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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

% *Judgment delivered on: 09.11.2016*

\+ **ITA 1108/2007**

DEPUTY DIRECTOR OF INCOME TAX ..... Appellant
Through: Mr. Rahul Chaudhary and Mr. Ragvendra Singh, Advs.

versus

VIRAGE LOGIC INTERNATIONAL ..... Respondent
Through: Mr. Balbir Singh, Sr. Adv. with Mr. Prakash Kumar and Mr. Ankit Vijaywargeja, Advs.

\+ **ITA 1249/2009**

DIRECTOR OF INCOME TAX ..... Appellant
Through: Mr. Rahul Chaudhary and Mr. Ragvendra Singh, Advs.

versus

VIRAGE LOGIC INTERNATIONAL ..... Respondent
Through: Mr. Balbir Singh, Sr. Adv. with Mr. Prakash Kumar and Mr. Ankit Vijaywargeja, Advs.

\+ **ITA 173/2016**

COMMISSIONER OF INCOME TAX-3 INTERNATIONAL TAXATION ..... Appellant
Through: Mr. Rahul Chaudhary and Mr. Ragvendra Singh, Advs.

versus

VIRAGE LOGIC INTERNATIONAL INDIA ..... Respondent
Through: Mr. Balbir Singh, Sr. Adv. with Mr. Prakash Kumar and Mr. Ankit Vijaywargeja, Advs.

CORAM:
HON'BLE MR. JUSTICE S. RAVINDRA BHAT
HON'BLE MR. JUSTICE NAJMI WAZIRI

S. RAVINDRA BHAT, J. (Oral)

1. The questions of law framed in ITA No. 1108/2007 are as follows:

(i) Whether the transfer of computer software by the Indian branch to the head office can be said to be 'sale' to the head office out of India?

(ii) Whether the assessee is entitled to claim benefit of Section 10A of the Income Tax Act, 1961, as the software is developed by the branch as per the requirement of Head Office and not sold to any third party?

2. The companion appeals i.e. ITA Nos. 1249/2009 and 173/2016 also concern the same questions of law, because the Income Tax Appellate Tribunal (in short 'ITAT') followed the decision rendered by it on 05.01.2007, (which is the subject matter of ITA No. 1108/2007).

3. The assessee is engaged in the business of software development and was accorded approval of the Reserve Bank of India (in short 'RBI') under the then prevailing Foreign Exchange Regulation Act, 1973 to establish a branch office in India: at Noida

and New Delhi, for development of software for export. It received approval for setting up of 100% Export Oriented Unit (EOU) under the Software Technology Park (STP) Scheme of the Central Government on 23.09.1999 for development of computer software; the software so developed by it is electronically transmitted to its head office, located abroad. In terms of the agreement between the assessee and its head office, the latter pays all direct and indirect cost for development of software with the mark up of 15% of such process.

4. The assessee had developed a software known as "Softex Form", and exported it through data communication links. It received consideration and furnished the relevant clarification which was accepted by the STPI authorities. It also received remittances from the head office towards the export/ transmission of such software. It reported a profit of Rs. 2,66,95,445/- for AY 2002-03 and filed a return seeking exemption under Section 10A of the Income Tax Act, 1961 (in short 'Act').

5. The Assessing Officer (AO) rejected the assessee's claim holding firstly its statement that it had sold software to its head office, was unacceptable because it and the head office were part of the same entity; and that, secondly, it merely provided services to the head office which reimbursed the costs to the assessee but with a nominal mark up. Importantly, the AO held that transfer of software in the circumstances of the case did not amount to its export.

6. The assessee had contended that its Indian branch constitutes a permanent establishment (PE) of its foreign office and the profits

were attributable to its business carried out in India and were taxable under the several provisions of the Act. The assessee had claimed that by virtue of the existing Double Taxation Avoidance Agreement (in short 'DTAA'), it could seek benefits to the extent that the DTAA's provisions apply. It also relied upon Article 7(1) of the DTAA. The AO's reasoning was premised *inter alia* on the basis that Section 10A was introduced with the objective of encouraging foreign exchange accruals and earnings in India. It was therefore held that what the assessee received was mere remuneration (on man hour basis) for the development of software and not proceeds of the software when sold by the head office. The AO further noted that the assessee remitted back its profits to the head office in foreign currency and that by this reason the objective for introducing Section 10A was defeated. The AO crucially referred to *explanation* 2 to Section 80HHC which provides that where goods and merchandise are transferred by a unit to a branch office, warehouse or other establishment situated outside India, and thereafter sold, such transfer shall be deemed to be export. The absence of a similar provision in Section 10A was held to be an adverse circumstance which precluded the treatment of the transfer of computer software in this case as export.

7. The Commissioner of Income Tax (Appeals) [CIT(A)], on being approached by the assessee, upheld the AO's order. In was in these circumstances an appeal was instituted before the ITAT.

8. The ITAT in its impugned order took note of the transaction and analysed Section 10A(7) of the Act and its inter-relationship with

Section 80-IA (8). The ITAT inter alia concluded as follows:

> *"....13. In the present case there is no dispute that the asseseee developed "Computer Software" and transmitted electronically to its head office. The assessee is an approved 100% export oriented unit for development of computer software duly approved by the STP of India. The export of software during the previous year is evidenced by the Softex form duly certified by the competent officer of STPI. The consideration has been received by the assessee in the form of convertible foreign exchange. The only reason assigned by the Revenue authorities for denying exemption under Section 10-A of the Act is that there has been no export sale by the assessee since the computer software was transmitted to head office and since the assessee and its head office were one entity, there was no sale to any third party. This approach of the Revenue authorities were not correct in view of the provisions of section 10-A(7) of the Act. The legal fiction of treating an assessee as a separate entity vis-a-vis sale by it or transfer by it from an eligible business or to an eligible business has been recognized under section 10-A(7) of the Act....."*

9. Arguing for the Revenue, Mr. Rahul Chaudhury, the learned counsel contends that the absence of a provision similar to *explanation* 2 to Section 80HHC(8) implies that intent of the Parliament was to exclude the kind of transaction which the assessee had undertaken. Urging this Court to accept the reasoning of the AO, the learned counsel also relied upon *explanation* 2(iv) to Section 10A and said that like Section 80HHC, the expanded definition extended only to export and import turnover profit of one kind of transaction i.e. on-site development of software and provision of services. The absence of this provision akin to Section 80HHC in Section 10A,

therefore, meant that for a transfer from a branch office to head office with a nominal mark up cannot be treated as export for the purposes of Section 10A. The learned counsel stated that although initially this Court had agreed and confirmed the findings of the ITAT in another decision i.e. ***Commissioner of Income Tax, Delhi-II vs. Moser Baer India Ltd. 177 Taxman 42 (Del)*** the reasoning there can be distinguished by the fact that the transfer of software involved was not between the branch and head office.

10. Mr. Balbir Singh, the learned senior counsel appearing for the assessee contends that the purpose of engrafting, by incorporation, as it were Section 80-IA(8) into the regime of Section 10A deduction through sub-Section (8) would be defeated if the Revenue's arguments are to be accepted. It is submitted that the entire machinery of calculation of consideration for such transfer/ import by reference is premised upon the acceptance by the legislature of such transfers or transactions as exports. Therefore, no interpretation which goes contrary to that intent would in fact render the provision i.e. Section 10A(7) as being ineffectual.

11. The decision in ***Moser Baer*** (supra) specifically dealt with the ITAT's logic and reasoning in the present case. There the Division Bench of this Court noted that transmission of computer software from an Indian entity to its head office on the basis of an arm's length price determined for export entitled the assessee to exemption under Section 10A. The Court is in agreement with the assessee's contention that mere omission of a provision akin to Section 80HHC Explanation (2) or the omission to make a provision of a similar kind

that encompasses *explanation* 2(iv) to Section 10A by itself does not rule out the possibility of treatment of transfer/ transmission of software from the branch office to the head office as an export. A plain reading of Section 80-IA(8) shows that transfer of any goods or service "for the purpose of the eligible business" to "any other business carried on by the assessee", are covered. The only condition insisted upon by the Parliament was that the face value of such transactions was inconclusive and that the AO could determine the market value: for such transactions or sales. The incorporation in its entirety without any change in this provision [Section 80-IA(8)] to Section 10A through sub-Section (7) is for the purpose of ensuring that inter-branch transfers involving exports are treated as such as long as the other ingredients for a sale are satisfied.

12. In this case the AO carried out the exercise mandated by Section 10A(7) read with Section 80-IA(8). Consequently the particulars of the price or cost reported by the assessee were not binding or conclusive but rather they attained finality in the assessment proceedings, after due addition. It underwent further inquiry/ scrutiny under Chapter X of the Act.

13 It is undoubtedly aphorism that a legal fiction ought to be taken to its logical conclusion and the mind should not be allowed to boggle. This merely implies that a fiction should logically take a direction; the train of thought however cannot divert elsewhere. The absence of a "deemed export" provision in Section 10A similar to the one in Section 80HHC does not logically undercut the amplitude of the expression "transfer of goods" under Section 80-IA(8) – which is

now part of Section 10A. Such an interpretation would defeat Section 10A(7) entirely.

14. For the above reasons, the Court is of the opinion that substantial questions of law framed are to be answered in favour of the assessee and against the Revenue. The ITA Nos. 1108/2007, 1249/2009 and 173/2016 are, accordingly, dismissed. It is clarified, however, that the AO is at liberty to give tax effect as a consequence of the interpretation adopted by this Court.

S. RAVINDRA BHAT, J

NAJMI WAZIRI, J

NOVEMBER 09, 2016/kk