आयकर अपीलीय अधिकरण, अहमदाबाद न्यायपीठ 'D' अहमदाबाद ।
IN THE INCOME TAX APPELLATE TRIBUNAL
"D" BENCH, AHMEDABAD

BEFORE MRS. ANNAPURNA GUPTA, ACCOUNTANT MEMBER
AND SHRI T.R. SENTHIL KUMAR, JUDICIAL MEMBER

ITA No. 365/Ahd/2022
निर्धारण वर्ष/**Assessment Year: 2018-19**

Axis Bank Limited, "Trishul", 3rd Floor, Opp. Samartheshwar Temple, Nr. Law Garden, Ellisbridge, Ahmedabad-380006 PAN : AAACU 2414 K	Vs.	Assistant Commissioner of Income-tax, Circle 1(1)(1), Ahmedabad
अपीलार्थी/ (Appellant)		**प्रत्यर्थी/** (Respondent)

Assessee by :	Shri Tushar Hemani, Sr. Advocate & Shri Parimalsinh B. Parmar, AR
Revenue by :	Dr. Darsi Suman Ratnam, CIT-DR

सुनवाई की तारीख/**Date of Hearing : 29.11.2023/03.04.2024**
घोषणा की तारीख **/Date of Pronouncement: 10.04.2024**

आदेश/O R D E R

PER ANNAPURNA GUPTA, ACCOUNTANT MEMBER:

By way of this appeal, the assessee-appellant has challenged correctness of the order dated 28th July, 2022 passed by the Assessing Officer under section 143(3) r.w.s. 144C(13) r.w.s. 144B of the Income Tax Act, 1961 [hereinafter referred to as "the Act" for short], for the Assessment Year (AY) 2018-19.

2. Ground No.1 raised by the assessee reads as under:-

> *"**1. Disallowance in respect of annual technical fees (Tax effect - Rs. 16,84,276)***
>
> *1.1 The learned DRP has erred in upholding addition made by AO in respect of treating Annual Technical Services (ATS) fees paid to Infosys Limited to the extent of Rs. 48.66 lacs as prior period expense.*
>
> *1.2. It is submitted that the expenditure relates to amount payable to Infosys and no part of the amount was claimed as expenditure at any time in the*

earlier years. The expenditure was debited pursuant to receipt of invoices from Infosys during the previous year. The amount was not debited in the earlier yean since the claim was raised for the first time during the year.

1.3 The learned DRP and AO erred in not considering favourable decision of Hon'ble Ahmedabad Bench of Tribunal upto AY 2015-16 Bank's own case."

3. The issue relates to disallowance of claim of Annual Technical Service (ATS) fees by the assessee to the tune of Rs.48,66,726/-, disallowed for the reason that they were found to be prior period expenses. The assessment order reveals the nature of these expenses as the amount paid by the assessee towards annual fee for the maintenance of its core banking software named "Finacle" developed by Infosys Technologies Limited. Infosys charged an annual fee per user for the maintenance of this software, and in substance these charges were paid in the context of technical support provided to the assessee-bank by Infosys to resolve the operational difficulties faced by the bank in the use of the software in various locations. The Assessing Officer noted that invoices pertaining to Annual Technical Service fees amounting to Rs.48,66,726/- related to the preceding year, and noting that the assessee was following the mercantile system of accounting, and applying the matching principle, the impugned expenses were proposed to be disallowed in the draft assessment order framed in terms of section 144C of the Act. The assessee objected to the proposed disallowance to the Dispute Resolution Panel (DRP) and the DRP directed the disallowance to be made merely to keep the issue alive ,noting that identical expenses disallowed in the preceding years were allowed consistently by the ld. CIT(A) and which orders were confirmed by the ITAT also in AYs 2009-10 to 2015-16. This fact is evident from paragraph Nos. 5.2.4 to 5.3.3 of the order of the DRP as under:-

"5.2.4 The assessee has also brought to our notice that The Hon. CIT(A) has granted relief to the Bank on this ground from AY 2009-10 to A.Y. 2015-16

and further that the Hon'ble Ahmedabad Bench of Tribunal in Bank's own case has rejected the appeal filed by Revenue from AY 2009-10 to AY 2015-16.

5.3.1 We have considered the facts of the case and submissions of the assessee. We have been informed by the Dy. CIT Ahmedabad, Circle 1(1)(1) that the department has not accepted the decision of the Hon'ble ITAT for AY for 2010-11 to AY 2014-15, and preferred further appeal before the Hon'ble High Court

5.3.2 We may observe here that the process before the DRP is a continuation of assessment proceeding as it is only the draft assessment order which is being challenged before it. The final assessment order is yet to be passed by the assessing officer. Hence, the DRP is not an appellate authority and the proceeding before the DRP is continuation of assessment proceedings. This view is fortified by the decision of the division bench of the Hon'ble High Court of Bombay in the Writ Petition No. 1877 of 2013 in the case of Vodafone India Services Pvt. Ltd. vs. Additional Commissioner of Income Tax &Ors. (2014) 264 CTR 0030 (Bom) (2013) 96 DTR 0193 (Bom) (2014) 361 ITR 0531 (Bom) (2014) 221 Taxman 0166 (Bom), held that:

> *"47. However as no final assessment order has yet been passed by the Assessing officer and the issues are still at large before the DRP the same could be urged before the DRP…… …….. … …….. . The process before the DRP is a continuation of the assessment proceedings as only thereafter would a final appealable assessment order be passed. Till date there is no appealable assessment order. The proceeding before the DRP is not an appeal proceeding but a correcting mechanism in the nature of a second look at the proposed assessment order by high functionaries of the revenue keeping in mind the interest of the assessee. It is a continuation of the Assessment proceedings till such time a final order of assessment which is appealable is passed by the Assessing Officer. This also finds support from Section 144C(6) which enables the DRP to collect evidence or cause any enquiry to be made before giving directions to the Assessing Officer under Section 144C(5) The DRP procedure can only be initiated by an assessee objecting to the draft assessment order. This would enable correction in the proposed order (draft assessment order) before a final assessment order is passed. Therefore, we are of the view that in the present facts this issue could be agitated before and rectified by the DRP."*

5.3.3 As discussed above, this issue is being contested by the Department. The issue has not yet attained the finality and the possibility that the issue is decided in favour of revenue, cannot be ruled out. However, at the stage when the issue attains the finality, it is likely that the remedial measures available to levy and

collect tax on account of this issue, may not be available to the Revenue on account of limitation placed by the statute. In this regard, we may refer to the decision of the Hon'ble Supreme Court of India in the case of Malabar Industrial Co. Ltd. vs. Commissioner of Income Tax (2000) 159 CTR 0001: (2000) 243 ITR 0083: (2000) 109 TAXMAN 0066 wherein it is observed that "The scheme of the Act is to levy and collect tax in accordance with the provisions of the Act and this task is entrusted to the Revenue." Therefore, with due respect to the decision of the Hon'ble Tribunal, in order to protect the interest of the revenue, the DRP is of the considered opinion that the issue has to be kept alive and hence the addition made by the TPO needs to be sustained."

4. Accordingly, following the directions of the DRP, the impugned disallowance of Annual Technical Service fees amounting to Rs.48,66,726/- was made by the Assessing Officer in the assessment framed.

5. As is evident from the order of the DRP, identical disallowance was made in the case of the assessee in the preceding years, i.e. from AYs 2009-10 to 2015-16; but was consistently deleted in first appeal by the ld. CIT(A) whose order was confirmed by the ITAT also. Neither has the DRP noted any distinction in facts in the present case from the preceding years nor has the ld. DR being able to point out any distinguishing facts before us. Also, no adverse decision of any higher judicial authority in the case of the assessee has been brought to our notice by the ld. DR. Therefore, there is no case made out by the Revenue before us for not following the decision of the ITAT, deleting identical disallowance, in the preceding years.

6. In view of the same we direct the deletion of the disallowance of Annual Technical Service (ATS) fees to the tune of Rs.48,66,726/-.

Ground of appeal No.1 (1.1 to 1.3) is, therefore, allowed.

7. Ground No. 2 reads as under:-

*"**2. Disallowance u/s 14A read with Rule 8D of the Income-tax Act, 1961 (Tax effect Rs.15,08,58,427)***

2.1 The learned DRP has erred in upholding action of AO in further disallowing Rs. 43.59 crores under section 14A read with Rule 8D. The learned DRP and AO has failed to appreciate that suo-moto disallowance made by the Bank under section 14A of the Act is made on a scientific basis by proportionately allocating all the operating expenses incurred towards earning tax-free income. Hence, there is no basis or reason for any further disallowance under Rule 8D of the Income-tax Rules.

2.2 The learned AO has erred in appreciating the fact that all the operating expenses based on proportion of salary of employees engaged in investment business have been allocated. The contention that only some expenses were allocated as mentioned on the page no. 10 of the assessment order by the learned AO is therefore incorrect.

2.3 The learned DRP and AO erred in not appreciating that Rule 8D is neither charging provision nor automatic and Rule 8D(2)(ii) cannot supersede favourable judgements of Hon'ble Tribunal and Gujarat HC upto AY 2009-10 in the Bank's own case."

8. The above grounds relate to the disallowance of expenses pertaining to the earning of exempt income, in terms of the provisions of Section 14A of the Act. The assessee had earned exempt income of Rs.375,64,72,801/- and made a *suo-moto* disallowance of expenses pertaining to the same u/s 14A of the Act amounting to Rs.1,03,08,336/-. During assessment proceedings, the assessee had furnished the method of computation of the disallowance so made by it. The Assessing Officer, however, rejected the same and went on to compute the disallowance in terms of Rule 8D of the IT Rules, 1962, computing the disallowance, therefore, at Rs.44,62,14,562/-. Reducing the *suo-moto* disallowance made by the assessee therefrom, the Assessing Officer made disallowance of the balance amounting to Rs.43,59,06,226/-. The assessee objected to the said proposed disallowance to the DRP who in turn rejected the contentions of the assessee and directed the Assessing Officer to make the disallowance as computed.

9. The argument of the ld. Counsel for the assessee before us was that the law with regards to the invocation of Rule 8D for the purpose of computing disallowance u/s 14A of the Act is settled, that the same can be resorted to only if the Assessing Officer is not satisfied with the correctness of the claim of the assessee having regard to the accounts of the assessee, in terms of Section 14A(2) of the Act. That only thereafter the Assessing Officer can apply Rule 8D for computing disallowance u/s 14A of the Act. He referred to the decision of the Hon'ble jurisdictional High Court in this regard in the case of PCIT Vs. CIMS Hospital (P.) Ltd., [2021] 125 taxmann.com 227 (Gujarat). The ld. Counsel for the assessee contended that, in the present case, the Assessing Officer had invoked Rule 8D without assigning any reason for rejecting the assessee's working of *suo-moto* disallowance or without finding any defect in the same. He contended that there was no satisfaction on the part of the Assessing Officer as to why the claim of the assessee was incorrect.

10. In this regard, he pointed out that the assessee has adopted a scientific method of computing the disallowance. He drew our attention to the working of *suo-moto* disallowance placed at page nos. 327, 456-459 of the paper-book. He pointed out therefrom that the assessee had considered 0.20% of the total operating expenses for the purpose of working disallowance u/s 14A of the Act since the salary of the employees involved in the investment portfolio was 0.20% of the salary of the total employees of the assessee. That thereafter these expenses, i.e 0.20% of the total operating expenses, had been bifurcated between 'tax-free income earned from securities' and 'taxable trading income from securities' in the ratio in which they were earned, being 3.72% and 96.28% respectively. That, accordingly, operating expenses of Rs.1,03,08,336/- were worked out as allocable to the earning of exempt income and *suo moto* disallowance of the same made while computing the income of the assessee for the purpose of taxation. He pointed out that the assessee had sufficient

own interest-free funds by way of capitals and reserves amounting to Rs. 63,445.25 crores for the purpose of making tax-free investments of Rs.5,421.46 crores, warranting no disallowance of interest expenses. All the above, he stated, was demonstrated to the Assessing Officer during assessment proceedings, but the AO went on to reject the same without assigning any proper reasons. He drew our attention to paragraph no.21 of the assessment order wherein the Assessing Officer had rejected the assessee's methodology of computing disallowance u/s 14A of the Act as under:-

> *"21 As discussed above, in the current year, the amount proposed for disallowance under section 14 A of the Act by the assessee at Rs.1,03,08,336/- is found to be extremely low, considering that the assessee has earned exempt income of Rs.375,64,72,801/-. No sound basis is found for this apportionment of 3.72% of expenses into tax free investments.*
>
> *Allocation of the Proportionate expense between taxable & Tax-free income*

Nature	*% based on income*	*Amount (Rs.)*
- Towards Taxfree	*3.72%*	*1,03,08,336*
- Towards Taxfree	*96.28%*	*26,65,76,339*
Total		*27,68,84,675*

> *% of Salary of employee cost involved in Tax free investment to Total Salary* *0.20%*
>
> *When there is a clear formula in statute there is no need for the assesse to compute 14A disallowance based on proportionate allocation basis, the assesse is bound to compute 14A disallowance within the framework of the Income Tax Act, 1961. The assessee's allegation that there is no basis or reason for 14A disallowance as per rule 8D and a blanket formula to compute 14A disallowance is not acceptable. If assesse has an issue with the provision 14A r.w rule 8D it should raise the issue with appropriate judicial form by questioning the validity or the blanket formula stipulated in the said section. Hence the assessing officer, not being satisfied by this claim of the assessee, the undersigned is bound to revert to Rule 8D of the Rules, for computing this disallowance, the details of which were called for and duly submitted by the assessee.*
>
> *The relevant figures for the current A.Y. for working out the disallowance under Section 14A r.w. Rule 8D as submitted by the assessee are:-*

(Amount in cr)

Working u/s 14A as per amended Rule 8D

Month	*Opening Value of Investment*	*Closing Value of investments*	*Monthly average of tax-free investments*
April	*3,716*	*3,753*	*3,740*
May	*3,763*	*3,751*	*3,757*
June	*3,751*	*4,069*	*3,910*
July	*4,069*	*4,285*	*4,177*
August	*4,285*	*4,025*	*4,155*
September	*4,025*	*4,500*	*4,263*
October	*4,500*	*5,048*	*4,774*
November	*5,048*	*4,845*	*4,947*
December	*4,845*	*4,682*	*4,764*
January	*4,682*	*4,721*	*4,702*
February	*4,721*	*5,286*	*5,004*
March	*5,286*	*5,421*	*5,354*
Total			*53,546*

Annual Average of Monthly Average tax free investments (April 17 to March 18 (5,35,45,74,74,780/12) *4,442*

Amount as per section 14A r.w.r. 8D (under New Rule 8D) (1 % of Annual Average of Monthly Average investment yielding tax free return) *44.42*

3.4 Accordingly, a further disallowance under Rule 8D of Rs.(44,62,14,562.32-1,03,08,336)/-is being made. After considering the nature of addition, penalty u/s.270A for misreporting of income is separately initiated.

(Disallowance of Rs 43,59,06,226.32/-)"

He further referred to paragraph no. 6 of the AO's order as under:-

> *"6. It may be mentioned that the assessee had disallowed as sum of Rs.1,03,08,336/- in its computation of income. No basis of arriving at this figure was offered. A statement showing allocation of expenses for rent, salary, depreciation on computers, telephone and reuters was filed. However, the basis of allocation of expenses under these heads could not be substantiated. Further, why other expenses were not to be allocated also could not be explained. It is seen that this is merely an estimated amount without any validation."*

11. Referring to the above, he pointed out that the reasons assigned by the Assessing Officer for rejecting the assessee's methodology was two-fold;

- that there was no basis for holding that 3.72% of the expenses were attributable to tax free income.
- and that only a few expenses had been considered for allocation without any basis.

The ld. Counsel for the assessee contended that the reasoning of the Assessing Officer was contrary to the facts as demonstrated above wherein the assessee had given the basis and reasoning for assigning the operating expenses to be attributable to the earning of exempt income giving a scientific methodology for the same. That the Assessing Officer had not given any finding on this detailed methodology submitted by the assessee and had summarily gone on to reject the assessee's method. That considering the proposition of law as laid down by the Hon'ble jurisdictional High Court in the CIMS Hospital (P.) Ltd. (supra), therefore, the invocation of Rule 8D in the present case by the Assessing Officer for computing the disallowance of expenses u/s 14A needed to be set aside.

12. The ld. DR, however, relied on the order of the Assessing Officer.

13. We have heard both the parties. There is no dispute regarding the proposition of law that for invocation of Rule 8D of the Rules for computing the disallowance of expenditure under section 14A of the Act, the AO has to first record his satisfaction as to why the claim of the assessee to the disallowance is incorrect having regard to its books of accounts. The ld. Counsel for the assessee has relied on the decision of the Hon'ble jurisdictional High Court in the case of CIMS Hospital P. Ltd. (supra) wherein the Hon'ble Court has held in very clear terms that before invoking Rule 8D,

the AO is obliged to indicate that having regard to the accounts of the assessee, he is not satisfied with the correctness of the claim of the assessee in respect of such expenditure in relation to the income which does not form part of the total income under the Act. The Hon'ble Court interpreted the provisions of section 14A(2) of the Act while holding so.

14. Having said so, we find that in the facts of the present case, the AO has failed to fulfil this necessary prerequisite for invoking Rule 8D of the Rules. We have noted from the documents filed before us that the assessee had demonstrated to the AO that the *suo moto* disallowance made by it had been calculated on a scientific basis. The entire basis of calculating the same had been explained to the AO, pointing out that out of the operating expenses only that portion was considered for the purpose of disallowance which was in proportion to the salary of employee, involved in the investment activity to the salary of the total employees of the assessee being 0.20%; that thereafter, these operating expenses incurred for earning exempt income was determined by bifurcating these expenses in the ratio of tax free income earned from securities and taxable earned income therefrom, which came to 3.72% of the expenses. And accordingly an amount of Rs.1,03,08,336/- was determined *suo moto* by the assessee as disallowable under section 14A of the Act, and disallowed while computing its taxable income. Thus, the assessee had demonstrated a reasonable basis for calculating the disallowance of expenses pertaining to earning of exempt income, considering the expenses relatable to the investment activity and allocating that portion of the said expenses to the earning of tax free income therefrom on a scientific basis. Vis-à-vis the interest expenditure incurred, and allocable to the earning of exempt income, the ld. Counsel for the assessee had pointed out to the AO that it had enough owned interest free funds for the purpose of making investment in

securities, warranting no disallowance of interest under section 14A of the Act, which proposition has been settled by the Hon'ble Apex Court in the case of CIT Vs. Reliance Industries, 410 ITR 466.

15. The AO, we find, has not touched upon and made no adverse comment on the specific explanation offered by the assessee regarding the methodology adopted for allocating the expenses for the purpose of earning exempt income, as pointed out to us above. The AO, we find has made only certain general comments for rejecting the assessee's explanation, that too factually incorrect. We have noted, that the AO stated that the assessee has given no basis for holding 3.72% of the expenses attributable to earning of tax free income. This is clearly incorrect, since, as noted above by us, the assessee had given a basis for the same. Further, the AO has mentioned that only few expenses had been considered for allocation without any basis, which too is an incorrect finding, since the assessee had given a scientific basis for considering 0.20% of the total operating expenditure for allocation to the earning of tax free income. The assessee had also explained, why the interest expenditure were not being considered for the purpose of disallowance. Therefore, it is abundantly clear that the AO had proceeded to apply Rule 8D for computing the expenses disallowable under section 14A of the Act without fulfilling the mandatory pre-requisite of first recording dissatisfaction with the assessee's computation of the same, having regard to its books of accounts.

16. Moreover para 21 of the AO's order reveals the AO to be stating that when a clear formula for calculating disallowance of expenses u/s 14A of the Act is provided in the Rules, there is no scope for the assessee to adopt any method of proportional allocation of expenses. That if the assessee has any issues with regard to the formula so prescribed in law he can take up the matter at the appropriate judicial forum. These findings of the AO, no doubt

are contrary to the provision of law as interpreted by the jurisdictional High court itself in CIMS(supra) that the formula provided in Rule 8D of the Rules is to be applied only in the circumstance that the assesses calculation of disallowance appears to the AO to be incorrect having regard to its books of accounts.

17. In view of the same, we are in agreement with the ld. Counsel for the assessee that invocation of Rule 8D by the AO was against the provisions of law, and the disallowance therefore made of expenses by the AO amounting to Rs.43.59 crores u/s 14A of the Act in accordance with Rule 8D of the Rules is not sustainable in law, and is directed to be deleted.

Ground No.2 is accordingly allowed in above terms.

18. Ground No.3 raised by the assessee reads as under :-

*"**3. Bank guarantee commission (Tax effect - Rs. 65,17,58,043)***

3.1 The learned DRP has erred in upholding addition made by AO in respect of Bark Guarantee commission income of Rs. 188.32 crores being the sum relatable to unexpired period of the guarantee contract. This sum represents the pro rata income for the period beyond 1-4-2018 which shall be amortised by the Bank over the balance tenure of the guarantee contract. This addition represents timing difference which will be tax neutral and there will not be any loss of revenue to the department.

3.2 The DRP and AO failed to appreciate that the customer has inherent legal right to receive refund of proportionate amount of guarantee commission pertaining to the unexpired period of guarantee contract, in the event of bank guarantee being terminated before full period of the guarantee contract. Thus, the entire amount of commission received cannot be recognised as income in the year of receipt itself. Upfront collection of guarantee commission coven guarantee risk which extends over the tenure of the guarantee not being limited to the year in which such commission is received by the Bank

3.3 The learned DRP and AO erred in not considering favourable decision of Hon'ble Ahmedabad Bench of Tribunal upto AY 2015-16 in Bank's own case."

19. The above ground relates to the addition made to the income of the assessee on account of commission income amounting to Rs.188,32,58,331/-. The orders of the authorities below reveal that the impugned addition was made noting that in the preceding years the bank guarantee commission earned by the assessee was offered upfront but the assessee had changed the method of accounting and recognized commission income on pro rata basis over the period to which the guarantee was spread since assessment year 2010-11.All arguments made by the assessee in this regard were rejected by the AO and following identical addition made in the case of the assessee in proceeding years, the AO made the impugned addition of commission income amounting to Rs.188,32,58,331/- which was earned on guarantee issued by the bank during the year, but offered to tax by the assessee in succeeding years over the period of guarantee.

20. Objection to the proposed addition was made to the DRP, who though noted the fact that identical addition of commission income made in preceding years stood deleted by the ITAT, yet directions were given to the AO to make the addition for the reason noted in the order that the DRP had been informed that the decision of the ITAT for A.Y 2010-11 to A.Y 2014-15 had not been accepted by the department and appeal had been preferred to the High Court against the same. To keep the issue alive therefore to protect the interest of the Revenue, the DRP directed the AO to make the addition of commission income to the tune of Rs.188.32 Crs. Relevant para 7.3.1 of the DRP order.

21. The contention of the learned Counsel for the assessee before us was that identical disallowance made in the case of the assessee in preceding years, right from Assessment Year 2010-11 to Assessment Year 2014-15, had

been deleted by the ITAT consistently in its orders passed, as noted by the DRP and that even in AY 2015-16 ITAT had deleted identical addition made in its Order passed in ITA No.852/A/2019 dated 30-03-2022 . Copy of all the orders of the ITAT were placed before us. That the issue therefore stood covered in favour of the assessee. The learned DR, though was unable to controvert the contention of the learned Counsel for the assessee that the issue was covered in its favour by orders of the ITAT in the preceding years, however, he relied on the order of the AO.

22. As is evident from the order of the DRP, identical addition of commission income was made in the case of the assessee in the preceding years, i.e. from AYs 2010-11 to 2015-16; but was consistently deleted by the ITAT. Neither has the DRP noted any distinction in facts in the present case from the preceding years nor has the ld. DR being able to point out any distinguishing facts before us. Also, no adverse decision of any higher judicial authority in the case of the assessee has been brought to our notice by the ld. DR. Therefore, there is no case made out by the Revenue before us for not applying the decision of the ITAT in the preceding years in favour of the assessee.

23. In view of the same we direct the deletion of the addition of commission income to the tune of Rs.188.32 Crs.

Ground of appeal No.3 (3.1 to 3.3) is, therefore, allowed.

24. Ground of appeal No. 4 raised by the assessee reads as under:-

*"**4. Interest on NPA's (Tax effect - Rs. 82,36,01,184)***

4.1 The learned DRP has erred in upholding addition made by AO in respect of notional interest income on NPAs of Rs. 237.98 crores under Rule 6EA read with section 430 of the Act as interest income deemed to be accrued during previous year.

4.2 The learned DRP and AO failed to appreciate that recognition of interest income on NPAs is in accordance with binding RBI guidelines and specific

mandate of section 430 and that Rule 6EA is subservient to Section 43D and hence it cannot extend the scope beyond the charge of income provided in section 43D

4.3 The learned DRP and AO erred in not considering favourable decision of Hon'ble Ahmedabad Bench of Tribunal upto AY 2015-16 in Bank's own case."

25. The issue raised in the above ground relates to the addition made to the income of the assessee in respect of interest income on non-performing assets. The addition amounting in all to Rs. 237.98 crores. The case of the AO is that as per the Income-tax Rules, interest on NPA should not be recognized when the overdue period of 180 days has been completed. This is as per Rule 6EA of the Income-tax Rules, 1962. The AO however, noted that the assessee was not recognizing interest income from non-performing assets as per RBI guidelines where the overdue period was only three months/90 days. The AO held that the overdue interest needed to be recognized as per the Income-tax Rules and therefore the difference period, as per the RBI guidelines and the Income-tax Rules relating to which interest on NPAs was not recognized by the assessee, was subjected to tax which amounted in all to Rs.237.98 crores.

26. Objection to the proposed addition was made to the DRP, who though noted the fact that identical addition of commission income made in preceding years stood deleted by the ITAT, yet directions were given to the AO to make the addition for the reason noted in the order that the DRP had been informed that the decision of the ITAT for A.Y 2010-11 to A.Y 2014-15 had not been accepted by the department and appeal had been preferred to the High Court against the same. To keep the issue alive therefore to protect the interest of the Revenue, the DRP directed the AO to make the addition of commission income to the tune of Rs.188.32 Crs. Relevant para 8.3.1 of the DRP order.

27. The contention of the learned Counsel for the assessee before us was that identical disallowance made in the case of the assesse in preceding years, right from Assessment Year 2010-11 to Assessment Year 2014-15, had been deleted by the ITAT consistently in its orders passed, as noted by the DRP and that even in AY 2015-16 ITAT had deleted identical addition made in its Order passed in ITA No.852/A/2019 dated 30-03-2022. Copy of all the orders of the ITAT were placed before us. That the issue therefore stood covered in favour of the assessee. The learned DR, though was unable to controvert the contention of the learned Counsel for the assessee that the issue was covered in its favour by orders of the ITAT in the preceding years, however, he relied on the order of the AO.

28. As is evident from the order of the DRP, identical addition of commission income was made in the case of the assessee in the preceding years, i.e. from AYs 2010-11 to 2015-16; but was consistently deleted by the ITAT. Neither has the DRP noted any distinction in facts in the present case from the preceding years nor has the ld. DR being able to point out any distinguishing facts before us. Also, no adverse decision of any higher judicial authority in the case of the assessee has been brought to our notice by the ld. DR. Therefore there is no case made out by the Revenue before us for not applying the decision of the ITAT in the preceding years in favour of the assessee.

29. In view of the same we direct the deletion of the addition of interest on NPA's to the tune of Rs.237.98 Crs.

Ground of appeal No.4 (4.1 to 4.3) is, therefore, allowed.

30. Ground of appeal No. 5 raised by the assessee reads as under:-

"***5. Employee Stock Option cost (Tax effect - Rs. 53,85,11,272)***

5.1 The learned DRP has erred in upholding action of AO in respect of not allowing the ESOP cost of Rs. 155.60 crores claimed as deduction u/s 37(1) of the Act by following decision of Special Bench of tribunal in case of Biocon Ltd vs DCIT [2013] 25 ITR(T) 602 (Bangalore-Trib.) (SB) which has been subsequently upheld by High Court of Karnataka in CIT v. Biocon Ltd. [2020] 121 taxmann.com 351 (Karnataka)].

5.2 The learned DRP and AO failed to appreciate that the difference between market price as on date of exercise of options and the exercise price is actual discount offered to the employees.

5.3 The learned DRP and AO also failed in correctly applying the observations of the decision of Bangalore special bench of Hon'ble ITAT in case of Biocon Limited (supra) which states that ESOP cost in hands of the company has to be equivalent to amount taxable as perquisite in the hands of employees. Relying on the decision of Hon'ble Special Bench. the difference between market price as on the date of exercise of options and exercise price (i.e., market price on grant date) is an allowable deduction for computing income under the head 'profit and gains from business and profession' in the year of allotment of options to the employee (such amount being equal to the amount taxable as perquisite in hands of employee).

5.4 The learned DRP and AO have erred in law by emphasizing on the fact that the ESOP cost claimed by the Assessee is not an expenditure per se being a notional loss. As reading down the word "expenditure" as being confined to situation involving outlay of cash, would result in a very narrow inference of the expression, Further, the fact mentioned in the assessment order that Department is in appeal against the decision of Biocon Ltd. (Special Bench) and the issue has not attained finality is not correct as the issue has been decided by the Karnataka High Court against the Revenue.

5.5 The learned DRP and AO have failed to appreciate the fact that benefit has been actually offered to the employees in terms of discount. It has been held in the Biocon Limited that such discounted premium on shares is a substitute to giving direct incentive in cash for availing the services of the employees."

31. Facts relating to the case are that during the year, the assessee had claimed deduction amounting to Rs.155,60,31,183/- under section 37(1) of the Act in respect of Employees Stock Option Plan (ESOP), being the difference between the market price as on the date of exercise of option and the exercise price under the head "profits & gains from business and profession". In short

the assessee had claimed the discounted premium on the issue of shares to employees in terms of the ESOP scheme as an expense. The assessee had claimed the same on the basis of the decision of the Special Bench of the ITAT in the case of Biocon Ltd. Vs. DCIT, (2013) 25 ITR (T) 602 (Bang-Trib.)(SB) confirmed by the Hon'ble Karnataka High Court in the CIT Vs. Biocon Ltd., (2020) taxmann.com 351 (Kar). The AO, however, held that since the amount received on issue of shares was on capital account, the impugned expenses did not qualify as revenue expenditure under section 37(1) of the Act. He also held that the expenditure, even otherwise, was only notional loss, and therefore, also not allowable to the assessee. The AO noted that similar disallowance had been made in the earlier years also in the case of the assessee i.e. Asst. Year 2013-14 to 2015-16 and considering the fact that the Department had not accepted the decision of Hon'ble Karnataka High Court in Biocon Ltd. (supra) and SLP of the Department on an identical issue in the case of Pr.CIT Vs. Lemon Tree Hotels P. Ltd. had been admitted by the Hon'ble Apex Court, the AO disallowed the claim of ESOP expenditure of the assessee amounting to Rs.15.16 crores. The same was confirmed by the DRP noting that the issue is being contested by the Department before the Hon'ble Supreme Court in the case of Lemon Tree Hotel P.Ltd. (supra).

32. The contention of the ld. Counsel for the assessee before us was a reiteration of the arguments made to the authorities below, that the issue is now no longer res integra and has been decided in favour of the assessee in series of decisions including that of Hon'ble Karnataka High Court in Biocon Ld. (supra) followed by the ITAT in various decisions.

33. At this juncture, the ld. Counsel for the assessee was asked about the status of these expenses disallowed in the case of the assessee in the preceding years, as noted by the AO i.e. Asst. Year 2013-14 to 2015-16. To this, the ld.

Counsel pointed out that the matter had been restored back to the AO for adjudication afresh by the ITAT.

34. In view of the above admission of the ld. Counsel for the assessee, and to bring consistency on the issue, the impugned issue is also being restored back to the AO to be decided afresh in accordance with prevailing position of law.

35. Ground No.5 is allowed for statistical purpose.

36. Ground No. 6 raised by the assessee reads as under:-

> *"**6. TP adjustment (Tax effect - Rs. 25,59,032)***
>
> *6.1 The learned DRP has erred in partially agreeing with TPO in making transfer pricing adjustment of Rs.73,94,337 by rejecting the benchmark conducted by the Bank using Other Method as the most appropriate method with respect to international transaction of interest received from AE on the tier II loan of USD 25 million provided to it and applying an arbitrary spread of 50bps.*
>
> *6.2 Without prejudice to above, the TPO has not computed the amount of adjustment in line with the directions of DRP. Considering DRP directions, we believe that the correct amount should be Rs. 24,94,662. In the order of TPO the TPO had made adjustment by taking interest rate as per comparable quotation of Bank of India (6 months Libor plus 425 bps) and added a spread of 200 bps towards letter of comfort and considered 7.76% as arm's length interest rate, as against 3 Month LIBOR+ 425 bps applied by the Assessee. Hon'ble DRP vide its order has granted partial relief to the Assessee and reduced the adjustment towards letter of comfort from 200 bps 1.0.2% to 0.5%. Therefore, revised arm's length interest should be 6.26% (ie 7.76% less 15%) whereas TPO has computed 6.59% as revised arm's length interest rate."*

37. The above ground relates to the transfer pricing adjustment made to the International Transactions of interest charged on loan provided to Associate Enterprise of the assessee in terms of the provisions of Section 92CA of the Act.

38. The facts of the case are that the assessee had provided Tier-II loan of USD 25 million (Rs.148,47,50,000/-) to its Associate Enterprise "Axis UK"

during Financial Year 2013-14. The assessee had charged interest thereon @ 3 months USD LIBOR plus 425 bps with 'upfront fee @ 2.5%' of the loan amount to be collected and had shown interest received of Rs.9,04,50,688/-. The TPO noted that the assessee had benchmarked the transactions using other methods considering State Bank of India (SBI) and Bank of India (BOI)quotes received by the Associate Enterprise for similar loan. Further, perusal of the quote of BOI revealed that the BOI had required suitable 'Letter of Comfort' by Axis Bank Ltd. as term acceptable to BOI, and the rate of interest as per the quote was 6 months USD LIBOR plus 425 bps. No quotation of SBI was submitted by the assessee. Considering that the quotation of BOI was after taking into consideration Letter of Comfort to be provided, the TPO held that the same tantamounted to Corporate Guarantee given to BOI. That in the case of loan provided by the assessee, absent a letter of comfort, the entire risk was that of the assessee and held that the risk involved a suitable spread of 200 bps to be charged. Accordingly, the TPO held Arms Length Price (ALP) of interest to be charged on the Tier-II loan given to AE of the assessee to be 6 months USD LIBOR plus 425 bps plus 200 bps, i.e. the quote of BOI suitably adjusted for the Letter of Comfort given by the assessee to the BOI for providing the quote to the extent of 200 bps. The same resulted in the ALP of interest to be charged determined at 7.76% resulting in quantum of interest determined to be at ALP amount to Rs.11,52,16,600/-. Thus, in nutshell,

- the assessee had charged the interest at **3 months USD LIBOR plus 425 bps**, resulting the interest rate of **6.09%** and the quantum of interest earned accordingly being **Rs.9,04,50,688/-,** while
- The TPO held the ALP of interest to **be 6 months USD LIBOR plus 625 bps** resulting in rate of interest **of 7.76%** and quantum of interest at ALP being **Rs.11,52,16,600/-.**

39. Accordingly, the difference of interest so determined, of Rs.2,47,65,912/-, was adjusted upward to the interest charged by the assessee resulting in an addition to the said extent to the income of the assessee. The DRP confirmed the order of the TPO and directed the AO to make the impugned adjustment as proposed by the TPO.

40. The contention of the ld. Counsel for the assesse before us primarily was against treating LOC as equivalent to bank guarantee for making adjustment to the ALP of the impugned international transaction and briefly put it was to the effect:

- That there was a basic fallacy in the DRP as well as TPO equating Letter of Comfort with corporate guarantee. That the two could not be equated and were completely different in character. To this effect he pointed out the *Explanation*to Rule 10TA(c) of the Income Tax Rules, 1962, concerning Safe Harbour for International Transaction specifically excluded Letter of Comfort from the definition of corporate guarantee. Our attention was invited to the same as under:-

  "10TA …..
  (c) *"corporate guarantee" means explicit corporate guarantee extended by a company to its wholly owned subsidiary being a non-resident in respect of any short-term or long-term borrowing.*

  Explanation. – For the purposes of this clause, explicit corporate guarantee does not include letter of comfort, implicit corporate guarantee, performance guarantee or any other guarantee of similar nature:"

41. Further, it was pointed out that in several decisions the ITAT consistently held that the Letter of Comfort cannot be termed as international transaction in terms of Section 92B, requiring no transfer pricing adjustment. Reference was made to the following decisions:-

- Tata International Ltd Vs. ACIT, in ITA No. 4376/Mum/2010, order dated 29.01.2020

"24. Before ld. CIT(A), the assessee made elaborate submission and explained the difference between Letter of Comfort within Intra Group as well as the corporate guarantee. The ld. CIT()A) after considering the submission of assessee concluded that by issuing Letter of Comfort to the Bankers of AE, the assessee did not incurred any cost. The issuance of Letter of Comfort by assessee have no bearing on the profit, income or loss as the assessee did not incur any cost or expenditure for issuing such Letter of Comfort and it does not constitute international transaction under section 92B of the Act. The ld. CIT(A) concluded that there is a fundamental between guarantee and Letter of Comfort. Guarantee is a legal enforceable; however, Letter of Comfort is not. We have noted that Hon'ble Karnataka High Court in United Braveries (Holding) Ltd. vs. Karnataka State Industrial Investment and Development Corporation (supra) held that Letter of Comfort merely indicates the appellant's assurance that respondent would comply the term of financial transaction without guaranteeing performance in the event of default. The co-ordinate bench of Tribunal in India Hotels Co. Ltd. (supra) on similar ground of appeal by following the decision of Hon'ble Karnataka High Court held that Letter of Comfort does not constitute international transaction. So far as contention of ld. DR for the revenue that after amendment in Explanation to section 92B is concerned, we have noted that co-ordinate bench in SIRO Clinpharm P. Ltd. (supra) held that amendment in Explanation to section 92B by Finance Act, effective from 01.04.2002 is to be treated as effective at the best from A.Y. 2013-14. Thus, in view of the aforesaid discussion, we do not find any illegality or infirmity in the order passed by ld. CIT(A). In the result, Ground No. 6 to 9 (additional ground) of assessee's appeal are allowed and consequently the grounds of appeal raised by revenue are dismissed."

- Indian Hotels Company Ltd. Vs. DCIT [2019] 112 taxmann.com 340 (Mumbai - Trib.)

  TRANSFER PRICING: CUP method is most appropriate method to determine arm's length rate of interest of international transaction involving lending of money by assessee in foreign currency to its AE and LIBOR being inter-bank rate fixed for international transaction has to be adopted as arm's length rate.

  TRANSFER PRICING: Where letter of comfort was issued by assessee to banks for loan granted to AE, since assessee had not bound itself for repaying loans in event of defaults made by AE, same was outside ambit of international transactions.

  TRANSFER PRICING: Where relevant data of US comparable company was incomplete and unreliable to justify TP adjustment made by TPO, adjustment made on basis of said data was to be deleted.

- Asian Paints Ltd Vs. ACIT, 126 taxmann.com 242 (Mumbai – Trib.)

TRANSFER PRICING: Letter of comfort/support cannot be construed to be in nature of any sort of guarantee in respect of loan liability of AE as there was no financial implication on assessee then, provision of letter of comfort/support cannot be termed as an international transaction

TRANSFER PRICING: When Tribunal in separate orders accepted commission on corporate guarantee provided to AEs charged at 0.20 per cent to be at arm's length then following consistent view, addition made on account of adjustment to commission charged on corporate guarantee should be deleted.

42. Our attention was specifically invited to the decision of the Tata International Ltd. (supra), pointing out that the Letter of Comfort was explained in detail therein and differentiated with corporate guarantee.

- That without prejudice to the above corporate guarantees have been held to not qualify as international transactions by the Ahmedabad Bench of the Tribunal in the case of Micro Ink Ltd Vs. ACIT, (2015) 63 taxmann.com 353 (Ahd Trib.).
- That since the assessee had charged upfront fee @ 2.5% over and above the interest of 3 months USD LIBOR plus 225 bps, it would be sufficient to take care of the TP adjustment in question.
- That even as per the prevailing "Safe Harbour Rules" (Rule 10TD(2A)(5)(v) , interest rates prescribed for granting loan to AE in the foreign currency, in cases where credit rating of the AE is not available, is 6 months LIBOR plus 400 bps only. The TP adjustment could not in any case have exceeded the said rate by any means.

43. The ld. DR relied on the order of the Assessing Officer.

44. We have heard contentions of both the parties. The issue before us relates to the determination of ALP of the international transaction of interest charged on loan given to the associate entity of the assessee. Tier-II Loan having been provided by the assessee to Axis Bank, UK- amounting to 25

Million USD i.e. 148.47 crores. The facts relating to the interest charged by the assessee and that determined by the TPO to be ALP of the interest charged is as under:

- interest charged by the assessee --- 3 months USD LIBOR plus 425 bps along with upfront fee charged @ 2.5% of the loan amount
- ALP of the interest determined by TPO -- interest charged by BOI as per its quotation given to AXIS Bank , UK for the same Tier II Loan of 25 million USD -6 months USD LIBOR plus 425bps + 200bps added by the TPO on account of adjustment made for the letter of comfort (LOC) required by BOI from the assessee before us ,as per its terms and conditions for granting the loan as per the quotation. In effect ALP determined by TPO 6 months USD LIBOR plus 625 bps (425bps + 200bps). The DRP in turn restricted the adjustment made on account of LOC to 0.5%

45. The assessee, before us, has contested this adjustment made to the ALP of interest on account of LOC contending that both the TPO and the DRP have erred in equating LOC to bank guarantee while making the adjustment. In this regard, he has referred to various decisions of the ITAT, and also to Rule 10A of the Income Tax Rules, 1962, pointing out that the said rule excluded the letter of comfort from corporate guarantee.

46. The short point for adjudication before us therefore is whether LOC can be equated to Bank guarantees or for that matter whether LOC 's call for any sort of adjustment to be made to interest rates when compared to interest rates charged on non LOC loans.

47. For adjudicating the same it is necessary to understand what bank guarantees and LOC's are and therefore in effect what consequences they have on the risks associated with loans with respect to which they are sought. Bank guarantees as is common knowledge is a kind of guarantee from a lending organization. It signifies that the lending organization ensures that

the liabilities of a debtor are going to be met. It is a promise from a bank that it will step in and pay a debt if a borrower defaults.

48. Letter of comfort on the other hand is an assurance in writing to a lender about the position of a borrower. It provides an assurance that the obligation will ultimately be met. To be more specific it supports the request for a loan made by one. Obtaining the letter helps businesses gain trust and prove creditworthiness in the eyes of parties with whom they are dealing and obligated.

49. As is evident from the above there is no scope for equating bank guarantees with letter of comfort. Bank guarantees entail risk, with the provider of guarantee having to pay the amount guaranteed on the default in payment of loan by the person guaranteed. Letters of comfort entail no such financial risk on the provider of the LOC. Therefore we completely agree with the Ld. Counsel for the assessee that both the TPO and the DRP had erred in equating LOC's to bank guarantees.

50. However, having said so it is also evident that LOC's facilitate obtaining loans by entities on the assurance of their creditworthiness provided by the LOC provider. The person giving loan is assured about the creditworthiness of the party to whom loan is contemplated to be given. LOC's are sought generally from parent companies who are in a position to provide an assurance of creditworthiness of their subsidiaries. In effect it establishes a parent company's commitment to providing its subsidiary with the resources it needs to meet its financial obligations or get credit. Ultimately all boils down to how the letter of comfort is worded to understand the underlying import of the LOC vis-a-vis the liability shouldered by the provider of LOC.

51. In the facts of the present case the LOC is asked for by BOI in its quote to Axis Bank, UK but the format in which it is asked is not available. Nothing

therefore can be said about the impact of the same on the interest to be charged on the loan transaction.

52. In view of the same, though the adjustment made to the interest rate by the AO/DRP treating the LOC as bank guarantee cannot be upheld, at the same time, the assessee's alternative argument of treating the interest rates prescribed under the head "safe harbour rules" i.e. Rule 10TD(2A)(5) of the Income Tax Rules can be accepted, which is six months LIBOR plus 400 bps. The AO is directed to treat the said rate as ALP of the impugned international transaction and make adjustment accordingly.

53. The ld. Counsel for the assessee also contended that the assessee has charged upfront fees also at 1.25% of the loans, and therefore, no adjustment on account of LOC is called. We are unable to agree with the same, since we have noted, even as per the quote of BOI, identical upfront fee of 1.25% of the bank loan was charged. Therefore, the LOC was, over and above, charging of upfront fees, calling for a separate adjustment to the interest on account of the same.

In view of the above, this ground of appeal No.6 raised by the assessee is partly allowed in the above terms.

54. In effect, the appeal of the assessee is partly allowed for statistical purposes.

Order pronounced in the open Court on 10/04/2024 at Ahmedabad.

Sd/-	**Sd/-**
(T.R. SENTHIL KUMAR) **JUDICIAL MEMBER**	**(ANNAPURNA GUPTA)** **ACCOUNTANT MEMBER**

Ahmedabad; Dated 10/04/2024

*%

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

1. **अपीलार्थी** / The Appellant
2. **प्रत्यर्थी** / The Respondent.
3. **संबंधित आयकर आयुक्त** / Concerned CIT
4. **आयकर आयुक्त (अपील)** / The CIT(A)-
5. **विभागीय प्रतिनिधि, अधिकरण अपीलीय आयकर ,**/DR,ITAT, Ahmedabad,
6. **गार्ड फाईल** /Guard file.

आदेशानुसार/ BY ORDER,

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सहायक पंजीकार (Asstt. Registrar)
आयकर अपीलीय अधिकरण
ITAT, Ahmedabad