are identical we, therefore, restore the issue of outsourcing to AO/TPO for fresh examination and order after hearing the assessee.

22. OPTIMUS GLOBAL SERVICES LTD.

This comparable had been selected by the assessee. However, both the TPO and CIT (A) have excluded this comparable on the ground that the company was incurring persistent losses for last three years. The argument of the assessee for inclusion of this comparable was that this company was engaged in the same business of call centre and had been set up in the year 2002 which was around the same time the assessee company started business. It has been argued that losses in the business in the initial years is quite normal and it has also been pointed out that in the next assessment year i.e. assessment year 2008-09, the company has started making profit. We have carefully considered the various aspects of the matter. We have already held in earlier part of this order that only loss or super normal profit could not be the sole ground for exclusion of a particular comparable unless there are some factors such as abnormal business conditions which affected the functioning of the company. However, in case, a company is making continuous losses year after year, it definitely reflects some abnormal circumstances and, therefore, the Tribunal in case of Brigade Global Services (P) Ltd. ltd. ITA (1484/HYD/2010) held that the company could not be considered as comparable as it was incurring continuous losses year after year. The Tribunal in case of Goldman Sach (I) Securities (P) Ltd. (Supra) have also held that in case a company had persistent losses for a period of three year it has to be excluded. In the present case the company has been incurring losses for the last three years. The argument of the learned AR that in subsequent year the assessee company had a profit could not be accepted as for the purpose of comparability only the results of current year or up to past two years could be considered and not the results of subsequent year. The learned CIT (DR) has also brought to our notice the decision of Tribunal in case of FIRMENICH Aromatics (I) (P) Ltd. in ITA no. 2056/Mum/06 in which it has been held that age and formation of the company could not be the criteria for the purpose of making comparative analysis. Therefore, considering the various decisions of Tribunal (Supra) and facts of the case, we are convinced that this company which has persistent losses for the last three years has to be excluded. The order of CIT (A) is, therefore, upheld on this point.

23. Comparables of TPO excluded by CIT (A)

As pointed out earlier, out of 23 new comparables selected by TPO, 2 comparables had been accepted by the assessee and out of the remaining 21, 15 comparables have been accepted by CIT (A) which have already been dealt with. The 6 comparables which have been excluded by CIT (A) are as under:–

Sl. No.	Name of the Company	Margin
1.	Bodhtree Consulting Ltd. (Seg).	29.58%
2.	ICRA Techno Analytics ltd. (Seg).	12.24%
3.	Infosys BPO Ltd.	28.78%
4.	Wipro Ltd. (Seg)	29.70%

5.	Maple Solutions Ltd.	34.05%
6.	Triton Corp Ltd.	34.93%

24. We take up each company separately for examination and analysis with a view to decide its comparability to the case of the assessee

24.1 BODHTREE CONSULTING LTD. (SEG.)

The TPO had selected the company as an ITES company holding it comparable to the case of assessee CIT (A) held that the company was engaged in software business and therefore functionally not comparable and has thus excluded it. The learned CIT (DR) has placed some fresh materials before us, which has been collected by the revenue u/s 133(6) of the IT Act. The information gathered shows that the assessee in addition to developing software, is also engaged in data cleansing services, the segmental results for which are available which is an ITES activity. The learned AR for the assessee pointed out that there is some element of software development also involved in providing such services. We find that this issue had come up for consideration by the Tribunal in case of Willis Processing Services India (P) Ltd. in which the Tribunal restored the issue to the file of AO/TPO for examination of material collected u/s133 (6) of IT Act. Therefore, following the decision of the Tribunal (Supra) we restore this issue to the file of AO/TPO for fresh decision after considering the fresh material and after hearing the assessee.

24.2 ICRA TECHNO ANALYTICS LTD. (SEG.)22

The assessee has objected to the inclusion of this comparable on the ground that the company was into software business and is also engaged in high end ITES segment. CIT (A) has accepted the argument of the assessee and excluded this comparable. The annual report of the company has been placed on record before us by the learned CIT (DR) which shows that the company is dealing in computer software, software development, consultancy and training. We also find that this company had been considered by the Tribunal in case of Willis Processing Services India (P) Ltd. (Supra) in which the Tribunal noted that the company had 23.86% related party transactions. The Tribunal in the said case held that any company having related party transactions more than 15% has to be excluded as comparable. Therefore, following the decision of Tribunal in case of Willis Processing Services India (P) Ltd. (Supra), the exclusion of this comparable by the CIT (A) is held valid.

24.3 INFOSYS BPO LTD.

The company is engaged in BPO business which is an ITES activity. The assessee has objected to the inclusion of this company on the ground that the company had high brand value and incurred heavy expenditure on marketing and selling expenses and on acquisition of software package for its own use. CIT (A) has accepted the objections of the assessee and excluded this comparable. The learned CIT (DR) has argued that the arguments advanced by the assessee had been considered by the Tribunal in case of Actis Advisors (P) Ltd. in ITA no. 5277/Del/2011 and had not been accepted. The learned AR, however, pointed out that brand was a valuable asset which as per rules is one of the factors for deciding the comparability. It was pointed out that this aspect had not been considered by the Tribunal in case of Actis Advisors (P) Ltd. (Supra). Besides, it has also been argued that the companies in the high end BPO segment of ITES on which ground also the company shall be excluded. It has been further argued that in the TP study the assessee had considered only the companies whose turn over was up to Rs. 500 Crore, whereas the turnover of the assessee is 649.57 Crore. It has therefore been argued that the company should also be excluded on the ground of high turnover. Reliance has been placed on some decisions of Tribunal in support of the turnover filter. It was also brought to our notice that the issue whether turnover could be the basis of exclusion of a comparable has been referred to the special bench recently. However, both the parties agreed that the comparability of the company may be decided on the basis of existing decisions.

24.3.1 The learned DR on the other hand submitted that high margin or turnover could not be the basis for inclusion of the comparables. It was pointed out that the issue of turnover has been examined in detail recently by the Tribunal in case of Willis Processing Services India (P) Ltd. (Supra) as well as in the case of Capgemini India (P) Ltd. in ITA no. 7861/M/2011 and not accepted.

24.3.2 We have carefully considered the various aspects of the issue and the rival arguments advanced by both the parties. We have already held that high end services in ITES sector could not be the basis for exclusion of comparables. Similarly, we have also not found the arguments based on high margin convincing for the reason given earlier. The argument of the learned AR based on brand value and high marketing /selling expenses had been examined in detail by the Tribunal in case of Actis Advisors (P) Ltd. (Supra). The Tribunal noted that high marketing expenses did create marketing intangibles such as brand. But it was not necessary that it always resulted into high margin. The Tribunal in that case noted the finding of TPO that 95% of the revenue of Infosys came from repeat business which showed that marketing intangibles did not help Infosys to get any better business. The Tribunal also accepted the finding of TPO that marketing intangibles may be helpful in getting better business but the same may not be applicable in the case of service industries like ITES. The department in that case had placed on record some instances in which companies with much lower marketing expenses had shown much higher margin. The Tribunal therefore, concluded that marketing intangibles such as brand could not be considered as a factor for raising the margin in a particular case. Brand is an asset which can bring in more business and can give more turnover but there is no evidence to show that it results in higher margin. Brand is no doubt an asset which is a relevant factor for deciding comparability but in the absence of any concrete material to show that it raises the margin, the argument based on branding cannot be accepted. We therefore, follow the decision of Tribunal (Supra) and reject the arguments advanced based on high marketing expenses and branding.

24.3.3. The argument based on turnover has also been examined in detail by the Tribunal in case of Willis Processing Services India (P) Ltd. (Supra) and in case of Capgemini India (P) Ltd. (Supra) and not found acceptable. In that case material in the form of graph and chart had been placed by the department before the Tribunal to point out that there was no linear relationship between turnover and margin and it was pointed out that in many cases with rise in turnover the margin came down. The Tribunal in both the cases referred to above also noted the argument based on concept of economy scale and held that it was relevant to manufacturing concerns and not applicable to service companies. The Tribunal in case of Capgemeni India (P) Ltd. (Supra) noted that employees in service companies were not doubt, valuable assets which have to be considered as a factor for comparability. The Tribunal observed that the assets employed had two dimensions i.e. quantity and quality, more employees would mean more turnover but there was linear relationship between margin and turnover. As regard the quality of employees, the Tribunal noted that this would depend upon the nature of projects and employee cost being more in case of more skilled manpower, it will not result into higher margins. Therefore following the decisions of Tribunal (Supra), we reject the argument advanced for exclusion of Infosys BPO Ltd. and accordingly hold that this has to be accepted as a good comparable.

24.4 <u>WHIPRO LTD. (SEG.)</u>

The case of Wipro Ltd. which has been excluded by CIT (A) is identical to the case of Infosys BPO Ltd. with only difference that turnover in case of Wipro Ltd. is 939.78 whereas in case of Infosys BPO Ltd. the turnover is 649.57. The argument advanced by the assessee for exclusion of this comparable is the same as advanced in the case of Infosys BPO Ltd. Therefore, for the same reasons given in case of Infosys BPO Ltd. we reject the argument advanced and uphold the inclusion of this comparable by Assessing Officer/TPO.

24.5 Maple (E) Solutions

This company is in the call centre business. A copy of the annual report placed on record by learned CIT (DR) shows that call centre revenue is 12.21 crore and sale of software is only Rs. 9000/- which is negligible. Therefore, almost whole of the revenue is from call centre. CIT (A) has excluded this comparable on the ground that it has related party transactions. CIT (A) also noted that this company became subsidiary of triton w.e.f 1.1.2007. Since, CIT (A) had excluded Triton ltd and therefore held that this company should also be excluded on this ground. The Leanred CIT (DR) pointed out, referring to the details given in the annual report of the company, that there were three related parties but there were no transactions with those parties on revenue account and the transaction were only on account of loan etc. These factual details placed on record have not been controverted by the learned AR. Therefore, this company could not be excluded on the ground of RPT. We also note that this company had become a subsidiary of triton w.e.f 1.1.2007. There was no merger or amalgamation of the two companies. The subsidiary company remains an independent company till it is merged. Therefore argument advanced by the learned AR on the ground of merger could not be accepted. Further, even if there was merger, as held by the Tribunal in case of Willis Processing Services India (P) Ltd. (Supra), only on the ground of merger, the comparable could not be excluded. It has to be examined if there are functional differences arising on account of merger. In this case, both the companies are in the same line of business and, therefore, even if they had merged, it will not impact the comparability. It has been argued that merger and amalgamation gives the benefit of synergies and operational efficiencies which increases the margin. It may however be pointed out that after merger it takes sometime for rationalization of workforce etc. and, therefore, effects of synergies etc. cannot be seen in the first year of merger or amalgamation. Facts of each case has to be examined carefully to find out whether merger has resulted into synergies and high margin. No such material has been produced before us. However as pointed out earlier there is also no material to show that this company had merged with Triton Corp. Ltd in the relevant year. We accordingly, reject the argument raised based on merger. We are therefore, unable to accept the order of CIT (A) excluding this comparable and therefore the order is set aside and this company is included as a comparable.

24.6 Triton Corp. Ltd.

This company which had been selected by the TPO as comparable has been excluded by CIT (A) on the ground that the assessee was engaged in high end service of ITES segment i.e. KPO. CIT (A) has also observed that the company was trading in IT peripherals and there were no segmental results available. Amalgamation/restructuring has also been cited as a reason for excluding the comparable. The learned CIT (DR) has placed on record the annual report of the company for the relevant year which shows call centre revenue of Rs. 47.50 Crore and revenue from support services at Rs. 5.54 Lakh. The income from trading in IT peripherals is Rs. 5.80 Crore. It is therefore, clear that the company is predominantly in the call centre business. The revenue from trading in IT peripherals is small at about 11% which in our view will not have much impact on the margin. It is also clear from the fact that the margin in case of Triton Corp. Ltd is 34.93% which is almost similar to the margin in case of Maple (E) Solutions Ltd. which is wholly in call centre business, which shows that trading in IT peripherals has not impacted the margin. No details of merger/amalgamation as mentioned by CIT (A) has been placed before us to show that it has impacted the comparability. We therefore do not agree with CIT (A) for excluding this comparable, Accordingly, we set aside the order of CIT (A) on this point and include this case in the list of comparables.

25 The assessee has also disputed the decision of CIT (A) to reject the claim of the assessee that no TP adjustment could be made as income of the assessee was exempt u/s 10A of the IT Act. The assessee has placed reliance on the decision of Bangalore Bench of Tribunal in case of Phillips Software Centre (P) Ltd. (Supra) in which it has been held that in case the income of the assessee was exempt transfer pricing provisions could not be applied. The learned CIT (DR) has, however, pointed that said decision of Tribunal has been stayed by Hon'ble High Court of Karnataka in ITA No. 49/2008. Therefore, the argument based on decision of Bangalore Bench of Tribunal can not be accepted. The argument of the learned AR is that the purpose of the transfer pricing provisions is to ensure that the companies do not transfer profit to low tax jurisdiction through related parties for reducing tax. In the present case, it has been pointed out that the income of the assessee was exempt and, therefore, there was no tax avoidance in transferring the profit to low tax jurisdiction. The argument of the learned AR is however not convincing. The law has to be applied as enacted. There is no provision in the transfer pricing regulations, that for applying the said provisions revenue has to prove tax avoidance. Once there is a international transaction, ALP has to be computed with respect to similar transaction with unrelated party as per the method prescribed and the adjustment has to be made on the basis of ALP. The revenue is not further required to prove that there is tax avoidance. This view is also supported by the decision of Tribunal in case of 24/7 Customer . Com (P) Ltd. in ITA no 227/Mum/2010 and the decision of special bench of Tribunal in *Aztech Software Technology Ltd.* (107 ITD 141). We therefore see no merit in the arguments advanced by learned AR and accordingly confirm the order of CIT (A) on this point.

26 The assessee has also raised dispute regarding method of margin computation for the purpose of comparability. The assessee had computed the margin on operating cost which has also been followed by Assessing Officer/TPO. The assessee has, however pointed out that under the provision of Rule 10 B(1) (e) (i) the margin could be computed in relation to cost incurred, or sales affected, or asset employed. It has therefore been argued that the assessee has the option to compute the margin on the basis of return on asset employed (ROA) or on capital employed (ROCA). It has been pointed out that on this basis margin of the assessee is higher

than mean margin of comparables selected by the TPO and also higher than the mean margin of the comparables selected by the assessee. This argument has not been accepted by CIT (A) aggrieved by which the assessee is in appeal before Tribunal.

26.1 The learned CIT(DR) has referred to the OECD transfer pricing provision para (2.97) as per which return on asset or capital employed can be an appropriate basis only in cases where assets are a better indicator of the value added by the tested party. The method is therefore, suited to certain manufacturing or other asset intensive activities. He also referred to United Nations Practical Manual on transfer pricing provision para (6.3.7.3) in which it has been mentioned that ROCA/ROA are typically used for manufacturing activities. He has also placed reliance on the decision of Delhi bench of Tribunal in case of Johnson Matthey India Pvt. Ltd. in ITA No.344/Del/2010 in which the Tribunal observed that PLI selected should be appropriate to the transactions under consideration. The assessee in that case was engaged in the manufacturing of Automobile exhaust catalyst and making import of raw materials from its AE. The Tribunal held that the return on capital employed was not an appropriate PLI in the case. The learned AR on the other hand submitted that even the call centre activity is not possible without sophisticated equipments such as computers and telecommunication systems. Therefore, it has been argued that like manufacturing organization, it also has to employ plant and machinery for carrying out services efficiently. Therefore, ROCA/ROA should be employed for the purpose of margin computation.

26.2 We have perused the records and considered the rival contentions carefully. The dispute is regarding method of computation of margin for the purpose of comparability. The OECD as well as United Nations practical manual provide that ROCA/ROA are suitable for manufacturing and other capital or asset intensive industries. The assessee is in the service sector which is not capital asset incentive. No doubt in every sector there is some use of equipments and other assets but the same cannot be said to be as capital intensive as in case of manufacturing concerns. Moreover, in case of service companies, main asset is employees which is not reflected in the balance sheet and, therefore, ROCA/ROA in our view will not be an appropriate method for the purpose of computation of margin. We accordingly, do not see any infirmity in the order of CIT (A) rejecting ROCA/ROA as PLI. The order of CIT (A) is accordingly held on this point.

27. Working capital adjustment and adjustment on account of other costs:

The assessee has requested for adjustment on account of working capital. It has been submitted that the assessee was receiving money in advance whereas in other cases receivable may be pending for a longtime which affect the sale price as well as the margin. It has therefore, been requested that working capital adjustment may be allowed. The learned CIT (DR) on the other hand submitted that in case working capital adjustment was considered appropriate, the adjustment may be made as per the OECD guidelines and not as per the method adopted by the assessee. In other words the adjustments should be made in relation to both the payables and receivables.

27.1 We have perused the records and considered matter carefully. Under the provisions of Rule 10B (2) (d) the comparability has to be judged with respect to various factors such as marketing conditions, geographical locations, cost of labour and capital in the market, Accounts receivable/payable affect the cost of working capital. The more accounts receivable would mean more capital blocked with debtors which may also mean higher sale prices. Therefore, in our view it will be appropriate to make working capital adjustment to improve the comparability. Further we agree with the submissions of learned CIT (DR) that while making the working capital adjustment guidelines framed by OECD must be followed. We therefore, do not uphold the order of CIT (A) rejecting the working capital adjustment. The issue therefore, is restored to the file of AO/TPO for working out the working capital adjustment as per OECD guidelines and after allowing the opportunity of hearing to the assessee.

27.2 As regards the adjustment claim by the assessee on account of linked cost and other cost incurred by the AE on behalf of the assessee, it has been argued by the learned AR that in case the AE had not incurred the cost, the assessee will have to incur it and the margin in that case may have been different. The learned CIT (DR), on the other hand submitted that the assessee was following "cost + 7% mark up". Therefore in case the cost had been incurred by the assessee, it would have charged the AE at "cost + 7% mark up' and it will have no impact on the margin. We have considered the matter carefully. We agree with the submission of learned CIT (DR) that adjustment on account of linked cost and other cost incurred by the AE on behalf of the assessee is not justified as margins are unaffected in case these costs were incurred by the assessee. The claim is rejected and order of CIT(A) on this point is upheld.

28 <u>The benefit of +/ - 5% deviation in the computation of margin.</u>

The assessee has requested for the benefit of +/ - 5% deviation in the margin under the proviso to section 92 C (2) This has not been allowed by AO/TPO, which has been upheld by CIT (A). It has been pointed out by the revenue that the proviso to section 92 C(2) was amended by the Finance Act 2009 to provide that the standard deviation could be allowed only when the sale price was within 5% of transfer price. It has also been clarified by the Finance Act 2012 that the said amendment would apply to all assessments/reassessments pending before Assessing Officer as on 1.10.2009. In this case proceedings were pending before AO/TPO as on 1.10.2009. Therefore, the assessee is not entitled to the benefit of +/- 5% as the ALP determined has exceeded the transfer price by more than 5%. We therefore see no infirmity in the order of CIT (A) in rejecting the claim and the same is therefore upheld.

29. In the result both the appeals are partly allowed.

Order pronounced in the open court on 26th April 2013

2013 TRI 1328 (S.C. Ind.)

SUPREME COURT OF INDIA

D.K. Jain and R.M. Lodha, jJ.

Commner. of Income Tax, Coimbatore
v.
M/s Textool Co. Ltd.

FACTS/HELD

Though section 36(1)(v) requires direct payment to the gratuity trust fund, payment to the LIC Group Gratuity Scheme is also allowable

1. The assessee set up a gratuity fund which was duly approved by the CIT. However, instead of making payment to the fund directly, the assessee paid an amount of Rs. 50 lakhs as initial contribution and an amount of Rs. 5 lakhs as annual premium to the Life Insurance Corporation ("LIC") pursuant to the group Life Assurance Scheme framed by the LIC for the benefit of the employees of the assessee. The AO disallowed the claim for deduction on the ground that payment towards the gratuity fund was not made to an approved gratuity fund and was not allowable u/s 36(1)(v). The CIT(A), Tribunal and High Court (257 ITR 39 (Mad)) upheld the assessee's claim on the basis that the payment to LIC under the Group Life Assurance Scheme was for the exclusive benefit of the employees of the assessee under the policy issued by it and that the conditions stipulated in s. 36(1)(v) had not been violated. On appeal by the

department to the Supreme Court, HELD dismissing the appeal:

> While it is true that a fiscal statute has to be construed strictly and nothing should be added to or subtracted from it, yet a strict construction of a provision does not rule out the application of the principles of reasonable construction to give effect to the purpose and intention of any particular provision of the Act. From a bare reading of s. 36(1)(v), it is manifest that the real intention behind the provision is that the employer should not have any control over the funds of the irrevocable trust created exclusively for the benefit of the employees. On facts, it is evident that the assessee had absolutely no control over the fund created by the LIC for the benefit of the employees of the assessee and further all the contribution made by the assessee in the said fund ultimately came back to the Textool Employees Gratuity Fund, approved by the CIT. Thus, the conditions stipulated in s. 36(1)(v) were satisfied.

Appeal dismissed.

Civil Appeal No. 447 of 2003.

Decided on: 9th September, 2009.

JUDGMENT

D.K. Jain, J.–

This appeal, by special leave is directed against the judgment, dated 4th February, 2002, rendered by the High Court of Judicature at Madras, in Tax Case No. 267 of 1989. By the impugned judgment, the High court has answered the question of law, referred to it by the Income Tax Appellate Tribunal, Madras Bench (for short, "the Tribunal") under Section 256(1) of the Income Tax Act, 1961, (for short, "the Act") at the instance of the Revenue. The question of law, so referred, was as follows:

> "...Whether on the facts and in the circumstances of the case, the Appellate Tribunal is right in allowing the deduction of Rs.55,84,754/- being the payment made by the assessee company directly to Life Insurance Corporation towards Group Gratuity Fund under Section 36 (1)(v) of the Incocme Tax Act, 1961?"

Material facts relevant for the purpose of the present appeal may be stated thus:

For the assessment year, 1983-84, for which the relevant previous year ended on 30th April, 1982, the assessee claimed a deduction of Rs. 92,06,978/- as contribution/provision towards the approved gratuity fund. As per the breakup of the said amount, an amount of Rs.5,84,754/- was paid as annual premium to the Life Insurance Corporation("LIC" for short); a sum of Rs. 50,00,000/- was paid to the LIC as initial contribution in the group Life Assurance Scheme framed by the LIC for the benefit of the employees of the assessee and the remaining amount of Rs. 36,22,224/- was shown as provision for initial contribution. It is common ground that assessee company's gratuity fund, viz., the Textool Company Ltd. Employees Group Gratuity Fund was approved by the Commissioner of Income Tax, coimbatore, w.e.f. 25th February, 1983. While completing assessment, the Assessing Officer allowed a deduction of Rs. 36,22,224/- under Section 40A(7) of the Act. However, deduction for the balance amount was disallowed on the ground that payment towards the gratuity fund was made by the assessee directly to the LIC and not to an approved gratuity fund and, therefore, it was not allowable under Section 36(1)(v) of the Act.

Being aggrieved, the assessee preferred appeal to the Commissioner of Income Tax (Appeals). The Commissioner observed that the initial payment of Rs.50,00,000/- and the annual premium of Rs. 5,57,943/- was made by the assessee directly to the LIC instead of as a contribution towards the approved gratuity fund; the LIC had accepted the said payment on behalf of the Group Life Assurance Scheme for the exclusive benefit of the employees of the assessee under the policy issued by it. Upon perusal of the original Master policy issued by the LIC, the Commissioner recorded his satisfaction that the initial contribution as well as annual premium had been credited by the LIC to the Group Life Assurance Scheme on behalf of the Textool Company Ltd. Employees Group Gratuity Fund only, meaning thereby that the insurance policy had been taken in the name of the approved gratuity fund only; this fund was shown as the payee in the policy; vide its letter dated 20th November, 1985, addressed to the I.A.C., the assessee had confirmed that in the subsequent assessment years, they had contributed funds to the Employees Group Gratuity Fund and the trustees in turn had made payment to the LIC in respect of the Textool Co. Ltd.; Employees Group Gratuity Assurance Scheme under the said policy and it was only the initial payment and first annual premium had been made directly to the LIC against the said policy. The Commissioner was thus, convinced that by making payment of the amounts in question directly to the LIC, the assessee had not violated any of the conditions stipulated in Section 36 (1) (v) of the Act. Accordingly, the Commissioner came to the conclusion that since, on the facts of the case, the objective of the fund was achieved, a narrow interpretation of the provision would be straining the language of Section 36(1)(v) of the Act so as to deny the deduction claimed by the assessee. Consequently, the Commissioner allowed the said amount of Rs. 58,84,754/- as deduction for the relevant assessment year.

Being dissatisfied with the view taken by the Commissioner, the Revenue took the matter in further appeal to the Tribunal. Relying on its earlier decision in the case of Janambikai Mills Ltd, the Tribunal dismissed the appeal.

As stated above, by the impugned order, the afore extracted question, referred at the instance of the revenue, has been answered by the High Court in favour of the assessee. While answering the question, the High Court has observed as follows:

> "In our opinion, the Commissioner of Income Tax (Appeals) as well as the Tribunal have correctly held that merely because the payments were made directly to the LIC, the company could not be denied the benefit under Section 36(1)(v) and the amount had to be credited in favour of the assessee. Both the Commissioner (appeals) as well as the Tribunal have correctly read the law and have correctly relied upon the aforementioned Supreme Court judgment. In our opinion, since the finding of fact is that all the payments made were only towards the Group Gratuity Fund, there would be no question of finding otherwise."

Learned counsel appearing on behalf of the Revenue has submitted before us that the provisions of Section 36(1)(v) of the Act have to be construed strictly and for claiming deduction, conditions laid down in Section 36(1)(v) of the Act must be fulfilled. It is urged that since during the relevant previous year the contribution by the assessee towards the gratuity fund was not in an approved gratuity fund the High Court was not justified in affirming the view taken by the Commissioner as also by the Tribunal while answering the reference in favour of the assessee. However, on a query by us as to whether the contribution made by the assessee in the approved gratuity fund credited by the LIC for the employees of the assessee and ultimately the entire amount deposited with the LIC came back to the fund created by the assessee for the benefit of its employees and approved by the Commissioner w.e.f. 25th February, 1983, or not, learned counsel is not in a position to make a categorical statement in that behalf.

Having considered the matter in the light of the background facts, we are of the opinion that there is no merit in the appeal. True that a fiscal statute is to be construed strictly and nothing should be added or subtracted to the language employed in the Section, yet a strict construction of a provision does not rule out the application of the principles of reasonable construction to give effect to the purpose and intention of any particular provision of the Act. (See : Shri Sajjan Mills Ltd. vs. Commissioner of Income Tax, M.P. & Anr. (1985) 156 ITR 585). From a bare reading of Sectin 36(1)(v) of the Act, it is manifest that the real intention behind the provision is that the employer should not have any control over the funds of the irrevocable trust created exclusively for the benefit of the employees. In the instant case, it is evident from the findings recorded by the Commissioner and affirmed by the Tribunal that the assessee had absolutely no control over the fund created by the LIC for the benefit of the employees of the assessee and further all the contribution made by the assessee in the said fund ultimately came back to the Textool Employees Gratuity Fund, approved by the Commissioner with effect from the following previous year. Thus, the conditions stipulated in Section 36(1)(v) of the Act were satisfied. Having regard to the facts found by the Commissioner and affirmed by the Tribunal, no fault can be found with the opinion expressed by the High court, warranting our interference.

Resultantly, the appeal is dismissed with no order as to costs.

2013 TRI 1332 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
MUMBAI "L" BENCH, MUMBAI

B. Ramakotaiah, Accountant Member and Vijaypal Rao, Judicial Member

FACTS/HELD

Section 115AD: FII's securities transactions' profits not assessable as "business profits'

1. The assessee, a Foreign Institutional Investor ("FII"), suffered a loss of Rs. 41 crore on account of derivative transactions. The AO & CIT(A) relied on the AAR Ruling in Royal Bank of Canada 323 ITR 380 and held that as the said loss arose out speculative transactions, it had to be treated as a business loss and could not be set-off against STCG. On appeal by the assessee to the Tribunal HELD allowing the appeal:

   Under the policy of the Central Government and the SEBI (FII) Regulations, 1995 a FII can only "invest" in securities and cannot do "business" in securities. S. 115AD also provides that all income arising to a FII from securities, whether from their retention or from their transfer, is taxable as a capital gain. This is also the view expressed in Press Note F. No. 5(13)SE/91-FIV dated

24.03.1994 issued by the Ministry of Finance. If the Revenue is permitted to make a distinction between the securities held by a FII by classifying them as a capital asset or as stock in trade, s. 115AD will become otiose. The result is that all income arising to a FII, including from dealings in derivatives has to be assessed as capital gains. The contrary view of the AAR in Royal Bank of Canada cannot be followed (LG Asian Plus Ltd 46 SOT 159 followed)

Appeal allowed.

ITA No.3598/Mum/2010 (Assessment Year :2007-2008).

Heard on: 20th November, 2012.

Decided on: 5th December, 2012.

Present at hearing: F.V. Irani, for Appellant. Mahesh Kumar, for Respondent.

JUDGMENT

Per Vijaypal Rao:– (Judicial Member)

This appeal by the assessee is directed against the order dated 29-3-2010 of CIT(A)-11, Mumbai for the assessment year 2007-08 on the following grounds:–

"1. Based on the facts and circumstances of the case, the learned Commissioner of Income-tax (Appeal) ['CIT(A)'] erred in upholding the action of the Assessing Officer ('AO') in treating the net loss arising on derivative transaction of Rs.41,42,03,363/- as business loss as against capital loss claimed by your Appellant having failed to appreciate that your Appellant have invested in derivative transactions and so the income arising from derivative transaction is capital gains/loss and not business income/loss.

2. Without prejudice to ground of Appeal No.1 above, the CIT(A) erred in confirming the action of the AO in ignoring the business loss, by suo motu applying the provisions of the Treaty between India and Australia to put the Appellant into a disadvantageous position as compared to the provisions of the Act having failed to appreciate that the provisions of the treaty are applicable only to the extent that they are more beneficial than the provisions of the Act as per Section 90(2) of the Act.

3. Without prejudice to (1) above, net business loss from derivative transaction be set off against capital gains arising on sale of shares as per section 71 of the Act."

2. The assessee is a sub-account of the Foreign Institutional Investor (in short 'FII') M/s Platinum Investment Management Ltd. registered under the Securities and Exchange Board of India (FII) Regulations, 1995. The only activity in which the assessee is involved is purchase and sale of securities in India and trading in derivatives. The assessee has filed its return of income for the assessment year under consideration on 23-7-2007 declaring 'nil' income and claimed refund. The assessee has shown short term capital gain arising on sale of shares, short term capital gain arising from transactions in derivatives and short term capital loss from transactions in derivatives. The details of the same are as under:–

Particulars	***Rs.***
Short term capital gain arising on sale of listed shares	274,036,423
short term capital gain arising from transactions in derivatives	1,290,480,258
short term capital loss arising from transactions in derivatives	(1,704,683,620)
Net short term capital loss	(140,166,940)

3. The Assessing Officer treated the derivatives loss as business loss instead of capital loss claimed by the assessee. Thus, the capital gain on sale of shares and capital gain arising from transactions in derivatives have been accepted as capital gain but the loss on derivatives transactions was treated as business loss and accordingly by applying the provisions of DTAA, the Assessing Officer held that since the assessee had no PE in India, the loss arising from business is not taken into consideration for determining the total income of the assessee.

4. The assessee challenged the action of the Assessing Officer before the CIT(A) and contended that the assessee is permitted only to invest in the shares and derivatives being an FII as per the SEBI FII Regulations, 1995 and, therefore, the loss arising from transaction in derivatives cannot be treated as business loss. Alternatively, the assessee contended that the Assessing Officer, *suo motu*, cannot apply the provisions of Treaty to put the assessee into disadvantageous position when the assessee had not claimed the benefit under the Treaty. Therefore, the assessee contended before the CIT(A) that even if the loss arising from transactions in derivatives is treated as business loss, the same is liable to be set off against the business income from derivative transactions and balance against the short term capital gain arising from sale of shares under the provisions of Section 7(1) of the Income Tax Act. As far as the profit and loss arising from derivative transactions, the CIT(A) has held that both should be treated as business profit and loss and the loss of derivative transaction should be set off against business profit of the

derivative transaction. Therefore, on the issue of treating the capital gain and loss arising from derivative transactions, the CIT(A) has treated both as business profit and loss respectively but concurred with the view of the Assessing Officer with respect to the application of the provisions of the treaty for ignoring the loss arising from the transactions in derivatives amounting to Rs.14,01,66,940/-.

5. Before us, learned AR of the assessee has advanced two fold arguments. The first leg of argument of the learned AR is regarding the categorization of the income arising on sale of shares and arising from transactions in derivatives. Learned AR has submitted that treating the capital loss arising from derivative transactions as business loss by the Assessing Officer is based on wrong facts as the Assessing Officer has considered as if the derivatives sold in one day whereas the actual fact is that the derivatives were sold on or before the various dates during the month and the same were closed out on the various dates by the subsequent purchase or closed out within the month. Learned AR has referred the details of the transactions of derivatives giving rise to the loss in question at page No.49 and further details as per the statement at page 65 to 69 of the Paper Book and submitted that the Assessing Officer wrongly taken the holding period as 'nil' and treated that the derivatives were sold on the next date whereas the derivatives are settled/closed on the predetermined dates in the month itself. Learned AR of the assessee has submitted that as far as the issue of treating the derivative transaction as business the same is covered by the decision of the coordinate Bench of this Tribunal in the case of *LG Asian Plus Ltd. vs ADIT* (International Transaction)-3(2), reported in (2011) 46 SOT 159 and contended that when the issue is covered by the decision of the coordinate bench of the Tribunal then the order of the CIT(A) on this issue is not sustainable. Alternatively, the learned AR of the assessee submitted that when the assessee has not claimed the benefit under the DTAA (Treaty) then the revenue authorities cannot thrust upon the provisions of the Treaty to put the assessee into a disadvantageous position as compared with the provisions of the Act which is in violation of the provisions of Section 90(2) of the Act. Learned AR has referred the details of the income of the various years as per the chart placed at page 306 of the paper book and submitted that in the earlier years i.e. Assessment Year 2006-07, though there is no scrutiny assessment but the Assessing Officer has accepted the loss from the transactions of derivatives as capital loss. Similarly, for the Assessment Year 2008-09, the Assessing Officer has accepted the profits from derivatives transaction as capital gain and allowed the setting off of the derivative loss brought forward from the assessment year 2007-08. For the assessment year 2009-10, the Assessing Officer treated the profit on derivative transaction as capital gain though the assessee made an alternative claim as business profit. Similarly, for the assessment year 2011-12 and 2012-13, the profit as well as loss from derivative transaction are treated as capital gain and loss respectively, though there is no scrutiny assessment. Thus, the learned AR has submitted that on the facts of the case, the profit or loss arising from derivative transactions cannot be treated as business profit or loss but the same is to be treated as capital gain or loss.

6. On the other hand, learned DR has submitted that the FII is permitted to invest in the shares in the recognized stock exchange but not in the derivative transactions. He has referred to the various clauses of the constitution of the Platinum Trust consolidated and submitted that the assessee is allowed for short sale and, therefore, by doing the derivative transactions as hedging against the investment cannot be treated as investment but the very nature of the transaction is speculative and, therefore, the Assessing Officer has rightly treated the same as business and the loss arising from the transaction is to be treated as business loss and not the capital loss. He has relied upon the Ruling of the Authority for Advance Rulings (Income Tax) in the case of Royal Bank of Canada, dated 22nd March, 2010 and submitted that an identical issue has been decided by the AAR by holding that the income arising from the derivatives would be in the nature of business profit and not capital gain.

7. In rebuttal, learned AR has submitted that as far as the aspect of 'short selling' is concerned, the CIT(A) had dealt with the issue in para 2.51 and 2.54 of the impugned order and held that the transactions carried out by the assessee are not in the nature of short selling, therefore, there is no issue arising from the finding of the CIT(A) on this aspect. As regards, the Ruling of the AAR in case of Royal Bank of Canada (supra), learned AR of the assessee has submitted that the said Ruling is in the case of the bank whereas the assessee is an FII and, therefore, the decision of the coordinate Bench of this Tribunal is binding and not the Ruling of the AAR.

8. We have considered the rival submissions of the parties as well as relevant material on record. As regards the observation of the Assessing Officer that the derivative were sold on same day, we find that there is a factual error on this point because the derivative were settled/closed on various dates, either by subsequent purchases or on the expiry of period within the month. This fact is clear from the details of page Nos.49 and 65-69 of paper book. On the issue of capital gain or business income, we note that an identical issue has been considered by the coordinate Bench of this Tribunal in the case of LG Asian Plus Ltd. (supra), one of us the Judicial Member is party to the decision. Though the Ruling of the Authority for Advance Ruling has a persuasive value, however, when a direct decision of the coordinate Bench of this Tribunal is on the identical issue then as per the rule of uniformity, the same is binding on us in the absence of any contrary decision of Tribunal or the High Court. The coordinate Bench of this Tribunal has considered and decided the issue

after a detail and elaborate discussion of the relevant provisions and aspect relating to the transactions of derivatives by FII. The relevant concluding part of the order from para 8.12 to 11 is as under:–

> *8.11. From the Memorandum explaining the provisions of the Finance Bill, it is palpable that the foreign institutional investors shall be allowed to invest in the country's capital market. Income in respect of securities and income from transfer of securities has been made the subject matter of sec. 115AD. As per this provision, the income arising from the transfer of such securities is to be considered as short-term or long-term capital gain.*
>
> *8.12. Thus, on a close scrutiny of the SEBI (FII) Regulations, 1995 together with section 115AD seen in the light of the Memorandum explaining this provisions of the Finance Bill, 1993, it is visible that a FII is allowed to invest only in the 'securities' and further the income from securities, either from their retention or from their transfer, is to be taxed as per this section alone. Coming to income arising from the transfer of securities, it has been provided in section 115AD that it shall be charged as short-term or long-term capital gain, which depends upon the period of holding of such securities. A FII is not allowed by the Central Government to do 'business' in the 'securities'. Once it is noticed that a FII can only 'invest' in 'securities' and tax on the income from the transfer of such securities is covered by a special provision contained in section 115AD, the natural corollary which follows is that tax should be charged on income arising from transfer of such securities as per the prescription of this section alone, which refers to income by way of short term or long term capital gains.*
>
> *8.13. The ld. D.R. has relied on sub-section (2) of sec. 115AD for contending that the existence of 'Business income' from dealing in securities is also envisaged. We find that sub-sec. (2) of sec. 115AD has two clauses. Clause (a) provides that where the gross total income of a FII consists only of income in respect of security referred to in clause (a) of sub-sec. (1) (i.e. income received in respect of securities, otherwise than from their transfer), then no deduction shall be allowed to it under sections 28 to 44C or section 57 or Chapter VI-A of the Act. It is but natural that when a lower rate of tax has been provided in respect of income earned by a FII from securities, then that rate of tax is final and the assessee cannot claim double benefit, firstly by being taxed at lower rate and secondly by claiming normal deductions etc. against this income. As sec. 115AD(2)(a) refers to income received in respect of securities and not from their transfer, the same would have no application to the instant case. According to*

clause (b) of sub-sec. (2) of sec. 115AD, where the gross total income includes any income referred to in clause (a) or clause (b) of sub-sec. (1) (i.e. income received in respect of securities by either retaining them or from their transfer), then the gross total income shall be reduced by the amount of such income and the deduction under Chapter VI-A shall be allowed as if the gross total income so reduced is the gross total income of the FII. A plain reading of sub-sec. (2) makes it manifest that the gross total income of a FII may include income other than that received in respect of securities or from the transfer of such securities. The emphasis of the ld. DR is on this part of the provision to bring home the point that a FII may also have 'Business income' arising from the transfer of securities. The argument is that a FII may have income from securities as falling under the head 'Capital gains', which is covered under section 115AD(1)(b) and also business income, as comes out from sec. 115AD(2)(b). This argument though looks attractive at first flush, but does not stand scrutiny in depth. The rationale behind section 115AD(2)(b) is that the income of a FII, other than that arising from the holding or transfer of securities, should find its place in the total income and the deductions under Chapter VI-A be allowed by considering gross total income net of income received in respect of securities or arising from the transfer of such securities. It is quite possible that a FII may deposit its surplus funds in banks resulting into interest income. Such interest income, which shall not fall under sub-sec. (1) of sec. 115AD, shall constitute part of the gross total income. It is a simple and plain interpretation of sub-sections (1) and (2) of sec. 115AD. We want to make it clear that the question before us is not to determine whether a FII can have any business income or not. We are confined to determining whether the income from the transfer of securities would fall under sub-section (1) or (2). If it is presumed as a hypothetical case that a FII may also have any business activity, whether legal or illegal, then the income from such activity shall be considered as 'Business income' covered under subsection (2)(b). The only embargo against the above presumption is that the business should not be that of dealing in 'securities'. Once there is a special provision slicing away the income to a FII from the transfer of 'securities' from the other income, it has to find its home only under sub-section (1)(b), irrespective of the fact that the securities are viewed as 'Investment' or 'Stock in trade'. If the Revenue ventures to make a distinction between such securities as constituting capital asset or stock in trade, which is not contemplated by the Central Government as is evident from SEBI(FII) Regulations and the definition of FII in Explanation (a) to sec. 115AD, then this *provision will become otiose. In our considered opinion if a FII receives any income in respect of securities or from the transfer of such securities, the same can be considered under sub-sec. (1) alone and sub-sec. (2)(b) cannot be invoked to construe it as 'Business income'.*

8.14. The position has been clarified by way of a Press Note : F No. 5(13)SE/91-FIV dated 24.03.1994 issued by the Ministry of Finance, Department of Economic Affairs (Investment Division), New Delhi, the relevant part of which is as under:

> *"The taxation of income of Foreign Institutional Investors from securities or capital gains arising from their transfer, for the present, shall be as under:–*
>
> *(i) The income received in respect of securities (other than units of off-shore funds covered by section 115AB of the Income-tax Act) is to be taxed at the rate of 20%;*
>
> *(ii) Income by way long-term capital gains arising from the transfer of the said securities is to be taxed at the rate of 10%;*
>
> *(iii) Income by way of short-term capital gains arising from the transfer of the said securities is to be taxed at the rate of 30%;*
>
> *(iv) The rates of income-tax as aforesaid will apply on the gross income specified above without allowing for any deduction under sections 28 to 44C, 57 and Chapter VI-A of the Incometax Act.*

2. The expression "Foreign Institutional Investor" has been defined in section 115AD of the Incometax Act to mean such investors as the Central Government may, by notification in the Official Gazette, specify in this behalf. The FIIs as are registered with the Securities and Exchange Board of India will be automatically notified by the Central Government for the purpose of section 115AD."

8.15. From the above Press Note, it is abundantly clear that FIIs have been considered as "investors" (and not as traders). Secondly, income from transfer of securities has been viewed as chargeable to tax under the head 'capital gains' as long-term or short-term capital gain depending upon the period for which such securities are held.

8.16. In view of the above discussion, it is out-and-out that income arising to a FII from the transfer of 'securities' as specified in Explanation (b) to sec. 115AD can only be considered as shortterm or long-term capital gain and not as 'business income'. As the 'derivatives' have been included in the definition *of 'securities' for the purposes of this section, the income from derivatives shall also be considered as short-term or long-term capital gain depending upon the period of holding. If the viewpoint of the Department, to the effect that income from transfer of shares or debentures etc. should be considered as short-term or long-term capital gain (as has been accepted by the AO in the instant case) but that from derivatives should be considered as 'Business income' (speculation business), then it would mean considering shares and debenture etc. as distinct from derivatives. Moreover there is nothing on record to demonstrate that the assessee was visited with any consequences as per Regulation 7A for violation of Regulations 15 or 16. It shows that the regulations have been conscientiously followed by the assessee as per which it simply made only Investment in securities and there is nothing of the sort of trading. Although in common parlance, the shares or debentures etc. are distinct from derivatives, and their taxation may also differ in the case of non-FIIs, but such distinction is obliterated in the context of FIIs due to the inclusion of both shares and debentures etc. on one hand and derivatives on the other, in the definition of "securities" for the purpose of sec. 115AD and subsection (1) providing for the income from their transfer to be considered as long term or short term capital gain.*

8.17. It is noticed that sec. 115AD falls in Chapter XII which deals with the determination of tax in certain special cases. This Chapter consists of sections 110 to 115BBC. Each section contains special provisions dealing with specific types of incomes for which a specified rate of tax is provided. If a particular item of income is covered in any of these sections, it shall be strictly governed by the prescription of that relevant section alone. We are reminded of the legal maxim 'Generalia specialibus non derogant', which means that special provisions override the general provisions. It is a well settled legal position that specific provisions override the general provisions. In other words, if there are two conflicting provisions in an enactment, the special provisions will prevail and the subject matter covered in such a special provision shall stand excluded from the scope of the general provision. The Hon'ble Supreme Court in the case of Britannia Industries Ltd. vs. CIT (2005) 278 ITR 546 (SC) has held that expenditure towards rent, repairs, maintenance of guest house used in connection with business is to be disallowed u/s. 37(4) because this is a special provision overriding the general provision.

9. Coming back to our context, it is seen that income arising from the transfer of securities of the FIIs has been included under sec.

115AD(1)(b) to be categorized as short-term or long-term capital gain depending upon the period of holding. In such a situation, it is impermissible to consider such income as falling under the head "Profits and gains of business or profession". Such income arising from the transfer of securities shall be charged to tax under the head "capital gains" alone. Once inclusion of such income from the transfer of securities is held to be falling only under the head "Capital gains", it cannot be considered as 'Business income', whether speculative or non-speculative.

10. The heading of section 43 is : 'Definitions of certain terms relevant to income from profits and gains of business or profession'. The opening part of this section is : "In sections 28 to 41 and in this section, unless the context otherwise requires-". Thereafter, six subsections have been given, of which sub-sec. (5) defines "speculative transaction". It is, therefore, clear that sec. 43(5) defining 'speculative transaction' is relevant only in the context of income under the head 'Profits and gains of business or profession'. It rules out its application to income under any other head. If that be the position, the picture is clear that sec. 43(5) has no application to FIIs in respect of 'securities' as defined in Explanation to sec. 115AD, income from whose transfer is considered as short term or long term capital gains.

11. We, therefore, hold that the ld. CIT(A) was not justified in holding that income from Index based or non-Index based derivatives be treated as 'business income', whether speculative or nonspeculative. The impugned order is, therefore, set aside by holding that income from derivative transaction resulting into loss of Rs.11.27 crores is to be considered as short-term capital loss on the sale of securities which is eligible for adjustment against shortterm capital gains arising from the sale of shares."

9. Respectfully following the decision of the coordinate Bench of this Tribunal, we decide this issue in favour of the assessee and against the revenue. Accordingly, we hold that the income arising from the transaction in derivatives by the assessee, being FII, cannot be treated as business profit or loss but the same has to be capital gain or loss.

10. Since we have decided the nature of transaction and treatment of the same as capital gain or loss in favour of the assessee, then we do not propose to go into the alternative plea of the assessee regarding thrusting upon the provisions of the Treaty and putting the assessee in disadvantageous position.

11. Resultantly, appeal filed by the assessee is allowed.

Order pronounced in the open court on this 5th day of December,2012.

INCOME TAX APPELLATE TRIBUNAL
MUMBAI "A" BENCH, MUMBAI

R.S. Syal, Accountant Member and Vijaypal Rao, Judicial Member

Order accordingly.

I.T.A.No. 2645/Mum/2008 (Assessment Year 2004-05)) & I.T.A.No. 2691/Mum/2008 (Assessment Year 2004-05).

Decided on: 27th May, 2011.

Present at hearing: Rajan Vora, for Appellant. Usha S. Nair, for Respondent in I.T.A.No. 2645/Mum/2008. Usha S. Nair, for Appellant. Rajan Vora, for Respondent in I.T.A.No. 2691/Mum/2008.

JUDGMENT

Per R.S. Syal:– (Accountant Member)

These two cross appeals– one by the assessee and the other by the Revenue – arise out of the order passed by the ld. CIT(A) on 29.01.2008 in relation to the asstt. year 2004-05.

2. The Revenue has raised the following effective ground in its appeal:

> "On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in directing the Assessing Officer to treat the losses incurred by the assessee on futures and options on indexes as loss under the head income from business or profession and to re-compute the income and charge tax as per the provisions of Section 115AD of the Act."

3. The assessee is aggrieved against the impugned order on the following two effective grounds:

> "1. In treating the short-term capital loss of Rs.112,744,596 arising from exchange traded derivative transactions as a business loss and ignoring the special provisions contained in section 115AD of the Act, applicable to your appellant, being a Foreign Institution Investor ("FII").
>
> 2. In treating the short-term capital loss of Rs.18,818,500 arising from non-indexed exchange traded derivative transactions as speculative loss and thereby, disallowing its setoff against short-term capital gains earned on equity shares."

The other grounds taken by the assessee are in support of the main issue contained in ground nos.1 & 2 as reproduced above.

4. Briefly stated, the facts of the case are that the assessee is a company incorporated in Cayman Islands and a tax resident of Cayman Islands. At the material time, there was no Double Taxation Avoidance Agreement between India and Cayman Islands. The assessee is registered with the SEBI as a sub-account of Lloyd George Investment Management (Bermuda) Ltd., which is registered with SEBI as a Foreign Institutional Investor (hereinafter called "FII"). The status of the assessee in the titles of the assessment order has also been given as FII. The assessee showed short-term capital gain of Rs.34.73 crores and short-term capital loss of Rs.25.98 crores. These two amounts comprised of short-term capital gain/loss on shares to the tune of Rs.31.06 crores and Rs.11.04 crores respectively, thereby leaving the remaining amount of Rs.3.67 crores and 14.94 crores as gain/loss from Derivaties – both under Option contracts and Future contracts. There is no dispute as gain/loss offered by the assessee on sale of shares, which has been accepted as short-term capital gain. The controversy is on the treatment of the loss in derivates to the tune of Rs.11.27 crores (Rs.14.94 crores loss as reduced by Rs.3.67 crores gain on derivates). The amount of loss of Rs.11.27 crores was adjusted by the assessee against the short-term capital gain from the shares as discussed above, as a result of which the taxable shortterm capital gain stood reduced to that extent. On being called upon to explain as to why the transactions in Derivatives be not treated as speculative transactions, the assessee submitted its reply through various letters. The AO observed that the Derivatives – Option contracts and Future contracts - were routed through the Stock Exchange without any actual delivery. Considering the provisions of sec. 43(5), he held that before the insertion of proviso (d) by the Finance Act, 2005, transactions in respect of trading in derivates were to be considered as speculative. It was also opined by him that the insertion of proviso (d) by the Finance Act, 2005, commanding that the transactions in respect of trading in derivatives shall not be deemed to be speculative transactions, is prospective and hence could not apply to the year under consideration. In view of the above opinion, the AO held that the loss of Rs.11.27 crores arising on account of derivative transactions was to be assessed as speculation loss and hence the same was not eligible for set off against the shortterm capital gain earned by the assessee from the sale of shares.

5. The assessee went up in appeal before the ld. CIT(A) contending that it was registered as FII as per SEBI Regulations, which entitled it only to make investments in securities. It was, therefore, contended that 'Investment' implied purchase and sale of capital assets and not earning of any business income. It was also argued that the assessee was governed by the special provision contained in sec. 115AD and as such the resultant income from the derivatives could be taxed only under the head 'Capital gains'. The ld. CIT(A) noted that the assessee traded in Future contracts based on individual company's shares and also Nifty Indexes. He noticed that the Index Futures were the artificial trade

instruments created by Stock Exchanges which could have a lifespan of not more three months and hence it was not possible to have the physical/actual delivery because the underlying Index was not a physical commodity. Once these artificial securities were not capable of delivery from one person to another, he held that the same could not be considered as a commodity and hence the provisions of sec. 43(5) would not apply. As regards loss from the Non-Index based derivatives, that is, where the underlying asset is some specific share, the ld. CIT(A) held that the same would qualify as speculative transaction inasmuch as there was a possibility of delivery of shares underlying such Futures and hence the resultant loss would be speculative loss. He finally held that the loss incurred by the assessee in Non-index based derivatives was hit by the provisions of section 43(5) and liable to be treated as speculative loss, but the loss from the Index based derivatives would fall under the head 'Profits and gains of business or profession' and hence become non-speculation business loss. Both the sides are in appeal before us against their respective stands in terms of the grounds positioned supra.

6. We have heard the rival submissions and perused the relevant material on record. It is seen that the assessee claimed net loss of Rs.11.27 crores from derivatives under the head 'Capital gains', whereas the AO held such loss to be speculation business loss u/s. 43(5) of the Act. The ld. CIT(A) bifurcated such loss into two parts viz., non-speculation i.e. normal business loss (from Index based derivatives) and speculation loss (from non-Index based derivatives i.e. based on individual shares). Now the assessee wants that the entire loss should be treated as short term capital loss and the Revenue contends that the entire loss should be held as speculation loss.

I. TRANSACTIONS IN DERIVATIVES – SEC. 43(5)

7. Section 43(5) defines '*speculative transaction*' to mean "*a transaction in which a contract for the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips*". Such a transaction is deemed to be speculative transaction unless a case falls under any of the specific clauses of the proviso to this sub-section. Here, it is important to mention that up to assessment year 2005-06, there were three clauses, (a) to (c) to this proviso. However, by the Finance Act, 2005, w.e.f. 01-04-2006, the following clause (d) has been inserted, which reads as under:

> *"(d) an eligible transaction in respect of trading in derivatives referred to in clause (ac) of section 2 of the Securities Contracts (Regulations) Act, 1956 (42 of 1956) carried out in a recognized Stock Exchange".*

7.2. The effect of this insertion from the assessment year 2006-07 is that transactions in respect of trading in derivates are not to be deemed as speculative transactions, as a result of which the gain or loss from such transactions shall not be considered as gain or loss from speculation business. The Special Bench of the Tribunal in *Shree Capital Services Ltd. vs. ACIT* (2009) 28 DTR 1 (Kol.) (SB) (Trib.) has held that the 'derivative' in which underlying asset is a share, falls under the expression 'commodity' u/s 43(5) and thus loss on account of transactions in futures and options derivates with the underlying assets as shares is speculative loss up to assessment year 2005-06. It has further been held in this case that the insertion of clause (d) of proviso to sec. 43(5), taking such transactions outside the purview of the speculative transactions, is prospective in operation and applies only from assessment year 2006-07. Thus the Special Bench of the tribunal in the aforenoted case held that the transactions in derivatives with the underlying assets as non index are speculative transactions upto A.Y. 2005-06. It is further noticed that the Hon'ble jurisdictional High Court in *CIT vs. Shri Bharat R. Ruia* (HUF) vide its recent unreported judgment dated 18-04-2011 has held that transactions in Exchange traded finance derivatives are speculative transactions as defined in sec. 43(5) and further clause (d) inserted to the proviso to sec. 43(5) w.e.f. 01-04-2006 is prospective. In view of the judgment of the Hon'ble jurisdictional High Court and also the Special Bench Tribunal order, it becomes apparent that the transactions in the Exchange traded finance derivatives are to be considered as speculative transactions within the meaning of sec. 43(5) in relation to the asst. year 2004-05 under consideration.

7.3 It is noticed that the ld. CIT(A) has drawn a distinction between the transactions in Index based derivates and individual shares based derivatives by holding the former as business transactions and later as speculative transactions. The reasoning given by him in support of such a distinction is that there is a possibility of delivery of shares in the non-Index based derivatives because the underlying asset on which the value is derived is the share of the company. As regards loss from the Index based Exchange traded derivative transactions, the ld. CIT(A) held it to be 'Business loss' on the ground that no physical delivery is possible because the underlying asset on which the value is derived is an Index which is not a physical commodity. In our considered opinion, the ld. CIT(A) was not justified in drawing such a line of demarcation between the two sets of transactions. It is for the reason that the derivates are finance instruments whose value depend on the value of the other underlying finance instruments. The underlying asset may be a particular share or the Index such as BSE Index and Nifty Index. In other words, the Index based derivatives are not based on the value of a particular share in the Futures but on the Index as a whole, which comprises of a number of shares included in such Index. Derivative, in itself, cannot be compared with the underlying share or Index. In fact, these are Futures contracts in both Index as well as Stocks which can be purchased or sold through recognized Stock Exchange. It has been noticed by the Hon'ble jurisdictional High Court in the above noted case in para 31 that "Futures contracts expire on the last Thursday of the expiry month. All futures contracts are settled in cash either on a daily basis or at the expiry of the respective contracts as the case may be. Clients/Trading members are not required to hold any stock of the underlying for dealing in the Futures Market." It is still further noticed that in the case of Shree Capital Services Ltd. (supra), the Special Bench dealt with derivatives in which the underlying assets were shares, and such transactions have been eventually held to be a speculative transactions. From the above discussion, it is clear that the transactions in derivates, whether having underlying assets as shares or Index, are speculative transactions within the meaning of sec. 43(5). As such, we hold that the ld. CIT(A) was not justified in coming to the conclusion that the Index based derivative transactions be treated as normal business or non-speculative transactions. We, therefore, overturn the impugned order to the extent of holding that the loss in Option trading in Index Futures be considered as nonspeculative. The net result is that in a normal case, the loss in Option trading on individual shares or Index has to be held as speculative loss.

II. SECTION 115AD AND INCOME FROM DERIVATIVES BY F.I.Is.

8. Having held that transactions in derivatives, both Index based and individual shares based, are to be considered as speculative transactions u/s.43(5) in a normal case, their nature needs to be examined in the hands of FIIs. The ld. A.R. contended that sec. 115AD deals with taxation on income of FIIs from securities or capital gains arising from their transfer and that being a special provision would override the general provisions including sec. 43(5). While referring to sub-sec. (1) of sec. 115AD, the ld. A.R. pointed out that income from transfer of derivatives is to be considered as capital gain alone, depending upon the period for which such derivatives are held so as to further classify them as short-term or long-term capital gain. He submitted that sub-section (1) of sec. 115AD alone governs the taxability of income by way of short-term or long-term capital gains arising from the transfer of such securities and it was wrong on the part of the authorities below to consider such income under the head "Profits and gains of business or profession", whether as speculation or non-speculation. He also referred to the definition of "Foreign Institutional Investors" given under Securities and Exchange Board of India (Foreign Institutional Investors) Regulation, 1995, to mean an institution which proposes to make investment in India in securities. It was contended that the permission to carry on activities in India is subject to the terms and conditions stipulated in such Regulations, as per which the FIIs can only make investment in securities and not undertake trade in them.

8.2 In the opposition, the ld. D.R. relied on the impugned order to contend that sec. 115AD(2) envisages the existence of business income, distinct from capital gains *qua* the dealings in securities. It was submitted that the argument advanced on behalf of the assessee that there can be no business income from the transactions in derivatives, was devoid of any force.

8.3 In order to appreciate the rival contentions, it would be apposite to consider the marginal note as well as the provisions of sec. 115AD, as under:

> **"Tax on income of Foreign Institutional Investors from securities or capital gains arising from their transfer**
>
> *115AD. (1) Where the total income of a Foreign Institutional Investor includes–*
>
> *(a) income other than income by way of dividends referred to in section 115-O received in respect of securities (other than units referred to in section 115AB); or*
>
> *(b) income by way of short-term or long-term capital gains arising from the transfer of such securities,*
>
> *the income-tax payable shall be the aggregate of–*
>
> *(i) the amount of income-tax calculated on the income in respect of the securities referred to in clause (a), if any, included in the total income, at the rate of twenty per cent;*
>
> *(ii) the amount of income-tax calculated on the income by way of short-term capital gains referred to in clause (b), if any, included in the total income, at the rate of thirty per cent;*
>
> ***Provided** that the amount of income-tax calculated on the income by way of shortterm capital gains referred to in section 111A shall be at the rate of fifteen per cent;*
>
> *(iii) the amount of income-tax calculated on the income by way of long-term capital gains referred to in clause (b), if any, included in the total income, at the rate of ten per cent; and*
>
> *(iv) the amount of income-tax with which the Foreign Institutional Investor would have been chargeable had its total income been reduced by the amount of income referred to in clause (a) and clause (b).*
>
> *(2) Where the gross total income of the Foreign Institutional Investor–*
>
> *(a) consists only of income in respect of securities referred to in clause (a) of subsection (1), no deduction shall be allowed to it under sections 28 to 44C or clause (i) or clause (iii) of section 57 or under Chapter VI-A;*

(b) includes any income referred to in clause (a) or clause (b) of sub-section (1), the gross total income shall be reduced by the amount of such income and the deduction under Chapter VI-A shall be allowed as if the gross total income as so reduced, were the gross total income of the Foreign Institutional Investor.

(3) Nothing contained in the first and second provisos to section 48 shall apply for the computation of capital gains arising out of the transfer of securities referred to in clause (b) of sub-section (1).

Explanation.—For the purposes of this section,–

(a) the expression "Foreign Institutional Investor' means such investor as the Central Government may, by notification in the official Gazette, specify in this behalf;

(b) the expression "securities" shall have the meaning assigned to it in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956)."

8.4 From Explanation (a) above, two things are noticeable. Firstly, the FII is an 'Investor' and secondly, it can transact only when the Central Government notifies in the Official Gazette. It is further noticed that the FIIs are monitored through the regulations specifically made by the SEBI for FIIs, which are known as the Securities and Exchange Board of India (Foreign Institutional Investors) Regulation, 1995. Regulation 2(f) defines "Foreign Institutional Investors" to mean "*an institution established or incorporated outside India which proposes to make an **investment** in India in securities*". It is imperative to observe that the SEBI has allowed the FIIs to operate in a limited field. The restrictions on the making of Investment by the FIIs are contained in Regulation 15(1) which reads as under :

"15. (1) A Foreign Institutional Investor may invest **only** in the following:-

(a) securities in the primary and secondary markets including shares, debentures and warrants of companies unlisted, listed or to be listed on a recognised stock exchange in India; and

(b) units of schemes floated by domestic mutual funds including Unit Trust of India, whether listed on a recognised stock exchange or not,units of scheme floated by a Collective Investment Scheme.

(c) dated Government Securities;

(d) derivatives traded on a recognised stock exchange;

(e) commercial paper;

(f) security receipts;"

8.5 From the prescription of Regulation 15(1), it can be viewed that there are restrictions on a FII in making investments, which can only be in the specified securities which, inter alia, include shares, debentures and derivatives traded on a recognized Stock Exchange. It is further essential to note that the regulations, apart from providing that a FII can invest only in the specified securities, also provides for certain additional conditions, which have been laid down in Regulation 15(3), the relevant part of which is as under:

> "(3) In respect of investments in the secondary market, the following additional conditions shall apply:-(a) a foreign institutional investor or sub-account shall transact in the Indian securities market only on the basis of taking and giving delivery of securities purchased or sold:
>
> Provided that nothing contained in this clause shall apply to any transactions in derivatives on a recognised stock exchange:
>
> Provided further that a foreign institutional investor or subaccount may enter into short selling transactions only in accordance with the framework specified by the Board in this regard;]
>
> (b) no transaction on the stock exchange shall be carried forward; and
>
> (c) the transaction of business in securities shall be only through stock brokers who has been granted a certificate by the Board under sub section (1) of section 12 of the securities and Exchange Board of India Act,1992:
>
> ………"

8.6 It is further relevant to note that even after the grant of initial registration by the Central Government, a FII has to adhere to the regulations of the SEBI. Its activities are monitored on day to day basis, as can be seen from Regulation 16, which spells out certain obligations and responsibilities of the FIIs. It is worthwhile to take notice of Regulation 16(2), which is as under:–

> "The Foreign Institutional Investor shall ensure that the domestic custodian takes steps for–
>
> > (a) monitoring of investments of the Foreign Institutional Investor in India;
> >
> > (b) reporting to the Board on a daily basis the transactions entered into by the Foreign Institutional Investor;
> >
> > (c) preservation for five years of records relating to his activities as a Foreign Institutional Investor; and
> >
> > (d) furnishing such information to the Board as may be called for by the Board with regard to the activities of the Foreign

Institutional Investor and as may be relevant for the purpose of this regulation."

8.7 The consequences which follow from non-compliance of the relevant regulations by a FII have been provided for in Regulation 7A.

When we view Regulation 15(1) in juxtaposition to Regulation 15(3), it becomes abundantly clear that a FII is eligible to make only investments (not trading) in the specified securities and secondly, investment in the secondary market can be only on the basis of taking and giving delivery of securities purchases or sold. The restriction regarding taking and giving delivery of securities purchased or sold does not apply to any transaction in derivates provided these are routed through recognized Stock Exchange.

Section 2(h) of the Securities Contracts (Regulation) Act defines "securities" to include–

(i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;

(ia) derivative;

(ib) units or any other instrument issued by any collective investment scheme to the investors in such schemes;

(ic) security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;

(id) units or any other such instrument issued to the investors under any mutual fund scheme;

(ii) Government securities;

(iia) such other instruments as may be declared by the Central Government to be securities; and

(iii) rights or interest in securities;

From the above definition of 'securities', it is discernible that derivatives and shares etc. have been kept on a single platform.

8.8 Having taken insight into the Regulations governing FIIs, we return to section 115AD. Explanation (a) defines the expression "Foreign Institutional Investor' to mean such an investor as the Central Government may, by notification in the official Gazette, specify in this behalf. On a conjoint reading of Regulation 15 with Expl. (a) to sec. 115AD, it is easily perceptible that a FII can only 'Invest' but not trade in the specified securities. Further Expl. (b) to section 115AD defines the expression 'securities' to "have the meaning assigned to it in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956).", which refer to derivatives and shares etc.

8.9. In the light of the above background, we will examine sec. 115AD which is a special provision enshrined in the Act for charging tax on the income of FIIs from securities or capital gains arising from their transfer. Sub-sec. (1) provides through clause (a) that the income, other than from the units of a Mutual Fund specified under sec. 10(23D) or of the United Trust of India, received in respect of securities except the income by way of dividend from domestic companies, shall be charged to tax @ 20%. Clause (b) of sec. 115AD(1) deals with income by way of short-term or long-term capital gains arising from the transfer of securities. Separate rates of tax have been provided in respect of long-term and short-term capital gains arising from the transfer of securities. Explanation (b) defines the expression "securities" to have the meaning assigned to it in sec. 2(h) of the Securities Contracts (Regulation) Act, 1956, which has been noted above. From such definition of "securities", that has been bodily lifted in sec. 115AD, it is explicitly obvious that it includes shares and also derivatives. Further when we examine Regulation 15, it can be seen that a FII is entitled to invest in the 'specified securities', which also, include shares and derivatives. Thus, it is patent that for the purposes of section 115AD, both the derivatives and shares have been categorized as 'securities' to be treated alike, notwithstanding the different tax treatment in the hands of non-FIIs to the income from the transfer of shares, which may vary from 'Business income' to 'Capital gains' depending upon the facts and circumstances of each case and from the transfer of derivatives which shall be speculative income up to the A.Y.2005-06.

8.10. We again slip back to sub-sec. (1) of sec. 115AD, clause (a) of which refers to income in respect of securities and clause (b) refers to income way of short-term or long-term capital gain arising from the transfer of such securities. Thus, the scope of clause (a) encompasses the income earned by retaining the 'securities' other than from transfer of such 'securities' and clause (b) specifically deals with income arising from the transfer of such 'securities'. Therefore, it is manifest that the income earned by a FII either by way of retention or by way of transfer of securities (including derivates) is subject matter of sub-sec. (1) of sec. 115AD.

8.11. Before we proceed further, it would be apt to note that sec.115AD was inserted by the Finance Act, 1993. The Memorandum explaining the provisions of the Finance Bill, 1993 reported at 200 ITR (St) 152 provides as under:

"MEASURE TO PROMOTE CAPITAL MARKET

Tax incentive for Foreign Institutional Investors Investing in securities

While presenting the Budget for 1992-93, the Finance Minister had stated that ways would be considered of allowing *reputable* ***foreign investors to invest*** *in the country's capital markets. In pursuance of this announcement, guidelines have been issued through a Press Note dated 14th September, 1992,* ***for such investment*** *by Foreign Institutional Investors.* ***Income from such investment*** *is to be taxed at concessional rates. Accordingly, the Bill seeks to insert a new section 115AD in the Income-tax Act relating to* ***tax on income of Foreign Institutional Investors from securities or capital gains arising from their transfer****.*

The income received in respect of securities (other than units referred to in section 115AB) listed in a recognized stock exchange in India in accordance with the Securities Contracts (Regulation) Act, 1956, is proposed to be taxed at the rate of twenty per cent. Income by way of long-term capital gains arising from the transfer of the said securities is proposed to be taxed at the rate of ten per cent. Income way of short-term capital gains arising from the transfer of the said securities is proposed to be taxed at the rate of thirty per cent. However, these rates of tax will apply on the gross income of the nature specified above without allowing for any deduction under sections 28 to 44C and Chapter VI-A. The first and second provisos of section 48 relating to computation of capital gains will not apply in the case of transfer of the aforesaid securities by the Foreign Institutional Investors.

The expression "Foreign Institutional Investor" is proposed to be defined to mean ***such investor*** *as the Central Government may, by notification in the Official Gazette, specify in this behalf. The expression "securities" is proposed to have the meaning assigned to it in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956.*

This amendment will take effect from 1st April, 1993 and will, accordingly, apply in relation to the assessment year 1993-94 and subsequent years".

(Emphasis supplied by us)

8.12. From the Memorandum explaining the provisions of the Finance Bill, it is palpable that the foreign institutional investors shall be allowed to invest in the country's capital market. Income in respect of securities and income from transfer of securities has been made the subject matter of sec. 115AD. As per this provision, the income arising from the transfer of such securities is to be considered as short-term or long-term capital gain.

8.13. Thus, on a close scrutiny of the SEBI (FII) Regulations, 1995 together with section 115AD seen in the light of the Memorandum explaining this provisions of the Finance Bill, 1993, it is visible that a FII is allowed to invest only in the 'securities' and further the income from securities, either from their retention or from their transfer, is to be taxed as per this section alone. Coming to income arising from the transfer of securities, it has been provided in section 115AD that it shall be charged as short-term or long-term capital gain, which depends upon the period of holding of such securities. A FII is not allowed by the Central Government to do 'business' in the 'securities'. Once it is noticed that a FII can only 'invest' in 'securities' and tax on the income from the transfer of such securities is covered by a special provision contained in section 115AD, the natural corollary which follows is that tax should be charged on income arising from transfer of such securities as per the prescription of this section alone, which refers to income by way of short term or long term capital gains.

8.14. The ld. D.R. has relied on sub-section (2) of sec. 115AD for contending that the existence of 'Business income' from dealing in securities is also envisaged. We find that sub-sec. (2) of sec. 115AD has two clauses. Clause (a) provides that where the gross total income of a FII consists only of income in respect of security referred to in clause (a) of sub-sec. (1) (i.e. income received in respect of securities, otherwise than from their transfer), then no deduction shall be allowed to it under sections 28 to 44C or section 57 or Chapter VI-A of the Act. It is but natural that when a lower rate of tax has been provided in respect of income earned by a FII from securities, then that rate of tax is final and the assessee cannot claim double benefit, firstly by being taxed at lower rate and secondly by claiming normal deductions etc. against this income. As sec. 115AD(2)(a) refers to income received in respect of securities and not from their transfer, the same would have no application to the instant case. According to clause (b) of sub-sec. (2) of sec. 115AD, where the gross total income includes any income referred to in clause (a) or clause (b) of sub-sec. (1) (i.e. income received in respect of securities by either retaining them or from their transfer), then the gross total income shall be reduced by the amount of such income and the deduction under Chapter VI-A shall be allowed as if the gross total income so reduced is the gross total income of the FII. A plain reading of sub-sec. (2) makes it manifest that the gross total income of a FII may include income other than that received in respect of securities or from the transfer of such securities. The emphasis of the ld. DR is on this part of the provision to bring home the point that a FII may also have 'Business income' arising from the transfer of securities. The argument is that a FII may have income from securities as falling under the head 'Capital gains', which is covered under section 115AD(1)(b) and also business income, as comes out from sec. 115AD(2)(b). This argument though looks attractive at first flush, but does not stand scrutiny in depth. The rationale behind section 115AD(2)(b) is that the income of a FII, other than that arising from the holding or transfer of securities, should find its place in the total income and the deductions under Chapter VI-A be allowed by considering gross total income net of income received in respect of securities or arising from the transfer of such securities. It is quite possible that a FII may deposit its surplus funds in banks resulting into interest income. Such interest income, which shall not fall under sub-sec. (1) of sec. 115AD, shall constitute part of the gross total income. It is a simple and plain interpretation of sub-sections (1) and (2) of sec. 115AD. We want to make it clear that the question before us is not to determine whether a FII can have any business income or not. We are confined to determining whether the income from the transfer of securities would fall under sub-section (1) or (2). If it is presumed as a hypothetical case that a FII may also have any business activity, whether legal or illegal, then the income from such activity shall be considered as 'Business income' covered under subsection (2)(b). The only embargo against the above presumption is that the business should not be that of dealing in 'securities'. Once there is a special provision slicing away the income to a FII from the transfer of 'securities' from the other income, it has to find its home only under sub-section (1)(b), irrespective of the fact that the securities are viewed as 'Investment' or 'Stock in trade'. If the Revenue ventures to make a distinction between such securities as constituting capital asset or stock in trade, which is not contemplated by the Central Government as is evident from SEBI(FII) Regulations and the definition of FII in Explanation (a) to sec. 115AD, then this provision will become otiose. In our considered opinion if a FII receives any income in respect of securities or from the transfer of such securities, the same can be considered under sub-sec. (1) alone and sub-sec. (2)(b) cannot be invoked to construe it as 'Business income' .

8.15. The position has been clarified by way of a Press Note : F No. 5(13)SE/91-FIV dated 24.03.1994 issued by the Ministry of Finance, Department of Economic Affairs (Investment Division) , New Delhi, the relevant part of which is as under:

> *"The taxation of income of Foreign Institutional Investors from securities or capital gains arising from their transfer, for the present, shall be as under:–*
>
> *(i) The income received in respect of securities (other than units of off-shore funds covered by section 115AB of the Income-tax Act) is to be taxed at the rate of 20%;*
>
> *(ii) Income by way long-term capital gains arising from the transfer of the said securities is to be taxed at the rate of 10%;*
>
> *(iii) Income by way of short-term capital gains arising from the transfer of the said securities is to be taxed at the rate of 30%;*
>
> *(iv) The rates of income-tax as aforesaid will apply on the gross income specified above without allowing for any deduction under sections 28 to 44C, 57 and Chapter VI-A of the Incometax Act.*

> *2. The expression "Foreign Institutional Investor" has been defined in section 115AD of the Incometax Act to mean such investors as the Central Government may, by notification in the Official Gazette, specify in this behalf. The FIIs as are registered with the Securities and Exchange Board of India will be automatically notified by the Central Government for the purpose of section 115AD."*

8.16. From the above Press Note, it is abundantly clear that FIIs have been considered as "investors" (and not as traders). Secondly, income from transfer of securities has been viewed as chargeable to tax under the head 'capital gains' as long-term or short-term capital gain depending upon the period for which such securities are held.

8.17. In view of the above discussion, it is out-and-out that income arising to a FII from the transfer of 'securities' as specified in Explanation (b) to sec. 115AD can only be considered as short-term or long-term capital gain and not as 'business income'. As the 'derivatives' have been included in the definition of 'securities' for the purposes of this section, the income from derivatives shall also be considered as short-term or long-term capital gain depending upon the period of holding. If the viewpoint of the Department, to the effect that income from transfer of shares or debentures etc. should be considered as short-term or long-term capital gain (as has been accepted by the AO in the instant case) but that from derivatives should be considered as 'Business income' (speculation business), then it would mean considering shares and debenture etc. as distinct from derivatives. Moreover there is nothing on record to demonstrate that the assessee was visited with any consequences as per Regulation 7A for violation of Regulations 15 or 16. It shows that the regulations have been conscientiously followed by the assessee as per which it simply made only Investment in securities and there is nothing of the sort of trading. Although in common parlance, the shares or debentures etc. are distinct from derivatives, and their taxation may also differ in the case of non-FIIs, but such distinction is obliterated in the context of FIIs due to the inclusion of both shares and debentures etc. on one hand and derivatives on the other, in the definition of "securities" for the purpose of sec. 115AD and subsection (1) providing for the income from their transfer to be considered as long term or short term capital gain.

8.18. It is noticed that sec. 115AD falls in Chapter XII which deals with the determination of tax in certain special cases. This Chapter consists of sections 110 to 115BBC. Each section contains special provisions dealing with specific types of incomes for which a specified rate of tax is provided. If a particular item of income is covered in any of these sections, it shall be strictly governed by the prescription of that relevant section alone. We are reminded of the legal maxim '*Generalia specialibus non derogant*', which means that special provisions override the general provisions. It is a well settled legal position that specific provisions override the general provisions. In other words, if there are two conflicting provisions in an enactment, the special provisions will prevail and the subject matter covered in such a special provision shall stand excluded from the scope of the general provision. The Hon'ble Supreme Court in the case of *Britannia Industries Ltd. vs. CIT* (2005) 278 ITR 546 (SC) has held that expenditure towards rent, repairs, maintenance of guest house used in connection with business is to be disallowed u/s. 37(4) because this is a special provision overriding the general provision.

9. Coming back to our context, it is seen that income arising from the transfer of securities of the FIIs has been included under sec. 115AD(1)(b) to be categorized as short-term or long-term capital gain depending upon the period of holding. In such a situation, it is impermissible to consider such income as falling under the head "Profits and gains of business or profession". Such income arising from the transfer of securities shall be charged to tax under the head "capital gains" alone. Once inclusion of such income from the transfer of securities is held to be falling only under the head "Capital gains", it cannot be considered as 'Business income', whether speculative or non-speculative.

10. The heading of section 43 is : 'Definitions of certain terms relevant to income from profits and gains of business or profession'. The opening part of this section is : "In sections 28 to 41 and in this section, unless the context otherwise requires-". Thereafter, six subsections have been given, of which sub-sec. (5) defines "speculative transaction". It is, therefore, clear that sec. 43(5) defining 'speculative transaction' is relevant only in the context of income under the head 'Profits and gains of business or profession'. It rules out its application to income under any other head. If that be the position, the picture is clear that sec. 43(5) has no application to FIIs in respect of 'securities' as defined in Explanation to sec. 115AD, income from whose transfer is considered as short term or long term capital gains.

11. We, therefore, hold that the ld. CIT(A) was not justified in holding that income from Index based or non-Index based derivatives be treated as 'business income', whether speculative or nonspeculative. The impugned order is, therefore, set aside by holding that income from derivative transaction resulting into loss of Rs.11.27 crores is to be considered as short-term capital loss on the sale of securities which is eligible for adjustment against short-term capital gains arising from the sale of shares.

12. In the result, the appeal of the assessee is allowed and that of the Revenue is dismissed.

Order pronounced on the 27th day of May, 2011.

2013 TRI 1357 (H.C. Kar.)

HIGH COURT OF KARNATAKA AT BANGALORE

N. Kumar and B. Manohar, JJ.

Bhoruka Engineering Inds. Ltd.
v.
The Deputy Commissioner of Income Tax

FACTS/HELD

Section 10(38): Scheme of sale of land through sale of shares of shell company is valid

1. The assessee held 98.73% shares in Bhoruka Financial Services Limited (BFSL). In AY 2005-06 BFSL purchased a plot of land from a group sick company called Bhoruka Steels Ltd for Rs.3.75 crores which was accepted to be the prevailing market price u/s 50C. BFSL was a shell company with no assets other than the said land. In AY 2006-07 the assessee sold its shareholding in BFSL to DLF Commercial Developers Ltd for a net consideration of Rs. 20 crore. As the sale of shares was executed through the Magadh Stock Exchange and STT was paid, the assessee claimed that the gain on sale of shares was exempt u/s 10 (38). The AO, CIT(A) and Tribunal rejected the assessee's claim on the basis that the assessee, BFSL and Bhoruka Steels were all controlled by common shareholders and that the scheme to first sell the land to BFSL and then to sell the shares of BFSL was devised with the sole purpose of avoiding tax on the capital gains which would have arisen if the land had been sold directly. It was held that the formalities of the transaction and the legal nature of the corporate bodies had to be ignored by lifting the corporate veil and the transaction had to be taxed as a sale of the land. On appeal by the assessee to the High Court, HELD allowing the appeal:

   Though BFSL was a shell company with no asset other than the land and by buying the shares of BFSL, DLF in effect purchased the land, the transaction cannot be said to a sham or an unreal one. In coming to the conclusion that the transaction is a colourable devise, the authorities have been carried away by the fact that the assessee was able to avoid payment of income tax. The assessee did resort to tax planning and took advantage of the law/ loopholes in the law. After seeing how the loophole was exploited within the four corners of the law, it is open to Parliament to amend the law plugging the loophole. However it cannot be done by judicial interpretation. S. 10(38) of the Act is unambiguous. If the share holder chooses to transfer the lands through a transfer of the shares of the company owning the land, it would be a valid legal transaction in law and cannot be said to be a colourable devise or a sham merely because tax is avoided thereby (McDowell 154 ITR 148 (SC), Azadi Bachao Andolan 263 ITR 706 (SC) & Vodafone International 341 ITR 1 (SC) referred)

Appeal allowed.

ITA No.120 of 2011.

Decided on: 9th April, 2013.

Present at hearing: Jehangir D.J Mistri, Sr. Counsel, S. Parthasarathi, & Mallaharao K., Advocates, for Appellant. E.R. Indra Kumar, Senior Counsel & Sanmathi, Advocate, for Respondent.

JUDGMENT

Per N. Kumar, J.–

This appeal is filed against the order passed by the Tribunal dismissing the appeal preferred by the assessee against the order of the lower authorities who have held that the assessee is liable to pay capital gain tax for the lands sold during 2005.

2. Bhoruka Steel Limited (BSL) was incorporated in the year 1969. It had a mini steel plant for the manufacture of billets and rolled products at Bangalore. It commenced its commercial production in 1972 and set up a refractory plant at Bangalore. They also set up a stevedoring division in Chennai in the year 1988-89, mainly to handle import of shredded scrap. They also took over the assets and liabilities of Bangalore Wire Road Mill, a division of Transport Corporation of India in 1991. The company became a sick industrial company within the meaning of SICA. The company's case was first heard by BIFR on 9.2.1996 when IDBI was appointed as Operating Agency. A scheme came to be formulated for the rehabilitation of the BSL. The said scheme envisaged, inter alia, closure of the unviable steel division, sale of surplus assets and OTS of institutions/Canara Bank's/debentureholders' existing dues. One of the

means by which the finance is to be raised was by way of sale of surplus fixed assets for a sum of Rs.1,560 Lakhs. Accordingly, fixed assets (land, building and machinery) were proposed to be sold for estimated realization of Rs.1,560 Lakhs, 50% of which representing Rs.780 Lakhs each being received during 2000-01 and 2001-02. The book value of assets to be sold was Rs.1,218 Lakhs as on 31.3.1998. The company had 37 acres of land in Bangalore, out of which 7 acres was proposed to be retained for refractory division and the balance 30 acres along with building and structure therein were proposed to be disposed of. An asset sale committee (ASC) was constituted comprising one representative each of the company, OA, Canara Bank, GoK and the BIFR's special director. The ASC would oversee and supervise the sale of identified surplus assets (including 30 acres land at Whitefield Road, Bangalore, Steel Melting Shop and Wire Road Mill) in a transparent manner. In case of any delay/shortfall in realization of the expected amount of Rs.1,560 Lakh from sale of assets, the promoters would be required to bridge the gap by inducting interest free funds from their own sources.

3. One M/s R.K. Makhija and Company, Registered Valuers were entrusted with the job of valuing 30 acres which is to be sold. The said valuers vide their valuation report dated 15.3.2002 valued the said land at Rs.25 Lakhs per acre. IDBI, the Monitoring Agency and AAIFR accepted the valuation of M/s Makhija at Rs.25 Lakhs per acre while approving the Rehabilitation Scheme. One Aeekay Enterprises offered Rs.20 Lakhs per acre for purchase of the said land. However, in the meeting held on 8.7.2002 the committee resolved that the offer of Rs.20 Lakhs per acre by Aeekay Enterprises was low and the company may release advertisement in Economic Times, Mumbai and New Delhi as the land was ideally suited for large complexes like Multiplex/IT Park, etc., It was made clear that, if no worthwhile offer was received within 10 days from the date of release of advertisement, then the company had no other alternative but to request the promoters/group companies to purchase the land with the price not less than Rs.25 lakhs per acre. Thereafter, the company was directed to issue paper notification inviting tenders for purchase of the said land. Accordingly, in Economic Times, Bangalore and Mumbai a paper publication was issued.

4. In the meeting held on 29.7.2002 a decision was taken to offer the land first to the promoters/sister companies jointly or severally with the reserve price of Rs.25 Lakhs per acre on the condition that the dues of the secured creditors and others as per the rehabilitation scheme are cleared by 31.12.2002 to enable them to release the title deeds and issuing "No Due Certificate" to the company. The committee also authorized Mr. R.C. Purohit, Managing Director to take up the matter with the promoters and bring a final proposal on the above lines before the next Asset Sale Committee Meeting, failing which the committee will have no option but to sell the land at the highest offer received and the promoters will have

to make up the shortfall from their own sources as provided in the scheme. In the meeting held on 16.12.2002 of the Asset Committee the Chairman informed the committee that the company had received an offer from Bhoruka Financial Services Limited (BFSL), a public limited company and also one of the group Companies offered to purchase 30 acres of land standing in the name of the company at Whitefield Road, Bangalore, for a total consideration of Rs.750 Lakhs, i.e., Rs.25 Lakhs per acre. The offerer deposited an advance of Rs.75 Lakhs being 10% of the total consideration along with the offer. After some discussion, the committee approved the sale of 15 acres of land at Whitefield Road, Bangalore to BFSL/its nominee/s for a total consideration of Rs.375 Lakhs. Accordingly, the said amount was paid and the said land measuring 15 acres was sold in favour of BFSL under two registered sale deeds dated 16.6.2004 and 30.6.2004.

5. The assessee company is a limited company whose shares are quoted in the stock exchange. The assessee is holding shares in BFSL. The assessee and other promoter shareholders are holding 98.73% shares in BFSL, whereas the public shareholders are holding the remaining shares. The assessee was holding the shares in BFSL for more than a decade. BFSL was a financial company engaged in the business of investments. BFSL has purchased 15 acres of land under the aforesaid two sale deeds for a consideration of Rs.3.75 crores which was then prevailing market consideration which was accepted for the purpose of Section 50C of the Income Tax Act (for short hereinafter referred to as 'the Act'). Thereafter, the assessee in the financial year related to the relevant assessment year 2006-07 sold its shareholdings in BFSL to the extent of 45,350 shares for a net consideration of Rs.20,29,08,626/- after paying Security Transaction Tax, Service Tax, etc., The sales were executed through a registered stock broker on a recognized stock exchange namely M/s Magadh Stock Exchange Association. The shares were sold to DLF Commercial Developers Limited. The assessee claimed the gain on sale of shares as exempt from taxation under Section 10 (38) of the Act.

6. The assessing authority proposed to bring to tax the gain arising on the sale of the shares as short term capital gain on sale of the immovable property by holding that the transaction was virtually for sale of the immovable property to DLFCDL and the sale of shares was only a devise to escape from taxation. The share holders of BFSL by selling the shares to DLFCDL vested the immovable property in DLFCDL and it is the devise to transfer the immovable property to DLFCDL and the property having been held by BFSL for a period of less than 36 months and therefore the capital gains is required to be computed as a short term capital gains and consequently the appellant was liable to be taxed accordingly. The assessing authority held that the transaction was a colourable devise and virtually the immovable property had been

transferred for consideration and the appellant was liable to tax on the short term capital gains on sale of immovable property as determined. The assessing authority relied on the judgment of the Apex Court in the case of *McDowell & Co., vs CTO* [(1985) 154 ITR 148].

7. Aggrieved by the aforesaid order, the assessee preferred an appeal to the Commissioner of Income Tax (Appeals). However, the Commissioner did not find any merit in the appeal and accordingly he dismissed the appeal.

8. Aggrieved by the said order, the assessee preferred an appeal to the Tribunal. The Tribunal held that, even though BEIL, BFSL and Bhoruka Steels Limited are all controlled by the same interest group of Agarwal family as common shareholders which is very prominent in the entire course of transaction involved in the present appeal. They had entered into an agreement on 20.7.2005 with DLF-CDL to sell the shares in BFSL to that company, DLF-CDL. The assessee, its group of individuals together held 1,88,850 equity shares representing 98.73% of fully paid-up equity capital of BFSL. Therefore, it follows that the assessee along with its group owned all the assets and properties of BFSL even though those assets and properties are technically held in the name of BFSL as an independent corporate entity, once this corporate veil is pierced, which is within the powers of the revenue authorities they were of the view that the assets of BFSL were held and de facto owned by the assessee company and its group. BFSL, a company since long in existence was engaged only in financial services relating to the investments of assessee group. The property was purchased from another associate concern Bhoruka Steels Limited for a consideration of Rs.3.75 crores. The said property now has become the property of DLF-CDL where 98.73% in BFSL were transferred to DLF-CDL on sale. DLF-CDL which is a real estate company by purchasing 98.73% of shares in BFSL has in fact acquired the ownership and possession of the landed property which was purchased by BFSL for an amount of Rs.3.75 crores just a few months back. DLF-CDL had acquired the shares of BFSL for a consideration of Rs.89,28,36,500/-. The substance of the transaction is apparent now. Bhoruka Steels Limited sells its landed property to its associate concern BFSL for a consideration of Rs.3.75 crores and immediately thereafter the shares in BFSL are sold and transferred to DLF-CDL for a consideration of more than Rs.89 crores. If the formalities of the transactions and the legal nature of the corporate bodies are ignored for a moment, the stark fact coming to surface is that the assessee's group has sold the property belonging to one of its concern to DLF-CDL for a consideration of more than Rs.89 crores through the medium of sale and transfer of shares which property was purchased for Rs.3.75 crores and thereby made attempt to avoid payment of short-term capital gains tax. If this is not a colourable device, then what would be a colourable device? Therefore, it held the series of transactions were well planned scheme so

as to transfer valuable landed properties to DLF-CDL without attracting corresponding liability of tax. The whole transaction has been arranged in a sequential manner with M/s Bhoruka Steels Limited selling its landed property to BFSL for a nominal value of Rs.3.75 crores. BFSL never before doing any business other than financial services purchases the land for Rs.3.75 crores; immediately thereafter the asessee company and its entire group holding 98.73% of shares in BFSL selling the share holding to DLF-CDL for a consideration of Rs.89,28,36,500/- without attracting any levy of taxation. This episode has been made possible by getting away from Bangalore Stock Exchange and going to Magadh Stock Exchange to carry out the sale transaction of shares and by paying STT for claiming exemption from long-term capital gains arising on sale of shares under Section 10(38) of the Act. Therefore, they recorded a finding that it is a case of colourable device to evade payment of taxation on short-term capital gains. Therefore, the Tribunal declined to interfere with the order passed by the Commissioner of Income Tax. It is against the said order, the assessee is in appeal.

9. This appeal was admitted on 15.6.2011 to consider the following substantial questions of law:–

1. *Whether the finding of the Tribunal that the transfer of shares by the appellant to another limited company would amount to sale of immovable property held by the company whose shares were sold by the appellant - company and the capital gains arising on such sale of shares will be liable to be assessed as capital gains arising on the sale of the property, is perverse and arbitrary?*
2. *Whether the finding of the Tribunal that the appellant is not entitled to benefit of exemption under Section 10(38), is contrary to law?*

10. The learned senior counsel appearing for the assessee assailing the impugned orders passed by the authorities as well as the Tribunal contended that, the authorities proceeded on the basis that the assessee has sold an immovable property and therefore the assessee is liable to pay capital gain based on such sale of immovable property. The assessee is only a share holder in BFSL. It is BFSL who has purchased the immovable property under registered sale deeds. Therefore, assessee is not the owner of the immovable property. However, the assessee has transferred his shares for a valuable consideration of Rs.4,490/- per share. The income derived from such share would not fall within the total income of the assessee in view of Section 10(38) of the Act. The assessee is a shareholder in BFSL from the year 1984 and therefore the assessee was incorporated prior to that date. Neither the assessee company nor BFSL are companies which came into existence as a part of the scheme to purchase the land in question and evade payment of tax as sought to be made out by the authorities. The authorities seem to have been carried away by the fact that, before sale of shares, the BFSL sold away all its

other assets and it is only thereafter the shareholders of BFSL have entered into an agreement to sell their shares in favour of DFL. In the agreement there is a reference to the immovable property which according to the authorities is proof of the colourable device adopted by the assessee to evade payment of tax. Even if the veil is lifted and if these companies are looked into, the assessee is formed somewhere in the year 1971, BFSL came into existence in 1984 and Bharuka Steels which owned this property became a sick industry only somewhere in the year 1996 and the revival scheme by the BFSL was formed in 2000 and it is in pursuance of the same, excess land 30 acres belonging to Bharuka Steel was sold and in such sale one of the sister concern has purchased this property. None of these facts could be termed as unreal. They are all events which have happened in normal course, are legal and even the same is not disputed by the department. It is only the factum of stripping of all the assets before the shareholders sold the shares, according to them constitute a colourable device to evade tax which in the facts of this case cannot be accepted and therefore he submits the three authorities have wrongly applied the law in McDowell's case and thus the order requires to be set aside and the assessee should be given the benefit of Section 10(38) of the Act.

11. Per contra, the learned counsel for the revenue supporting the impugned order contends that, the law laid down by the Apex Court in McDowell is not diluted in the subsequent judgment in the case of Azadi Bachao Andolan. In fact it is reiterated in the latest judgment of the Apex Court in Vodafone's case. Once it is demonstrated the purpose of this transaction is to avoid payment of tax then it constitutes a colourable scheme and the authorities have lifted the veil and moreover appreciated the series of transactions wherein the property which is worth Rs.89 crores is sought to be transferred for a consideration of Rs.7 crores by the medium of transferring of shares to claim exemption under Section 10(38) of the Act and therefore he submits the order passed by the authorities are valid and legal and does not call for any interference.

12. From the material on record, it is clear the 30 acres of land in White Field belong to Bhoruka Steel Limited (BSL). It became a sick industrial company. Before BIFR, a scheme was formulated. The IDBI was appointed as Operating Agency. In terms of the scheme formulated, Assets Sale Committee was constituted. They took steps to bring the property for sale. The minimum price was fixed for Rs.25 Lakhs per acre. Most of its shares which were held by Sri.S.N.Agarwal and his family members, either in their individual capacity or as partners of the concerns, which belong to Bhoruka Group. They purchased the property under two registered sale deeds dated 16.06.2004 and 30.06.2004 for a consideration of Rs.3.75 Crores. The assessee company is a shareholder of M/s.BFSL. In the balance sheet as on 31.03.2005, the value of the land is shown as 4.21 Crores which is inclusive of development expenses on the

land. The promoters of M/s.BFSL were having 1,98,850 equity shares whereas 2,550 shares were held by other public shareholders. The Promoters of M/s.BFSL sought permission from SEBI to exempt them from making public announcement in respect to sale of 1,98,850 equity shares to M/s.DLFCDL, New Delhi. They disclosed the rate of Rs.2,400/- per share for the purpose of selling the shares to DLFCDL. The shares were listed in the Bangalore Stock Exchange. It hardly got traded. The last quoted value of this share was Rs.5/- in the year 1985. During the financial year 2004-05, M/s.BFSL sold all the listed equity shares. Accordingly, the investments which were worth Rs.4.61 Crores as on 31.03.2004 got reduced to Rs.3.85 Crores as on 31.03.2005. These investments as on 31.03.2005 were equity shares of M/s.Bhoruka Power Corporation Limited. M/s.BFSL systematically reduced its investments except that of the land which it purchased from M/s.Bhoruka Steel Limited. As on 31.03.2004, there was no fixed asset in the Company. It had only Rs.4.61 Crores of investments and Rs.4.65 Crores ofloans and advances as on 31.03.2004. On 16.06.004 and 30.06.2004, M/s.BFSL acquired land of 15 acres for Rs.3.75 Crores from M/s.Bhoruka Steel Limited. During the financial year 2004-05, M/s.BFSL sold all listed equity shares and during financial year 2005-06, it sold the remaining shares held by it as investments. The unsecured loans which were at Rs.1.48 Crores as on 31.03.2005 have reduced to NIL as on 30.06.2005. As on 30.06.2005 apart from land, bank accounts, cheques receivable or payable, there was no asset in BFSL. A comparative study of Balance Sheet as on 31.03.2004, 31.03.2005 and 30.06.2005 makes it clear that the Directors and Promoters of M/s.BFSL disposed off all the other assets held by M/s.BFSL except land before the shares were sold to M/s.DLFCDL. The intention of the Directors and Promoters of M/s.BFSL is to transfer the underlying asset, being land to the buyer company M/s.DLFCDL. M/s.DLFCDL could not have bought the shares of M/s.BFSL at a substantial rate of Rs.4,490/- per share. The area where the land is situated has huge commercial value. It shows M/s.DLFCDL purchased the shares of M/s.BFSL keeping in views the value of the underlying asset being land at Whitefield. The transaction was structured in such a way that the Promoters and Directors, holding the shares of the Company, M/s.BFSL, sold their shareholdings to M/s.DLFCDL and receive the consideration. The assessee-company has sold 45,350 shares during the month of August 2005 for a consideration of Rs.20,29,08,626/-. The cost of these shares is Rs.3,59,077/-. The net consideration is Rs.20,25,49,549/-. It is in the background of undisputed facts according to the Assessing Authority, if one were to lift the corporate veil and understand the true nature of the transaction in commercial sense, M/s.DLFCDL has made the payment not to just buy the shares of M/s.BFSL but to acquire the underlying asset. The shares of the Company are listed in the Bangalore Stock Exchange. Without making full and complete efforts to transact through Bangalore Stock

Exchange, it has chosen to carry out the transaction from Magadh Stock Exchange. The unusual attempts of the assessee-company finally culminated in selling a non-competitive stock for Rs.4,490/- per share by stripping out all the assets and investments of M/s.BFSL, except the land, it was reduced to a shell company. The shell company was used to transfer a real asset and promoters took the fruits of the transaction. M/s.BFSL and its promoters, made deliberate attempt to structure deal to avoid tax implications. Relying on the judgment of the *Mc.Dowell and Company vs. CTO* (1985) 154 ITR 148 wherein it is held that the position of law is that if substance attracts tax, the form can be ignored by the tax collector. Following the well settled principle, the Assessing Authority held that the substance of the transaction of the assessee-company is that the land was transferred in the form of sale of shares. The shareholders to the extent of their share become the owners of this land in the company. The land was transferred to M/s.DLFCDL by way of above circuitous transaction. The land has to be held for a period of 36 months as a long term capital asset, since the land was sold during August 2005, the gains arising to the assessee-company would be short terms capital gain.

13. The Appellate Authority affirmed the said findings of the Assessing Authority. However, the Tribunal was of the view the transaction in question was a colorable device to avoid payment of short term capital gain tax. In the light of the aforesaid undisputed facts, the question arises for consideration is:

> *Whether the transfer of shares by the assessee in M/s.BFSL within effect would have the effect of M/s.DLFCDL which acquire the lands becoming entitled to the immovable property to the extent of 15 acres is a colorable device to avoid payment of income-tax?*

14. The income-tax authorities have relied on the judgment of the Apex Court in the case of *Mc.Dowell and Company Limited vs. Commercial Tax Officer* [1985 STC Vol.59 277] and in particular relied on the judgment of Chinnappa Reddyl.J., to the following effect:

> *"We think that time has come for us to depart from the Westminister [1936] AC 1 Principle as emphatically as the British Courts have cdone and to dissociate ourselves from the observations of Shah, J., and similar observations made elsewhere. The evil consequences of tax avoidance are manifold. First there is substantial loss of much needed public revenue, particularly in a welfare State like ours. Next there is the serious disturbance caused to the economy of the Country by the piling up of mountains of black money, directly causing inflation. Then there is "the large hidden loss" to the community (as pointed out by Master Wheatcraft in 18 Modern Law Review 2009) by some of he best brains in the Country being involved in the perpetual*

> *war waged between the tax-avoider and his expert team of advisers, lawyers and accountants on one side and the tax-gatherer and his perhaps not so skilful, advisers on the other side. Then again there is the "sense of injustice and inequality which tax avoidance arouses in the breasts of those who are unwilling or unable to profit by it". Last but not the least is the ethics (to be precise, the lack of it) of transferring the burden of tax liability to the shoulders of the guideless, good citizens from those of the "artful godgers". It may, indeed, be difficult for lesser mortals to attain the state of mind of Mr.Justice Holmes, who said: "Taxes are what we pay for civilized society. I like to pay taxes. With them I buy civilization". But, surely, it is high time for the judiciary in India too to part its ways from the principle of Westminster [1936] AC 1 and the alluring logic of tax avoidance. We now live in a welfare state whose financial needs, if backed by the law, have to be respected and met. We must recognize that there is behind taxation laws as much moral sanction as behind any other welfare legislation and it is a pretence to say that avoidance of taxation is not unethical and that it stands on no less moral plane than honest payment of taxation. In our view, the proper way to construe a taxing statute, while considering a device to avoid tax, is not to ask whether the provisions should be construed literally or liberally, nor whether the transaction is not unreal and not prohibited by the statute, but whether the transaction is such that the judicial process may accord its approach to it".*

15. The Apex Court subsequently had an occasion to consider this judgment in the case of *Union of India and another vs. Azadi Bachao Andolan and another* [AIR 2004 SC 1107]. In the aforesaid decision, after referring to the entire catena of cases up-to-date including the aforesaid Constitution Bench judgment as well as the opinion expressed in the said judgment by Justice Chinnappa Reddy, the Apex Court held as under:

> *"146. With respect, therefore, we are unable to agree with the view that Duke of Westminster is dead, or that its ghost has been exorcised in England. The House of Lords does not seem to think so, and we agree with respect. In our view, the principle in Duke of Westminster is very much alive and kicking in the country of its birth. And as far as this country is concerned, the observations of Shah, J. in CIT v. Raman are very much relevant even today".*

> *"153. The Constitution Bench reiterated the observations in Bank of Chettinad Ltd., -vs- CIT, quoting with approval the observations of Lord Russel of Killowen in IRC vs. Duke of Westminster and the observations of Lord Simonds in Russell –vs- Scott".*

> *"154. It thus appears to us that not only is the principle in duke of Westminster alive and kicking in England, but it also seems to have acquired judicial benediction of the Constitutional Bench in India, notwithstanding the temporary turbulence created in the wake of Mc Dowell."*
>
> *"We are unable to agree with the submission that an act which is otherwise valid in law can be treated as non est merely on the basis of some underlying motive supposedly resulting in some economic detriment or prejudice to the national interests, as perceived by the respondents".*
>
> *Though the words : "sham" and "device" were loosely used in connection with the incorporation under the Mauritius law, we deem it fit to enter a caveat here. These words are not intended to be used as magic mantras or catch-all phrases to defeat or nullify the effect of a legal situation."*

16. This Court had an occasion to consider the aforesaid judgments in the case of *State of Karnataka vs. M/s.Videocon International Limited* in STRP No.4/2000 in its judgment dated 14.07.2010, wherein it has observed as under:

> *"33. From the aforesaid discussion, it is clear that there is no inconsistency or deviation in the approach to the interpretation of the taxation law in England, America as well as in India. It is now well settled that a Citizen is entitled to arrange his affairs as not to attract taxes imposed by the State, so far as he can do so within the law. Every man is entitled to order his affairs in such a manner that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure the said result, his ingenuity is to be respected and he cannot be compelled to pay an increased tax. He may legitimately claim the advantage of any express terms or of any omissions that he can find in his favour in taxing statutes. His legal right so to dispose of his capital and income as to attract upon himself the least amount of tax is fully recognized. The law does not oblige a trader to make the maximum profit that he can out of his trading transactions. The legal right of tax payer to decrease the amount of what otherwise would be his taxes, or altogether to avoid them by means which the law permits, cannot be doubted. The basic proposition underlining this taxation law is that any tax payer is entitled so as to order his affairs in such a manner as to see that his liability to tax is as how as possible. If the tax payer is in a position to carry through a transaction in two alternative ways, one of which will result in liability to tax and the other of which will not, is at liberty to choose the latter and to do so effectively in the absence of any specific tax avoidance provision. The fact that the motive*

> *for a transaction may be to avoid tax does not invalidate it unless a particular enactment so provides. Every person is entitled to so arrange his affairs as to avoid taxation but the arrangement should be real and genuine and not a sham or make-believe. A tax payer may resort to a device to divert the income before it accrues or arises to him. Effectiveness of the device depends not upon considerations of morality, but on the operation of the Income-Tax Act. Colourable devices cannot be part of tax planning. A tax-saving motivation does not justify the taxing authorities or the Courts in nullifying or disregarding a taxpayer's otherwise proper and bona fide choice among courses of action. Legislative injunction in taxing statutes may not, except on peril of penalty, be violated, but it may lawfully be circumvented. Tax planning may be legitimate provided it is within the framework of law. The intention of the legislature in a taxation statute is to be gathered from the language of the provisions particularly where the language is plain and unambiguous. In a taxing Act, it is not possible to assume any intention or governing purpose of the statute more than what is stated in the plain language".*

17. Recently, these judgments fell for consideration before the Apex Court in the case of *Vodafone International Holdings B.V. vs. Union of India and another* reported in (2012) 341 ITR Page 01. After referring to the aforesaid two judgments of the Apex Court at Paragraph No.64, it has been held as under:

> *"64. The majority judgment in Mc. Dowell held that "Tax planning may be legitimate provided it is within the framework of law" (paragraph 45). In the latter part of paragraph 45, it held that "colourable devices cannot be a part of tax planning and it is wrong to encourage or entrain the belief that it is honourable to avoid the payment of tax by resorting to dubious methods". It is the obligation of every citizen to pay the taxes without resorting to subterfuges. The above observations should be read with paragraph 46 where the majority holds "on this aspect, one of us, Chinnappa Reddy J. has proposed a separate and detailed opinion with which we agree". The words "this respect" express the majority's agreement with the judgment of Reddy J. only in relation to tax evasion through the use of colourable devices and by resorting to dubious methods and subterfuges. Thus, it cannot be said that all tax planning is illegal / illegitimate / impermissible. Moreover, Reddy J. himself says that he agrees with the majority. In the judgment of Reddy J. there are repeated references to schemes and devices in contradistinction to "legitimate avoidance of tax liability." In our view, although Chinnappa Reddy J. makes a number of*

> *observations regarding the need to depart from the Westminster and tax avoidance – these are clearly only in the context of artificial and colourable devices. Reading Mc.Dowell, in the manner indicated hereinabove, in cases of treaty shopping and / or tax avoidance, there is no conflict between Mc.Dowell and Azadi Bachao or between Mc.Dowell and Mathuram Agrawal."*

18. Justice K.S.Radhakrishnan J., who has written a separate but a concurring opinion dealing with the question whether Mc.Dowell calls for re-consideration has observed as under:

> *"Revenue cannot tax a subject without a statute to support and in the course we also acknowledge that every tax payer is entitled to arrange his affairs so that his taxes shall be as low as possible and that he is not bound to choose that pattern which will replenish the treasury. Revenue's stand that the ratio laid down in Mc.Dowell is contrary to what has been laid down in Azadi Bachao Andolan, in our view, is unsustainable and, therefore, call for no reconsideration by a larger Bench."*

19. In view of the judgment of the Apex Court in Vodafone, it is held that "tax planning may be legitimate provided it is within the frame work of law". "Colourable devices cannot be a part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid payment of tax by resorting to dubious methods". It is an obligation of every citizen to pay the taxes without resorting to subterfuges. Therefore, though all tax planning is illegal/illegitimate/impermissible, the revenue cannot tax a subject without a statute to support and in the course we also acknowledge that every tax payer is entitled to arrange his affairs so that his taxes shall be as low as possible and that he is not bound to choose that pattern which will replenish the treasury. A Citizen may legitimately claim the advantage of any express terms or of any omissions that he can find in his favour in taxing statutes. His legal right so to dispose of his capital and income as to attract upon himself the least amount of tax is fully recognized. The legal right of tax payer to decrease the amount of what otherwise would be his taxes, or altogether to avoid them by means which the law permits, cannot be doubted. If the tax payer is in a position to carry through a transaction in two alternative ways, one of which will result in liability to tax and the other of which will not, is at liberty to choose the latter and to do so effectively in the absence of any specific tax avoidance provision. The fact that the motive for a transaction may be to avoid tax does not invalidate it unless a particular enactment so provides. A tax-saving motivation does not justify the taxing authorities or the Courts in nullifying or disregarding a taxpayer's otherwise proper and bona fide choice among courses of action. Tax planning may be legitimate provided it is within the framework of law. The intention of the legislature in a taxation statute is to be gathered from the language of the provisions particularly where the language is plain and unambiguous. In a taxing Act,

it is not possible to assume any intention or governing purpose of the statute more than what is stated in the plain language. Therefore, as long as the arrangement of the assessee to avoid payment of tax do not contravene any statutory provision and is achieved within the four corners of law, it cannot be found fault with. If the transaction in question is sham or colorable and entered into with the sole intention of evading payment of tax, then such a transaction would not have any legitimacy. Therefore, a colorable device cannot be a part of tax planning. Therefore, in each case, the transaction in question and the material on record has to be carefully examined to find out whether the transaction is "sham" or "unreal" or "colourable device" to evade payment of tax.

20. In the instant case, as set out above, according to the revenue, on the day the assessee transferred their share from BFSL, the only property which was available in BFSL was this land. Before transfer of the shares, the BFSL has systematically reduced this investment except that of the land instead of trading its shares through BSE. The shares were traded through Magadh Stock Exchange. In the agreement entered into for transfer of shares, reference is only made to the sale of the land. Therefore, what was attempted to for transfer of shares is nothing but the transfer of immovable property. On the date of transfer, BFSL has become a Shell company. Therefore, it was a deliberate structural device to avoid tax implications. The grievance is, the property which was purchased for 3.75 Crores was sold to a consideration of Rs.89,28,36,500/-, the assessee share being Rs.20,29,08,626/- without paying capital gain tax. From these facts, it is clear DLFCDL paid the market value and purchased the shares from the assessee. Therefore, the transaction of shares is not a nominal one. It is not a sham transaction. It is a real transaction for valuable consideration. The effect of the transaction is DLFCDL having acquired the shares became entitled to enjoy the asset of the company which was held by BFSL. For effecting the said transfer, instead of trading those shares through Bangalore Stock Exchange, it was traded through Magadh Stock Exchange. The material on record shows no trading activities took place in the BSE to the relevant period. The attempt on the part of the assessee to trade their shares through other Stock Exchange was not fulfilled. But they were able to trade the said shares through Magadh Stock Exchange was fulfilled though the trading license of Magadh Stock Exchange had been suspended earlier, subsequently it was revoked and after such revocation, the assessee traded the shares through Magadh Stock Exchange and therefore, the requirements of selling has been complied with. For each share, the assessee wanted permission from SEBI without being made available to the open public at a price of Rs.2,250/-. When it is traded through Magadh Stock Exchange, each share has fetched a sum of Rs.4,290/- and BFSL admittedly has paid Rs.89,28,36,500/- for the entire extent of 15 acres of land for which, a sum of Rs.20,29,08,626/- being the share value of the assessee. In the light of these undisputed facts, it cannot be said that the transfer of share by the assessee to BFSL was a colourable

device to avoid payment of tax. If BFSL has sold the shares by executing a registered sale deed and received the sale consideration, then, BFSL ought to have paid capital gains on the said consideration. That is one mode through which BFSL could have sold the property belonging to it. The law also provides for transfer of shares by the shareholders and this route the assessee has adopted in the instant case. By transferring 98.3% of shares held by the shareholders, virtually, the complete control of the company has been handed over to the BFSL and they have received the consideration for the shares held by them, may be proportionate to the value of the land on the date of transfer. But that does not make the transaction "colourable" or "unreal" or "sham."

21. Section 10 of the Act deals with incomes which do not form part of total income. Section 10 provides that in computing total income of a previous year of any person, any income falling within any of the following clause shall not be included.

22. Clause (38) of Section 10 of the Income-tax Act on which reliance is placed reads as under:

> *10. In computing the total income of a previous year of any person, any income falling within any of the following clauses shall not be included–*
>
> ………..
>
> ………..
>
> *(38) any income arising from the transfer of a longterm capital asset, being an equity share in a company or a unit of an equity oriented fund where–*
>
> *(a) the transaction of sale of such equity share or unit is entered into on or after the date on which Chapter VII of the Finance (No. 2) Act, 2004 comes into force; and*
>
> *(b) such transaction is chargeable to securities transaction tax under that Chapter:*
>
> ***Provided** that the income by way of long-term capital gain of a company shall be taken into account in computing the book profit and income-tax payable under Section 115JB.*
>
> *Explanation.—For the purposes of this clause, "equity oriented fund" means a fund–*
>
> *(i) where the investible funds are invested by way of equity shares in domestic companies to the extent of more than [sixty-five] per cent of the total proceeds of such fund; and*
>
> *(ii) which has been set up under a scheme of a Mutual Fund specified under clause (23D):*

> ***Provided** that the percentage of equity shareholding of the fund shall be computed with reference to the annual average of the monthly averages of the opening and closing figures;*

23. A reading of the aforesaid provision makes it clear that if the conditions mentioned therein are satisfied, the income arising from such transfer would not form part of the total income of the assessee. In other words, it is exempted from payment of tax. The condition to be satisfied are as under:

- *(a) It should be a transfer of long term capital asset, being a equity share in a company.*
- *(b) Sale of such equity share should be on or after chapter 7 of the Finance Act 2/2007 came into force. It is with effect from 29.08.2004.*
- *(c) the said transaction is chargeable to Securities Transaction tax under the chapter.*

24. In the instant case, the assessee is holding the shares in BFSL from 01.10.1984. Therefore, it is a long term Capital asset. The transaction has taken place subsequent to 28.09.2004 as such the second condition is fulfilled. They have paid the security transaction tax to Magadha Stock Exchange. Where all these three conditions stipulated under Section 10(38) of the Act are fulfilled, the assessee is entitled to the benefit flowing there from i.e., the income from such transfer shall not be included in the total income of the assessee for the previous year. Merely because if a registered sale deed has been executed by BFSL selling the land in favour of DFL-CDL in which event capital gain should have been paid on the sale consideration, is no reason to hold that when a share holder of BFSL transfer his share for a consideration, after complying with the legal requirements, is not entitled to the benefit of tax exemption. All the authorities are carried away by this aspect of the matter and because the assessee was able to avoid payment of income tax, consequently the Department was deprived of the tax, they have come to the conclusion that it is a colourable devise and tax planning to avoid payment of tax. The assessee by resorting to such a tax planning, has taken advantage of the benefit of the law or the loop holes in the law, which had enured to his benefit. After seeing how this loop hole has been exploited within four corners of the law, it is open to the Parliament to amend the law plugging the loophole. However, by any judicial interpretation we cannot read into the Section, which was not intended to, by the Parliament at the time of enacting this provision. The language employed in Section 10(38) of the Act is simple and unambiguous and it makes no distinction between the transfer of share of company with an immovable asset and movable asset, instead of executing a sale deed in respect of the immovable property by the company, which is owning the land. If the share holder chooses to transfer the lands and part with the land to the purchaser of the shares, it would be a valid legal transaction in law and merely because they were

able to avoid payment of tax, it cannot be said to be a colourable devise or a sham transaction or an unreal transaction.

25. As set out above, the transaction is real, valuable consideration is paid, all legal formalities are complied with and what is transferred is the shares and not the immovable property. The finding of the Assessing Authority that it is a transfer of immovable property is contrary to law and contrary to the material on record. They committed a serious error in proceeding on the assumption that the effect of transfer of share is transfer of immovable property and therefore, if the veil of the company is lifted what appears to them is transfer of immovable property. Such a finding is impermissible in law. Unfortunately, three authorities committed the very same mistake which is ex-facie, illegal, contrary to settled legal position and therefore, requires to be set-aside. In that view of the matter, we pass the following order:

(a) Appeal is ***allowed***.

(b) The impugned order passed by all the three authorities is hereby set-aside.

(c) The substantial question of law is answered in favour of the assessee and against the revenue.

Parties to bear their own costs.