

**IN THE INCOME TAX APPELLATE TRIBUNAL
“C” BENCH : BANGALORE**

**BEFORE SHRI GEORGE GEORGE K., JUDICIAL MEMBER
AND
Ms. PADMAVATHY S, ACCOUNTANT MEMBER**

IT(TP)A No.183/Bang/2022
Assessment year : 2017-18

M/s. Altisource Business Solutions Private Limited, Pritech Park, Block No.11, 6 th Floor, A Wing, Bellandur Village, Sarjapur, Marathahalli Ring Road, Bengaluru – 560 103. PAN: AAACO 9467A	Vs.	The Deputy Commissioner of Income Tax, NFAC, Delhi / Circle 1(1)(1), Bengaluru.
ASSEESSEE		RESPONDENT

Assessee by	:	Shri Nitin G. Inamdar, CA
Respondent by	:	Shri Srinivas T. Bidari, CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	12.07.2022
Date of Pronouncement	:	25.07.2022

ORDER

Per Padmavathy S., Accountant Member

This appeal is against the final assessment order passed by the National Faceless Assessment Centre (NFAC) u/s. 143(3) r.w.s. 144C(13) of the Income Tax Act, 1961 (the Act) dated 30.01.2022 for AY 2017-18.

2. The assessee is a private limited company engaged in the business of providing contract software development and support services and information Technology (IT) enabled services including data analysis, compilation and transmission on customized software to overseas group affiliates (AEs). The assessee also provides IT enabled back-office services to support the business lines of its group. For AY 2017-18, the assessee filed the return of income on 23.11.2017, declaring a total income of Rs.1,32,81,87,980/- under normal provisions of the Act and a book profit of Rs. 1,12,46,32,841/- u/s. 115JB of the Act. The case was selected for scrutiny and notice u/s. 143(2) was served on the assessee. The case was referred to Transfer Pricing Officer (TPO) who made a TP adjustment of Rs.68,55,27,641/-. The NFAC made a draft assessment order in which besides the TP adjustments, the following additions/disallowances were made on the corporate tax front: -

- i) Difference between revenue reported in ITR and ST3 – Rs. 5,49,66,590/-
- ii) Telecommunication line expenses treated as capital in nature – Rs.2,06,53,968/-
- iii) The foreign exchange loss – Rs.13,14,30,000/-
- iv) Miscellaneous expenditure – Rs. 93,50,000/-

3. The assessee filed objections before the DRP against the draft assessment order. The DRP after considering the submissions of the assessee gave partial relief. The DRP deleted the TP adjustment and on

the corporate tax, reduced/sustained the addition/disallowances as given below: -

- i) Difference between revenue reported in ITR and ST3 – Rs.4,16,273/-
- ii) Telecommunication line expenses treated as capital in nature – Rs.2,06,53,968/-
- iii) Foreign exchange loss – Rs.13,14,30,000/-
- iv) Miscellaneous expenditure – Rs.16,74,733/-

4. The final order giving effect to the directions of DRP was passed by NFAC against which the assessee is in appeal before the Tribunal raising the following grounds: -

i. Disallowance of telecommunication line expenses as capital in nature

- a. The Learned Assessing Officer ("Learned AO") and the Honourable Dispute Resolution Panel ('Hon'ble DRP') grossly erred in considering telecommunication line expenses as capital in nature.
- b. The Learned AO/ Hon'ble DRP erred in not considering the copy of invoices which were furnished, evidencing the fact that these expenses are recurring in nature.
- c. Without prejudice to the above, the Hon'ble DRP failed to appreciate that even if the expenses is to be considered as rendering enduring benefit, the same may not be treated as capital in nature as the expenditure only results in furtherance of the business profits and revenue.
- d. In addition to and without prejudice to the above, the Hon'ble DRP grossly erred in not considering the Assessee's argument that similar adjustment was proposed in the show cause notice for proceedings of AY 2018-19; however, upon furnishing

of sample invoices for relevant period which are similar in nature as incurred in AY 2017-18, the adjustment was not made in the draft order passed, since the Learned AO was satisfied that the expenses are revenue in nature.

e. The Hon'ble DRP erred in not providing any reasonable justification for not considering the technical arguments provided by the Assessee while rejecting the objection raised.

ii. Disallowance of foreign exchange loss

a) The Learned AO/ Hon'ble DRP erred in not considering foreign exchange loss as revenue in nature and hence, an allowable deduction under the Income-tax Act, 1961 ('the Act').

b) The Hon'ble DRP erred in not considering the break-up of foreign exchange loss establishing the fact that losses entirely pertain to year end restatement of foreign currency trade receivables/ payables.

c) The Hon'ble DRP erred in passing ambiguous directions on the objection raised by evidently misconstruing the objection against corporate tax adjustment as an objection related to transfer pricing adjustment.

d) The Learned AO failed to consider the above ambiguity highlighted by the Assessee.

iii. Disallowance of miscellaneous expenditure

a. The Learned AO erred in adding entire miscellaneous expenditure without issuing any show-cause notice and without providing an opportunity of being heard, after the Assessee inadvertently missed to provide the break-up of expenditure during course of assessment.

b. Subsequent to DRP directions, the Learned AO failed to provide the Assessee adequate time to furnish additional details sought by the AO.

iv. Levy of interest under section 234D of the Act

The learned AO has erred in levying interest under section 234D of the Act amounting to INR 8,44,222 which is consequential in nature.

v. The assessee craves leave to add, alter, rescind and modify the grounds herein above or produce further documents, facts and evidence before or at the time of hearing of this appeal.

For the above and any other grounds which may be raised at the time of hearing, it is prayed that necessary relief may be provided.

Disallowance of telecommunication line expenses as capital in nature

5. In the course of assessment proceedings the assessing officer (AO) noticed that the assessee has claimed a sum of Rs.10,32,69,841/- under the head 'Telecommunication Lines' and called for details pertaining to the same. The assessee submitted that –

- i. The company submits that majority of the telecommunication line expenses pertains to internet link, data circuit charges used for telephone, internet, or other data communication services.
- ii. The company operates from 2 major cities (Bengaluru & Mumbai) and employs substantial number of employees, who need to communicate internally over telephone and have constant access to internet. Accordingly, the volume of requirement for a stable internet line, data circuit is high, to keep the business running without any disruptions. The company does not derive any benefit from such lines apart from daily usage, which is billed on a monthly basis by the respective vendors.

- iii. Accordingly, the company has not capitalised the said expenditure. In support of the company's claim, it is in the process of collating sample invoices evidencing the nature of expenditure and will share the same along with other pending details.”

6. The assessee also furnished sample invoices before the AO to substantiate that there are monthly internet and telecommunication charges. The AO did not accept the contentions of the assessee and proceeded to treat the expenditure as capital in nature by holding that the expenditure pertain to ‘centrex wireline’ or ‘port charges’ which are capital expenditure. The AO also stated that these expenditure bring enduring benefit to the assessee and therefore to be treated as capital asset. The AO allowed 80% of the amount as depreciation and disallowed the balance Rs.2,06,53,968/-.

7. Aggrieved the assessee filed the objections before the DRP sustained the disallowance on the ground that the assessee has claimed internet and telephone expenses separately and that the telecommunication line expenses pertain to expenses incurred for IT infrastructure which is capital in nature. Aggrieved by the final order passed in pursuance to DRP directions, the assessee is in appeal before the Tribunal.

8. The learned A.R. made the following submissions before us

- i. That the vendorwise break-up of the expenditure along with invoices (pages 733 to 942 of PB) was submitted before the lower authorities.

- ii. That the AO in the assessment proceedings of AY 2018-19 have verified invoices pertaining the similar expenses and have accepted the same as revenue in nature.
- iii. That the nature of expenditure remain unaltered, as the assessee incurs the same expenditure year on year and therefore the expenditure is revenue in nature to be allowed as a deduction.
- iv. That the expenditure claimed by the Assessee as telecommunication line expense broadly pertain to invoices raised by the following vendors:
 - a. Tata teleservices (Tata Docomo) — payment towards telephone line bills;
 - b. Dishnet Wireless Limited (Aircel) — payment towards port charges;
 - c. Verizon Communications India Private Limited — payment towards recurring private IP ethernet, internet, LAN charges etc.
- v. That the AO has misconstrued it to be Centrex wireline (EPABX system), even though the copy of sample invoices did not carry any such description on the invoices and despite providing explanations, the AO has erred in observing and concluding as under:

"As can be seen in the assessee's reply, the nature of these expenses pertains to laying the infrastructure for seamless internet & telephone connectivity. While the internet and telephone usage are recurring expenses, and have even been claimed separately in "Communication Expenses" by the assessee, the telecommunication lines expense is a onetime expense. It is an asset of enduring nature, and thus is liable to be treated as a capital asset."
- vi. That the AO failed to appreciate that "communication expenses" was the master head of expenses and 'telecommunication line expense' was a part of such expenditure. Break-up of

'communication expenses' as furnished before Learned AO can be referred at page 638 of the paperbook.

- vii. That the significant portion of expense pertain to port charges and recurring private IP, LAN charges etc. Port charges are broadly towards charges for providing a place of termination on a switch/distribution frame to provide a point of access or interconnection for ingress and egress of traffic between the two interconnecting networks. These expenses facilitate communications within the company, which is critical for day-to-day operations. Private IP charges are towards having a non-internet facing IP addresses using an internal network. It does not support any direct customer access connections. This helps in protection of data used by the Assessee in providing services and is a critical aspect in IT sector. LAN charges are towards internet line connectivity offered through Local Area Network connections which are intended for local areas such as a house or office building and are designed to connect a handful of clients to each other. Each computer in a LAN network is connected to a central server which acts as a go-between within the LAN and beyond. This helps better and faster connectivity to internet which helps in smooth processing of work.
- viii. That from the above explanation of charges incurred, these are incurred by the Assessee to facilitate an increase in efficiency, leaving the fixed capital unaltered. In the given case, the expenditure towards recurring telecommunication expenses does not result into any enduring benefit. Further, the above expenses are incurred to ensure smooth running of operations, leading to effective man hours. Hence, the telecommunication expenses enables the business operations to be carried out more efficiently.

ix. That reliance is placed on the following judicial precedents:

- a. Assam Bengal Cement Co. Limited 27 ITR 34 (SC);
- b. Empire Jute Co Ltd vs CIT [1980] 124 ITR 1 (SC);
- c. Bombay Steam Navigation Co [1953] (P) Limited v CIT [1965] 56 ITR 52 (SC)

9. The learned D.R. supported the orders of the DRP and submitted that the assessee had claimed the telephone and internet charges separately. The learned D.R. also submitted that the DRP after perusal of the invoices has held that the expenditure to be capital in nature and therefore prayed that the same needs to be upheld.

10. We have perused the evidences submitted and have heard both the parties. The assessee is in the business of providing IT/ITES services to its group companies. The assessee is having operations in Bangalore & Mumbai. Given the number of employees employed in different locations, the argument that the assessee is incurring huge expenses towards interest and data circuit charges, has to be accepted. During the course of hearing the learned A.R. submitted the below table giving the breakup of expenditure along with a note on the nature of expenditure :-

Sl.No	Party Name/ Expense	Amount	Nature of expense
1	Tata Docomo		
	Telephone Charges	36,64,064	Monthly charges levied on actual basis for various telephone lines taken across Company for internal and external communications

2	Aircel		
Port Charges	5,45,417	Port charges are broadly towards charges for providing a place of termination on a switch/ distribution frame to provide a point of access or interconnection for ingress and egress of traffic between the two interconnecting	
3	Verizon		
Port charges	5,49,28,179	Port charges are broadly towards charges for providing a place of termination on a switch/ distribution frame to provide a point of access or interconnection for ingress and egress of traffic between the two interconnecting networks. These expenses facilitate communications within the company, which is critical for day to day operations.	
EF Real time CAR	1,54,66,896	Expedited Forwarding (EF) is a model or type of Quality of Service (QoS) feature used to provide resources to latency (delay) sensitive real-time, interactive traffic such as voice over IP media traffic (Real-time Transport Protocol) over two interconnecting networks (e.g. from Bangalore branch office to Mumbai branch office or to a private datacenter within or outside India). This feature enables the customer (Altisource) to prioritize network bandwidth for latency sensitive, interactive real-time traffic over other traffic that are not as latency sensitive over a Private IP Ethernet circuit. EF Real time CAR charges are for enabling and using this feature on the circuit	
Local Access Charges	51,77,744	LAN charges are towards internet line connectivity offered through Local Area Network connections which are intended for local areas such as a house or office building and are designed to connect a handful of clients to each other. Each computer in a LAN network is connected to a central server which acts as a go between within the LAN and beyond. This helps better and faster connectivity to internet which helps in smooth processing of work.	
TOTAL	7,97,82,299		

11. In the same details, there were references to the sample invoices which was submitted before the lower authorities. On perusal of few

sample invoices we notice that the invoices of Tata Docomo charges are towards telephone lines the numbers of which is listed as an annexure to the bills raised. The Aircel invoices are raised towards port charges which is a fixed payment on a monthly basis. Similarly the invoices of Verizon has the description as 'internet recurring' charges. From the above, it is clear that the charges paid by the assessee are towards telephone lines, monthly port charges and recurring internet charges and hence we are of the considered view that the expenditure incurred by the assessee under the head 'telecommunication lines' is of revenue nature. We also notice that the AO in assessee's own case for AY 2018-19 has allowed the expenditure after verifying the sample invoices on the basis that the expenditure is 'recurring charges' and paid for a 'specified period'. The DPR/AO has in the order had stated that the assessee has claimed telephone and interest charges separately and stated it as reason for holding that the expenditure incurred as telecommunication lines is capital in nature. This in our view is not correct as the expenditure incurred under the head 'telecommunication lines' have to be verified based on invoices submitted to decide whether they are capital or revenue in nature. From the sample invoices it is clear that the assessee incurs monthly recurring charges, towards internet, telephone lines, port charges, etc. which in our view are of revenue nature. These expenditure do not bring any benefit of enduring nature to the assessee and is incurred in the normal course of business. We therefore delete the addition made with regard to 'telecommunication lines'. This ground of the assessee is allowed.

Disallowance of foreign exchange loss

12. During the year under consideration the assessee has incurred Rs.13,14,30,000/- as foreign currency exchange loss and had claimed the same as an expenditure. The assessee submitted before the AO that the exchange loss (realized/unrealized) on revenue account has been treated as allowable expenditure and claimed as a deduction. The AO was not satisfied with the submissions of the assessee and hence disallowed the forex loss stating that the assessee has not provided proper explanation as to why the forex loss is claimed as an expenditure.

13. The DRP confirmed the disallowance stating that the forex loss has arisen out of the year end restatement of advances received from the AEs and that the same is of capital nature not allowed to be debited to the P&L a/c. The DRP while giving directions had incorrectly taken the forex loss as a TP adjustment stating that the DRP does not find infirmity in the action of the TPO. The assessee highlighted this before the DRP (Page 1564 of PB). The AO passed the final order without considering the submissions of the assessee in this regard and had arrived at the disallowance towards forex loss. Aggrieved assessee is in appeal before the Tribunal.

14. The learned A.R. submitted that

- i. The assessee has satisfied all conditions prescribed under section 43AA of the Act, which deals with taxation of foreign exchange fluctuation. It has computed foreign exchange loss/gain on

differences arising on date of settlement or last date of FY 2016 17, as the case may be, as provided in paragraph 5 of Income Computation and Disclosure Standards (ICDS) VI notified under sub-section (2) of section 145. Given this, it has satisfied the condition provided in section 43AA(1) of the Act, by complying with ICDS VI.

ii. The lower authorities failed to appreciate the fact that the whole of foreign exchange loss is revenue in nature (both monetary and non-monetary), which gets covered in section 43AA(2) of the Act, which is sufficient explanation for claiming the loss as a deduction. Reliance was placed on the decision of Hon'ble Apex Court in case of *CIT vs. Woodward Governor India (P.) Ltd. [2009] 179 Taxman 326 (SC)*, wherein the Apex Court has provided various tests in determination of whether foreign exchange loss is a deductible expenditure. It was held that —

a. "the 'loss' suffered by the assessee on account of the exchange difference as on the date of the balance sheet was an item of expenditure under section 37(1)

b. Exchange differences arising on foreign currency transactions have to be recognized as income or as expense in the period in which they arise. The important point to be noted is that AS-11 stipulates effect of changes in exchange rate vis-a-vis monetary items denominated in a foreign currency to be taken into account for giving accounting treatment on the balance sheet date. Therefore, an enterprise has to report the outstanding liability relating to import of raw materials using closing rate of exchange. Any difference, loss or gain arising on conversion of the said liability at the closing rate, should be recognized in the profit and loss account for the reporting period.

iii. The Apex court has also identified certain factors which would be critical to determine if an expenditure is deductible, viz;

- 1) whether the system of accounting followed by the assessee is mercantile system (which allows accrual system for expenditure and revenue);
 - 2) whether the same system is followed by the assessee from the very beginning and if there was a change in the system, whether the change was bona fide;
 - 3) whether the assessee has given the same treatment to losses claimed to have accrued and to the gains that may accrue to it;
 - 4) whether the assessee has been consistent and definite in making entries in the account books in respect of losses and gains;
 - 5) whether the method adopted by the assessee for making entries in the books both in respect of losses and gains as per nationally accepted Accounting Standards;
 - 6) whether the system adopted by the assessee is fair and reasonable or is adopted only with a view to reduce the incidence of taxation.
- iv. The above decision has been followed in various judicial decisions, including:
- 1) CIT vs. L. G. Electronics India (P.) Ltd [2009] 309 ITR 265 (Delhi);
 - 2) ACIT vs. Theolia Wind Power (P.) Ltd [2019] 109 taxmann.com 3 (Delhi - Trib.)
- v. The Assessee has satisfied all factors laid out in the above decision of Apex court viz., Assessee has followed accrual/mercantile system of accounting, has accounted for foreign exchange loss as per Accounting Standard 11, has also complied with ICDS VI and has offered to tax the foreign exchange gain, whenever earned.

vi. Based on the principles of the aforesaid judicial precedents and the break-up of entire foreign exchange loss (enclosed at page 962 of paperbook), the said expenditure is purely revenue in nature and should be allowed as a deduction under section 37 of the Act.

15. The learned D.R. relied on the order of the DRP.

16. We notice that the assessee has submitted the detailed breakup of the forex loss claimed which is reproduced below:-

Sl. No	Particulars	Amount (in INR)	Remarks
1	Unrealised loss on restatement of trade receivables	(12,31,87,163)	This pertains to restatement of outstanding balance of one debtor i.e. Altisource Solutions S.a.r.l. Total outstanding balance as on 31 March 2017 of this debtor was USD 5,35,62,688, which was accounted in books of accounts in INR based on conversion rate as on date of invoice. This balance was restated as per USD-INR conversion rate as on 31 March 2017. Transaction-wise details of restatement of balances evidencing computation of exchange loss is provided as <i>Annexure 2A</i> and screenshot of RBI evidencing conversion rate of USD to INR is enclosed as <i>Annexure 2B</i> .
2	Unrealised loss on restatement of trade receivables	(9,62,934)	The loss pertains to restatement of outstanding balance of debtors in foreign currency and allowable as a deduction under section 43AA of the Income-tax Act, 1961
3	Unrealised gain on restatement of trade receivables	73,105	The gain pertains to restatement of outstanding balance of debtors in foreign currency and allowable as a deduction under section 43AA of the Income-tax Act, 1961
4	Unrealised gain on restatement of EEFC bank account	9,98,893	The loss pertains to restatement of EEFC bank account maintained in foreign currency and allowable as a deduction under the Act
Total exchange loss		(12,30,78,099)	

17. Before going into analyzing the facts we will first look at the provisions of section 43AA and also the relevant clauses of ICDS VI

Taxation of foreign exchange fluctuation

43AA. (1) Subject to the provisions of section 43A, any gain or loss arising on account of any change in foreign exchange rates shall be treated as income or loss, as the case may be, and such gain or loss shall be computed in accordance with the income computation and disclosure standards notified under sub-section (2) of section 145.

(2) For the purposes of sub-section (1), gain or loss arising on account of the effects of change in foreign exchange rates shall be in respect of all foreign currency transactions, including those relating to—

- (i) monetary items and non-monetary items;

- (ii) translation of financial statements of foreign operations;
- (iii) forward exchange contracts;
- (iv) foreign currency translation reserves.

ICDS VI – Effect of changes in foreign exchange rates

Foreign currency monetary items are those items where there is the right/obligation to deliver a fixed/ determinable amount of currency units e.g. cash, receivable, payable.

Foreign currency non-monetary items are items other than foreign currency monetary items e.g. fixed assets, inventories, investment in equity etc.

Initial recognition of a foreign currency transaction is to be done based on the exchange rate prevailing on the date of transaction. An average rate for a week/month that approximates the actual rate may also be used.

On the last date of the previous year the following treatment to be given:
Foreign currency monetary items – to be converted into reporting currency based on closing rate and the difference shall be recognized as income/expense.

Foreign currency non-monetary items – to be converted into reporting currency by using the exchange rate at the date of transaction and the difference shall not be recognised as income/expense. Inventory if carried at Net Realisable Value, shall be reported using the exchange rate that existed when such value was determined.

Any premium or discount at the inception of a forward contract shall be amortised as expense or income over the life of the contract. Exchange difference on such a contract shall be recognised as income or expense in the previous year in which the exchange rates change. Any profit or loss arising on cancellation or renewal shall be recognized as income or expense for the previous year.

Premium, discount or exchange difference on contracts intended for trading or speculation or to hedge foreign currency risk of a firm commitment or highly probable forecast transaction, shall be recognized at the time of settlement.

Monetary Items: It means money held and assets to be received or liabilities to be paid in fixed or determinable amounts of money.

18. Consolidated reading of the above two makes it clear that the gain or loss arising out of change in the forex rate can be treated as an income or loss provided the same is computed in accordance with ICDS notified u/s.145(2). From the perusal of the breakup of the forex loss claimed by the assessee we notice that the major portion of the loss has arisen out of the year end restatement of receivables and the balance in the EEFC a/c of the assessee which as per the ICDS VI clauses extracted above is a monetary item and accordingly to be converted into reporting currency based on closing rate and the difference shall be recognized as income/expense. Therefore the assessee has correctly recognized the forex as per the ICDS which is to be recognized as a loss as per the provisions of section 43AA. It is also noticed here that the amount claimed is net loss after considering the forex gains arising in certain transactions and that the assessee has also submitted that the invoice-wise details of forex loss/gain at page 963 of PB. In view of the above discussion we hold that the forex loss claimed by the assessee is an allowable expenditure. This ground is allowed in favour of the assessee.

Disallowance of unexplained expenses

19. During the year under consideration the assessee has claimed Rs.93,50,000/- as 'other miscellaneous expenses'. The AO disallowed the expenditure on the ground that the assessee has not provided details of the nature of expenditure. Before the DRP the assessee submitted

that the breakup of the 'other miscellaneous expenses' along with sample invoices substantiating the claim. The DRP issued directions to the AO to verify the details and allow the claim accordingly. The AO after verification allowed a sum of Rs.76,75,267 based on invoices submitted. The AO disallowed a sum of Rs.16,74,733/- as per details below, on the ground that the assessee did not provide explanations and furnish supporting documents to this extent. :-

S.No.	Miscellaneous Expenses	Amount (Rs.)
1.	Foreign Exchange Fees	Rs.15,226/-
2.	Laundry	Rs.58,998/-
3.	Cost Allocation Employee Benefits	Rs.1,334/-
4.	Director-Travel Expenses	Rs.4,252/-
5.	Bank Charges	Rs.15,94,923/-
	Total	Rs. 16,74,733/-

20. The learned AR submitted before us that the issue may be remanded back to the AO, before whom the details for the balance amount disallowed would be furnished by the assessee. The learned D.R. did not raise any objections to this submission.

21. In view of the above, we remand this issue back to the AO for verification of further details and supporting documents and decide the allowability in accordance with law. The assessee is directed to submit the relevant details in this regard before the AO and cooperate with the proceedings. It is ordered accordingly.

22. In the result, the appeal is allowed in favour of the assessee.

Pronounced in the open court on this 25th day of July, 2022..

Sd/-

Sd/-

(GEORGE GEORGE K.)
JUDICIAL MEMBER

(PADMAVATHY S.)
ACCOUNTANT MEMBER

Bangalore,
Dated, the 25th July, 2022.

/Desai S Murthy /

Copy to:

1. Assessee
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.

By order

Assistant Registrar
ITAT, Bangalore.