IN THE INCOME TAX APPELLATE TRIBUNAL
"C" BENCH : BANGALORE

BEFORE SHRI GEORGE GEORGE K., VICE PRESIDENT
AND
SHRI LAXMI PRASAD SAHU, ACCOUNTANT MEMBER

IT(TP)A No.898/Bang/2022
Assessment year : 2018-19

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

Appellant by	:	Shri Nageshwar Rao, Advocate Shri Nitin Inamdar, CA
Respondent by	:	Dr. Manjunath Karkihalli, CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	30.11.2023
Date of Pronouncement	:	20.02.2024

O R D E R

Per Laxmi Prasad Sahu, Accountant Member

This appeal is filed by the assessee against the final assessment DIN & Order No.ITBA/AST/S/143(3)/2022-23/1044227432(1) dated 28.07.2022 of the NFAC, Delhi for the AY 2018-19 on the following concise grounds:-

"***General grounds***

1. The impugned order of the Additional/Joint/Deputy/Assistant Commissioner of Income-tax, National Faceless Assessment Centre, Delhi (hereinafter referred to as "Ld. Assessing Officer" or the "Ld. AO") / Deputy/Assistant Commissioner of Income

Tax - Transfer Pricing — 1(1)(1), Bengaluru (hereinafter referred to as the "Transfer Pricing Officer" or "Ld. TPO") and the directions issued by the Hon'ble DRP are based on incorrect appreciation of facts and incorrect interpretation of law and therefore, are bad in law.

2. The Ld. AO erred in assessing the total income of the Appellant at INR 1,75,60,07,470 as against the returned income of INR 1,11,00,07,810

3. The Ld. AO erred in determining a sum of INR 34,82,78,580 as balance tax payable by the Appellant.

Grounds relating to transfer pricing matters:

4. Adjustment on account of re-determination of arm's length price ('ALP') of the Information Technology enabled Services ('ITeS') rendered by the Appellant to its Associated Enterprises ('AEs')

The Ld. AO/ TPO / DRP have erred in law and in facts:

4.1 By making an addition of INR 28,61,39,692 to the total income of the Appellant on account of re-determination of ALP of the ITeS rendered by the Appellant to its AEs.

4.2 By not accepting the economic analysis undertaken by the Appellant in accordance with the provisions of the Act read with the Income-tax Rules, 1962 ("the Rules"), conducting a fresh economic analysis for the determination of the ALP in connection with the impugned international transactions, and holding that the Appellant's impugned international transactions are not at arm's length.

4.3 By rejecting companies by incorrectly applying certain quantitative and qualitative filters as a comparability criteria, such as —

(i) different accounting year filter (rejecting companies with accounting year other than March 31 or with accounting period other than 12 months), (ii) employee cost greater than 25 percent of the total operating revenue, (iii) export sales less than 75 percent of total sales, (iv) persistent loss filter (losses for any 2 out of 3 years), (v) modified related party transaction ('RPT') filter in two separate legs as provided below-

- RPT filter for the revenue transactions only (RPT revenue greater than 25 percent of total sales)
- RPT filter for the expense transactions only (RPT expenses greater than 25 percent of total expenses)

4.4 By accepting the following companies that cannot be considered as comparable to the Appellant based on unreasonable comparable criteria for the impugned international transaction, such as —

(i) Manipal Digital Systems Private Limited; (ii) Vitae International Accounting Services Private Limited; (iii) Tech Mahindra Business Services Limited; (iv) Datamatics Business Solutions Services Private Limited; (v) Fuzen Software Private Limited; (vi) Domex E Data Private Limited; (vii) Inteq BPO services Private Limited; (viii) MPS Limited; (ix) Motif India Infotech Private Limited; (x) Eclerx Services Limited; (xi) Infosys BPM Limited

4.5 By rejecting the following comparable companies selected by the Appellant in its TP documentation even though the companies are functionally comparable to the Appellant, such as —

(i) Cosmic Global Limited; (ii) R Systems International Limited; (iii) Allsec Technologies Limited; (iv) Crystal Hues Limited; (v) Sundaram Business Services Limited

4.6 By rejecting companies additionally introduced by the Appellant even though the companies are functionally comparable to the Appellant — (i) Goldstone Technologies Limited

4.7 By erroneously computing the operating margins of some of the comparable companies considered as comparable by the Ld. AO/ TPO.

4.8 By not making suitable adjustments to account for differences in the risk profile of the Appellant vis-a-vis the comparable companies.

5. Adjustment on account of notional interest on outstanding receivables

The Ld. AO/ TPO/ DRP erred in law and in facts:

5.1 In making a TP adjustment of INR 14,02,02,482 on account of the notional interest on outstanding receivables.

Without prejudice to our ground of objection 5.1 above, the Ld. AO/ TPO/ DRP erred in law and in facts:

5.2 In treating the outstanding receivables from its AEs as a separate international transaction and not considering the same to be closely linked with the primary transactions of provision of Information Technology ('IT') and ITeS.

5.3 By re-characterizing the outstanding receivables as an unsecured loan and not considering the business/commercial expediency of the arrangement.

5.4 By adopting SBI short term deposit rates for computing notional interest to be charged on the alleged delay in collection of receivables.

<u>Grounds relating to corporate tax matters</u>

6. Disallowance of deduction of service tax paid on input services:

6.1 The Ld. AO/ the Hon'ble DRP grossly erred in not considering the Service Tax *(paid in accordance with the Service tax Act, 1994)1* Goods and Service Tax ('GST') *(paid in accordance with the Central Goods and Service tax Act, 2017/ the Integrated Goods and Services Act, 2017, which came into effect from 01 July 2017)* claimed as a deductible expenditure under section 37 of the Income-tax Act, 1961.

6.2 The Ld. AO/ the Hon'ble DRP ought to have observed that deduction claimed is of 'service tax/GST paid' and not 'write off of refund of service tax/ GST'.

6.3 The Ld. AO/ the Hon'ble DRP ought to have appreciated the fact that the service tax/GST input which is claimed as expenditure is consistently being offered to tax as and when the refund is received.

7. Disallowance of software expenses because they are capital in nature:

7.1 The Ld. AO/ the Hon'ble DRP erred in alleging that the software expenses incurred by the Appellant are capital in nature without appreciating the fact that software expenses are mainly incurred for short term license with respect to application software.

7.2 The Ld. AO/ the Hon'ble DRP ought to have observed that the software purchased by the Appellant having enduring benefit is already capitalised in its books of accounts and only those which have short term license period were claimed as expense in profit & loss account.

7.3 The Ld. AO/ the Hon'ble DRP ought to have appreciated that the software purchased by the Appellant does not result in any enduring benefit, and hence, to be allowed as business expenditure under section 37 of the Act.

7.4 ***Without prejudice to the above,*** the Ld. AO/ Hon'ble DRP failed to appreciate that even if the expenses are 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.

8. Disallowance of leave encashment provision claimed as deduction:

8.1 The Ld. AO/ the Hon'ble DRP erred in disallowing the deduction of leave encashment provision, without issuing any show cause notice and without providing an opportunity of being heard, thereby violating the principles of natural justice.

8.2 The Ld. AO/ the Hon'ble DRP failed to consider the detailed reconciliation filed by the Appellant highlighting the discrepancies in the opening balance as reported in the tax audit report.

8.3 The Ld. AO/ the Hon'ble DRP ought to have appreciated that the Appellant **has also enhanced its disallowance along with deduction claimed,** thereby nullifying the impact of adjustment made in the return of income.

8.4 The Ld. AO/ the Hon'ble DRP erred in disallowing only the deduction claimed without providing any relief for disallowance already made.

<u>Consequential grounds:</u>

9. Erroneous levy of interest under section 2348 of the Act

9.1 The Ld. AO has erred, in law and on facts, in levying the interest of INR 12,47,15,552 under Section 234B of the Act.

9.2 The Ld. AO has erred by committing a mistake apparent from record in computation of interest under Section 234B of the Act.

9.3 The Ld. AO ought to have appreciated that the interest under section 234B of the Act has to be levied on the assessed income from beginning of relevant assessment year and only upto the month in which order is passed.

10. Erroneous levy of interest under section 234C of the Act

10.1 The Ld. AO has erred, in law and on facts, in levying the interest of INR 1,62,746 under Section 234C of the Act.

10.2 The Ld. AO has erred by committing a mistake apparent from record in computation of interest under Section 234C of the Act.

10.3 The Ld. AO ought to have appreciated that the interest under Section 234C of the Act can be levied only on the returned income.

11. The Ld. AO have erred in initiating penal proceedings under Section 270A (1) of the Act.

12. The Ld. AO have erred in issuing a demand notice under Section 156 of the Act.

The Appellant submits that each of the above grounds is independent and without prejudice to one another. The Appellant also humbly submits that the above are concise version of the grounds and have to be read along with detailed grounds taken in Form 36 filed before the Hon'ble ITAT on 22 September 2022.

The Appellant 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, so as to enable the Hon'ble Tribunal to decide on the appeal in accordance with the law."

2. The brief facts of the case are that the assessee filed return of income on 19.11.2018 declaring total income of Rs.111,00,07,810. Thereafter assessee filed revised return of income on 12.06.2019 declaring same income. Subsequently case was selected for scrutiny and notice u/s. 143(2) was issued and 22.09.2019 and other statutory notices were also issued to the assessee calling for details which were furnished by the assessee. From the submissions, the AO noted that the assessee had international transactions, therefore, the case was referred to TPO on 01.03.2021 for the computation of ALP in relation to international transactions after taking prior approval from the competent authority. The TPO after receiving reference in ITBA portal issued notice on 17.03.2021 u/s. 92CA(2) calling for documentation as prescribed u/s. 92D(3) and the assessee filed the same as per the requirement of the TPO. The TPO noticed that the assessee is engaged in the business of software development and IT enabled services including data analysis, compilation and transmission on customized group company. It supports Altisource Luxembourg's three business segments and also supports IT infrastructure services and general administrative services.

3. From the TP study it was observed that the ALP of the international transactions in SWD/ITeS segment provided to AE is determined by applying Transactional Net Margin Method (TNMM) stating to be the most appropriate method and OP/OC has been taken

as the PLI in TNMM analysis. From the TP documentation, it was noticed that that 17 and 16 companies in respect of SED and ITeS segments were selected by the tax payer by applying certain filters. The TPO issued show cause notice and the assessee submitted reply. The TPO rejected the TP study filed by the assessee and applied certain filters and some of the companies were rejected/accepted for both the segments. The assessee filed objections which were dealt by the TPO and finally in SWD segment 20 companies were selected and calculated Median at 23.60%, 35th Percentile at 20.19% and 65th percentile at 26.83%. In ITeS segment, finally 17 companies were selected by the TPO and 35th percentile was computed at 20.95%, median at 26.34% and 65th percentile was at 33.28%. Accordingly the shortfall adjustment made for SWD segment at Rs.235,727,549 and for ITeS segment at Rs.505,298,858.

4. The TPO also noted that the TP provisions are applicable for delayed trade receivables and relying on various judgments, concluded that the taxpayer has incurred cost in connection with the benefit and services provided to AE by way of delayed receipt of receivables and section 92B Explanation (1) (c) & clause (v) of section 92F are very much applicable. In this regard, the assessee submitted that delayed trade receivables should be benchmarked using a combined transaction approach and this plea was not accepted by the TPO and he noted that in various decisions it has been held that transaction by transaction approach should be adopted for benchmarking. The TPO also noted that the assessee failed to show that delay in payment of receivables

was compensated by AEs through set off of any other transactions. Accordingly the TPO adopted SBI short term deposit interest rate. He also noted at para 30.21 that "the period for which interest has been calculated has been limited to the year under consideration as interest accrued in other years cannot be taxed this year. Similarly, interest accrued during the year under consideration, in respect of invoices raised in earlier years which remained unpaid has also been charged." Accordingly the TPO asked to furnish invoice details of all trade receivables from AEs in a particular format. The assessee furnished details and contended that bills have been realized within 180 days. However the TPO observed that in a normal course of business, such long delayed payments are not allowable and computed interest on delay receivables by allowing 30 days credit period at Rs.19,99,96,106. Accordingly the total adjustment u/s. 92CA was made at Rs.941,022,513 and the TPO passed the order on 29.07.2021.

5. The AO after receipt of order u/s. 92CA proceeded to complete the draft assessment order u/s 144C of the Act and determined the income as under:-

Total income as per return of income	Rs1110007810
Add:- Add:- Adjustment of ALP proposed by the TPO order u/s. 92CA(3)	Rs. 941022513
Add:- as discussed above (para 5)	Rs. 37823651
Add:- as discussed above (para 6)	Rs. 13108
Add:- as discussed above (para 7)	Rs. 176145398
Add:- as discussed above (para 9)	Rs. 76146593
Assessed income u/s 143(3) rws 144B of the I.T. Act, 1961	Rs. 2341159073
Rounded off u/s. 288A	Rs. 2341159070

6. Aggrieved from the above order, the assessee filed objections on 28.10.2021 vide Form 35A dated 26.10.2021. The ld. DRP passed the order on 13.06.2022 after rejecting/accepting submissions of the assessee. The AO passed the OGE order and in the SWD segment there was no adjustment and in case of ITeS segment, the adjustment was reduced to Rs.28,61,39,692 and interest on delayed receivables was restricted to Rs.14,02,02,482. Accordingly the TP adjustment pursuant to DRP directions was restricted to Rs.42,63,42,174 and the AO passed final assessment order as under:-

Total income as per return of income	Rs 1110007810/-
Add:- Revised TP Adjustment by the TPO after giving effect to DRP order	Rs. 426342174/-
Add:- as discussed above (para 5)	Rs. 37823651
Add:- as discussed above (para 6)	Rs. 105687238
Add:- as discussed above (para 8)	Rs. 76146593
Assessed income u/s 288A	Rs. 1756007470

7. Aggrieved from the above order, the assessee filed appeal before the ITAT on 22.09.2022 raising the grounds noted supra.

8. Ground Nos.1, 2 & 3 are general in nature.

9. After filing the appeal before the ITAT, the assessee also filed rectification application u/s. 154 dated 26.08.2022 seeking rectification of the issue which is as under:-

> "The comparable company under ITeS segment has been excluded by the TPO on the ground that it fails net worth filter. As per the data available in Annual report of the company, it passes net worth filter. Therefore, the said comparable may be considered for inclusion in the final list of comparable companies in ITeS segment for computation of average PLI mark-up."

10. The TPO accepted the rectification application filed by the assessee for inclusion of Sundaram Business Services Ltd. and considered it as comparable for ITeS segment. Accordingly the final list of comparables were calculated for 19 companies in ITeS segment and noted that taxpayer's PLI is more, the revised adjustment was calculated at NIL. The TPO passed the order vide DIN & Order No.ITBA/COM/F/17/2022-23/1050584909(1) dated 10.03.2023.

11. The ld. AR of the assessee during the course of hearing produced the rectification order passed by the TPO dated 10.03.2023 in which we note that there is no adjustment in ITeS segment. Accordingly, we hold that the grounds raised by the assessee in regard to issue of adjustment in ITeS segment becomes infructuous and dismiss ground No.4.

12. Ground No.5 is towards notional interest on outstanding receivables. Grounds 5.2 & 5.3 were not pressed. The ld. AR relied on the judgment of ITAT Delhi in ITA NO.1248/Del/2012 for AY 2017-18 and on similar set of facts it was observed as under:-

> "9. The ld DR vehemently argued by placing reliance at page 495 of the appeal set for AY 2018-19 stating that the invoice wise details of outstanding receivables were called for by the ld TPO from the assessee and which was never provided by the assessee. In these circumstances, he argued that the ld TPO was justified in taking the opening balance and closing balance of receivables for arriving at the average receivables. The ld DR argued that the earlier year's tribunal decision in assessee's own case where this addition was deleted should not be followed as it had not properly considered the issue in dispute and the decision of the Hon'ble High Court of Karnataka Jurisdictional High Court in the case of Kusum Healthcare (supra). He argued that an error which had

occurred in the earlier order of the Tribunal need not be perpetuated. In this regard, he placed reliance on the decision of Hon'ble Supreme Court in the case of Distributors (Baroda) Pvt Ltd Vs. Union of India reported in 155 ITR 120, wherein, it was held that "To perpetuated an error is no heroism. To rectify the same is the compulsion of judicial conscience". Accordingly, he argued that the issue in dispute should be viewed independently for the years under consideration dehors the decision taken consistently by this Tribunal in favour of the assessee.

10. At the outset, we find that the assessee had not submitted the invoice-wise details of outstanding receivables from its AEs before the ld TPO. We have gone though the decision of the Hon'ble Delhi High Court in the case of Kusum Healthcare reported in 398 ITR 66 (supra). The relevant observations are reproduced herein below:-

> "10. The Court is unable to agree with the above submissions. The inclusion in the Explanation to Section 92B of the Act of the expression 'receivables' does not mean that de hors the context every item of receivables' appearing in the accounts of an entity, which may have dealings with foreign AES would automatically be characterised as an international transaction. There may be a delay in collection of monies for supplies made, even beyond the agreed limit, due to a variety of factors which will have to be investigated on a case to case basis. Importantly, the impact this would have on the working capital of the Assessee will have to be studied. In other words, there has to be a proper inquiry by the TPO by analysing the statistics over a period of time to discern a pattern which would indicate that vis-à-vis the receivables for the supplies made to an AE, the arrangement reflects an international transaction intended to benefit the AE in some way.
>
> 11. The Court finds that the entire focus of the AO was on just one AY and the figure of receivables in relation to that AY can hardly reflect a pattern that would justify a TPO concluding that the figure of receivables beyond 180 days constitutes an international transaction by itself. With the Assessee having already factored in the

> impact of the receivables on the working capital and thereby on its pricing/profitability vis-à-vis that of its comparables, any further adjustment only on the basis of the outstanding receivables would have distorted the picture and re-characterised the transaction. This was clearly impermissible in law as explained by this Court in CIT v. EKL Appliances Ltd. (2012) 345 ITR 241 (Delhi)."

11. From the perusal of the aforesaid decision, we find that Hon'ble High Court noted that there has to be a proper inquiry by the ld TPO by analyzing the statistics over a period of time to discern a pattern which would indicate that vis-a-vis the receivables for the supplies made to an AE, the arrangement reflects an international transaction intended to benefit the AE in some way. On perusal of the orders of the Tribunal in assessee's own case for earlier years, this aspect of the decision of the Hon'ble Delhi High Court had not been addressed in those years. Further whether the ld TPO had examined the pattern of receivables from the AE by the assessee is also not discernable. Hence, we are in agreement with the ld DR in principle on this issue.

12. But we find that the ld AR had also made an alternative argument that assessee had already recovered alleged short fall on account of delayed receivables by way of excess service income received from its AE thereby obviating requirement for any further adjustment on account of notional interest on delayed receivables. The ld AR also furnished a tabulation to this effect before us:-

Particulars	Distribution segment (OP/OR)	SWD Segment (OP/OC)	GCC Segment (OP/OC)
AY 2017-18			
TP margin as per TPO (SWD & GCC Segment)/ TP Study (Distribution Segment) (35th percentile*) —(A)	-0.44%	11.41%	10.22%
Taxpayer PLI —(B)	3.80%	13.33%	13.51%
Difference (C=A-B)	4.24%	1.92%	3.29%
Operating cost as per TP order (SWD & GCC Segment)/ Operating Revenue as per TP Study (Distribution Segment) ---------------------------------(D)	73,15,48,116	84,29,69,289	2,19,76,78,533
Excess amount received by Appellant from its AEs E-(C*D)	3,10,17,640	1,61,85,010	7,23,03,624
Total excess margin earned from AEs		11,95,06,274	
Adjustment made on account of outstanding receivables		4,02,41,692	
AY 2018-19			
TP margin as per TPO (SWD & GCC Segment)/ TP Study (Distribution Segment) (35th percentile*) --(A)	0.38%	10 91%	9.86%
Taxpayer PLI —(B)	3.59%	14.47%	14.27%
Difference (C=A-B)	3.21%	3.56%	4.41%
Operating cost as per TP order (SWD & GCC Segment)/	65,77,20,573	1,12,41,08,640	2,49,83,27,233

Operating Revenue as per TP Study (Distribution Segment) ---------------------------------(D)			
Excess amount received by Appellant from its AEs E-(C*D)	2,11,12,830	4,00,18,268	11,01,76,231
Total excess margin earned AEs		17,13,07,329	
adjustment made on account of outstanding receivables		4,88,40,680	

> 13. The aforesaid working, in our considered opinion, requires factual verification of the ld AO/ TPO. Hence, we deem it fit to restore the entire issue in dispute to the file of the ld AO/ TPO to consider the applicability of the decision of Hon'ble Delhi High Court rendered in Kusum Healthcare (supra) in its true spirit vis a vis the pattern followed by the assessee and also alternative argument made by the ld AR with regard to the aforesaid workings and decide the entire issue in accordance with law. The ld AR also made an alternative argument with regard to the adoption of LIBOR +200 basis points as against 400 basis points by placing reliance on certain decisions. The ld AO/ TPO is also directed to examine this alternative argument of the ld AR while deciding this issue. Accordingly, ground Nos. 3 to 5 raised by the assessee are allowed for statistical purposes."

13. The ld. DR relied on the orders of lower authorities

14. After hearing the rival contentions, we note that the TPO has made adjustment for outstanding receivables as international transactions of Rs.14,02,02,482. The ld. DRP has directed to adopt SBI short term deposit rate for computing the interest rate after allowing credit period of 30 days or as per agreement/invoices. We note from the case law relied by the ld. AR that the ITAT Delhi Bench has considered the judgment of Delhi High Court in the case of Kusum Healthcare. The ld. AR submitted that the assessee will comply before the lower authorities in terms of above judgment. Accordingly we remit this issue to TPO/AO for deciding the issue in terms of above judgment. Accordingly, ground Nos. 5.1 & 5.4 is allowed for statistical purposes.

15. Ground No.6 is regarding disallowance of service tax paid on input services. During the assessment proceedings, the AO noticed that the assessee has claimed Rs.5,69,92,418 as deduction on account of service tax paid on input services in col. of "any other amount allowable as deduction" in its ITR. The assessee was asked to substantiate the allowability of said deduction. The assessee submitted that it claimed input of service tax/GST paid on various expenses and consequently utilizes such inputs against its service tax/GST liability. The balance of amount of service tax is then applied for refund. Further, if service tax/GST refund application is accompanied with uncertainty of receiving it, service tax/GST input generated but not utilized in that particular financial year is claimed as deductible expenditure. In future, such amount will be offered to tax in the year in which refund is received. The submission made by the assessee was not found acceptable by the AO and he observed that it is in violation of mercantile system of accounting wherein receipts are supposed to be shown on accrual basis and noted that as per ICDS, accounting policy cannot be changed during a year, without there being a reasonable cause to do so. He noted that there is no section in the Income-tax Act under which this unrefunded service tax input can be allowed as expenditure. The amount has accrued to the assessee and is a statutory due which is in the nature of receivable i.e., an asset, but has not reached a stage where it can be considered as expenditure. Therefore section 37 does not apply here. Accordingly show cause notice was issued to the assessee for disallowing the entire amount of

Rs.5,69,92,480. The assessee submitted reply stating that it is not change in accounting policy of mercantile system as alleged by AO and has consistently claimed service tax/GST inputs as expenses and has offered to tax the refunds on receipt basis. The assessee further submitted that it has received refund amounting to Rs.1,91,68,787 on 30.07.2019 and the whole amount of refund has been offered to tax in the FY 2019-20 and computation of income was enclosed. Alternatively the assessee submitted that if the entire amount is not allowed as deduction, then the disallowance should be restricted to Rs.3,78,23,651. The AO accepted that amount of Rs.1,91,68,787 has been offered to tax by the assessee upon receipt of refund and the balance amount of Rs.3,79,23,651 was disallowed.

16. The ld. AR reiterated submissions made before the lower authorities and submitted that this practice is regularly followed by the assessee and whenever assessee received refund, it is offered for taxation for the relevant financial year. He relied on the decision of ITAT Bangalore in the case of Intuit India Product Development Center Pvt. Ltd. in ITA No.2501 & 2575/Bang/2017 dated 26.4.2022 for AY 2013-14 and requested that the matter may be sent to AO for verification.

17. The ld. DR relied on the orders of lower authorities and submitted that the AO has rightly accepted the alternative plea of the assessee and has given relief to the extent of refund received in subsequent financial year. He submitted that for computing income the

assessee has adopted dual system which is not permissible. Therefore he requested that the order of the AO should be upheld.

18. After hearing both the sides, perusing the entire material on record and the orders of the lower authorities we note that assessee has claimed expenses of Rs.5,69,92,418 in its ITR which was accounted for by the assessee that it is input tax credit towards payment of utilization of service tax/expenditure and claimed as deductible expenditure. We also note that the amount received in subsequent year has been offered for tax on receipt basis and allowed by the AO . The case law relied on by the ld. AR is not applicable to the present facts of the case since in this case the provisions of service tax receivable were made by the assessee and while computing income it was added back but in the case on hand the assessee has claimed the entire receivable as expenditure. We note from the order of the AO that AO has accepted on receipt basis and only disallowed Rs.3,79,23,651. We note from the submissions of the assessee that this system is followed regularly and consistently claimed service tax/GST input as expenses and has offered to tax the refund on receipt basis. In the peculiar facts of the case, the case of the assessee relates to FY 2017-18 and the assessee has received refund in the FY 2019-20. Therefore, for parity, since the AO himself has given the benefit to assessee for FY 2017-18 for refund received in FY 2019-20, we think it fit to remit back to the AO for further verification whether the assessee has received any refund in this year also and offered to tax. If the assessee substantiates

that the amount has been received in any subsequent year, then the AO will allow deduction to the extent of refund received.

19. Ground No.7 is regarding disallowance of software expenses as capital in nature. The AO noted that the assessee has claimed Rs.17,61,45,398 as software expenses and assessee had also claimed amortization of intangible assets in the books of account of assessee, these intangible assets are included under computer software. The AO noted that computer software licence provides benefit of enduring nature, therefore it cannot be allowed as revenue expenditure. Accordingly a notice was issued to assessee and assessee submitted reply, the AO noted that assessee has merely submitted the use of software expenses in its business and has stated that the benefit is not for a long period. However, the assessee has not furnished any documentary evidence of sample software licence contracts, etc. from where it could be seen that these assets are owned by the assessee for short duration. The assessee was specifically asked to comment on claim of amortization on account of computer software. The AO noted that the assessee has only stated that since it has not capitalized the software expenses, it has not claimed amortization on them. He noted that it cannot be accepted that the computer software which the assessee has treated as revenue expenditure is distinct from the computer software on which amortization has been claimed by the assessee. The assessee was given show cause notice and the assessee submitted that software expenses are incurred for regular business which do not have any enduring benefit and the fact that expenditure is

incurred for very short period. Therefore it cannot be treated as capital expenditure and filed sample invoices in Annexure 4A. The assessee alternatively submitted that in case the amount is disallowed, then consequently amortization towards such additional identified capital assets are to be provided. The AO examined the submissions of the assessee and noted that the assessee has not submitted details of the duration of the licence period or nature of licence so that it could be treated as capital expenditure. He further noted that if the licence is for 3 years, then the value will be amortised for 3 years life to allow the deduction upto 1/3rd for each year. If the validity of the licence is for two years, then their value will be amortised over two years equally. Accordingly he made disallowance.

20. The ld. AR reiterated submissions made before the lower authorities and further submitted that the company is engaged in the business of providing IT/ITeS services, hence as part of its business operations, the company has made certain payments towards purchase and maintenance of various software and amount debited into the profit & loss account and mainly incurred for short term licence. It is revenue expenditure as it is expended wholly and exclusively for the purpose of business and the company does not receive any enduring benefit from such license. Accordingly it should be treated as revenue expenditure. He reiterated the case laws relied before the lower authorities. He also requested that the matter may be sent back to AO for verification of age-wise licence and the assessee will submit the same for the purpose of verification.

21. The ld. DR relied on the orders of lower authorities and submitted that the assessee has debited entire amount to software expenses account which is not correct as observed by the DRP as well as AO. The ld. DRP has considered this issue at para 2.10.1 and during the course of proceedings before the DRP the details of software expenditure incurred which includes software licence, software program, etc., were not furnished. He further submitted that if the software licence and programs are used for more than 2 years, it gives enduring benefit to the assessee, therefore it should be treated as capital in nature.

22. After considering the rival submissions, we note that the AO has treated software licence and program as capital expenditure. We further note that before the DRP the assessee did not file any documents. Considering the submissions, if the duration of the licence is more than two years, then it should be treated as capital in nature and depreciation should be granted as per section 32 of the I T Act, but if the period of license/software expenses is .less than two years, it should be treated as revenue expenditure. We further note that in the case of CIT v. Toyota Kirloskar Motor (P) Ltd. [2013] 30 taxmann.com 294 (Karnataka), it is held that if the period of software is less than two years, then it will be treated as revenue expenditure. During the course of hearing the ld. AR of the assessee submitted that software/license fee has been incurred throughout the year. In the case on hand the entire expenditure incurred during the year has been debited into profit & loss account, accordingly if period of two years

has not expired in the impugned assessment year, the balance amount should be treated as payment in advance and not be claimed in the profit & loss account entirely and it should be accounted over the period of life of the software/license fee. For better understanding, we are giving example:-

(i) If software/program is purchased and used in the month of April, 2017 and the period of licence is for 18 months, then the assessee used it only for 12 months in this year. Therefore, the proportionate expenditure shall be allowed as revenue expenditure in the impugned assessment year and the rest amount shall be treated as payment in advance and the assessee will get benefit in the following year as revenue expenditure.

(ii) If the assessee purchased and used software/program in January, 2018 and validity period is 23 months and the assessee has claimed entire expenditure in the impugned AY, since in this case the assessee has used software only for 3 months, then the assessee is eligible to get benefit of revenue expenditure on proportionate basis only for 3 months and for 20 months the assessee is eligible for two following FYs on proportionate basis 12 months in the following FY 2018-19 and for 8 months in FY 2019-20.

22.1 As requested by the assessee, we think it fit to send back to AO for verification in above terms and decide the issue as per law. The assessee is directed to prepare a details of software/license fee expenses incurred in above terms.

23. Ground No. 8 is regarding disallowance of leave encashment provision claimed as deduction. The AO noted that assessee has claimed Rs.7,61,46,693 for leave encashment as part of "any other amount eligible as deduction". As per Form 3CD in col. 26(i)(A)(a) the amount of leave encashment paid on or before the previous year was Rs.3,48,34,348 & in col. 26(i)(B)(a) the amount of leave encashment paid on or before the due date for filing return was Rs.1,62,71,769. The total of these is Rs.5,11,06,117. The assessee was asked to explain the difference of Rs.2,50,40,576.

24. The assessee replied that Rs.3,27,97,471 is towards Ind AS adjustment. Owing to the requirement of recasting the books of FY 2016-17 as per Ind AS, an additional cost has arisen to the company amounting to Rs.3,27,97,471. The same has been adjusted in the opening balance of the leave encashment in the financials and corresponding reduction has been made in retained earnings. The Ind AS adjustment has not been disallowed in the computation of income since the same has not bee charged to the profit & loss account for FY 2017-18 (relevant to AY 2018-19). Given the same, opening balance of leave encashment was further enhanced by INR 3,27,97,471.

25. The assessee also submitted that Rs.4,33,49,222 is towards difference in brought forward opening balance of leave encashment which was erroneously missed to be brought forward from AY 2017-18 and this amount was disallowed when it was created and it has not been again disallowed in AY 2018-19. Given this, provision created for AY 2018-19 was enhanced by Rs.4,33,49,222.

26. The submissions of the assessee was not accepted by the AO and he noted that these are not amounts actually incurred by the assessee towards expenses during the year, therefore it cannot be allowed. The DRP upheld the order of the AO.

27. The ld. AR reiterated the submissions made before the lower authorities and he requested that the matter may be sent back to AO for the purpose of verification.

28. The ld. DR relied on the order of lower authorities and submitted that assessee is eligible to make claim towards leave encashment only on payment basis as decided by Apex Court in UOI v, Exide Industries Ltd. reported in [2020] 116 taxmann.com 378 (SC). Even the assessee has not complied the provisions as per section 43(B)(f). Therefore the order of lower authorities should be upheld.

29. Considering the rival submissions, we note that during the previous year the assessee has paid Rs.3,48,34,348 and Rs.1,62,71,769 on or before due date of filing of return towards leave encashment. Accordingly the total payment is Rs.5,11,06,117. However, the AO has made addition of Rs.7,61,46,593. The assessee has submitted that Rs.3,27,97,471 is on account of recasting of books of FY 2016-17 as per Ind AS and for Rs. 4,33,49,222 it is an adjustment towards opening balance brought forward for AY 2017-18. Since the payment of leave encashment has been decided by the Apex Court cited by the ld. DR supra that leave encashment is allowed only on payment basis, accordingly this issue is remitted back to the AO for decision as per the

judgment of Apex Court supra and the assessee is directed to produce necessary documents for substantiating its case.

30. Ground Nos. 10, 11 & 12 are consequential in nature.

31. In the result, the appeal by the assessee is partly allowed for statistical purposes.

Pronounced in the open court on this 20th day of February, 2024.

Sd/-	Sd/-
(GEORGE GEORGE K.)	(LAXMI PRASAD SAHU)
VICE PRESIDENT	ACCOUNTANT MEMBER

Bangalore,
Dated, the 20th February, 2024.

/*Desai S Murthy* /

Copy to:

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

By order

Assistant Registrar
ITAT, Bangalore.