

TP Alert: Income enhanced under Advance Pricing Agreement eligible for deduction under section 10A – Pune ITAT

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Summary

The Pune bench of the Income tax Appellate Tribunal (ITAT) has, in a recent case¹, held that deduction under section 10A (tax deduction on newly established undertakings in free trade zone, etc.) of the Income-tax Act, 1961 (Act) is available on additional income reported in accordance with a concluded Advance Pricing Agreement (APA) provided the taxpayer satisfies the prescribed conditions for availing the deduction.

Facts of the case

- During assessment year (AY) 2010-11, the taxpayer provided information technology (IT) enabled design engineering services to its associated enterprise (AE) on a cost plus mark-up basis.
- During scrutiny, the tax officer referred the case to the transfer pricing officer (TPO). The TPO made an adjustment to the total income of the assessee and ultimately the case reached the ITAT.
- Meanwhile, the taxpayer entered into an APA with the Central Board of Direct Taxes (CBDT), wherein transactional net margin method (TNMM) was selected as the most appropriate method for benchmarking related party transactions and a mark-up of 17% was agreed for the services provided to the AE.
- Since AY 2010-11 was part of the rollback application of the APA, the taxpayer filed a modified return taking into account the increased profit mark-up of 17%, which resulted in increased income. The taxpayer claimed deduction under section 10A of the Act

on the increased income in the modified return.

- The tax officer disallowed the deduction on the ground that modification of return was permissible only to the extent stipulated in the APA and the APA in question did not provide for such deduction.

Contentions of revenue before the ITAT

- The modified return cannot breach the mandate of the APA, the scope of which is restricted to determination of arm's length price (ALP).
- Claim for deduction is denied on following grounds:
 - Deduction on enhanced income is not allowed as per provisions of the Act².
 - Prescribed condition (of section 10A) of bringing the sale proceeds in India within six months from the end of the relevant previous year not fulfilled.

¹ Dar Al Handasah Consultants vs DCIT (ITA No.1413/PUN/2019)

² Section 92C(4)

Questions before the ITAT and its ruling

Whether provisions¹ debar deduction under section 10A on additional income?

ITAT ruling: The ITAT noted the provisions and observed that deduction is not allowed if total income has been computed³ and enhanced due to **computation by the tax officer or TPO.**

The ITAT, thus, held that since in the instant case the incremental income is offered by the taxpayer in the modified return in accordance with the APA, the same cannot be said to have fulfilled the aforementioned requirement for denying the deduction.

Whether deduction on enhanced income under section 10A can be granted in the modified return?

ITAT ruling: The ITAT referred to the provisions⁴ of the Act and observed that the modified return replaces the original return filed by the taxpayer and all other provisions of the Act apply to the modified return as if it was the original return. Thus, the ITAT held that the taxpayer would be eligible for deduction on enhanced income in the modified return.

Whether the taxpayer has satisfied the conditions of deduction u/s 10A?

ITAT ruling: On perusal of the APA entered into between the taxpayer and the CBDT, the ITAT noted that one of the conditions for the APA was

that the additional income realised by the taxpayer should be billed and collected in the month following the month in which the APA is signed.⁵

The ITAT then referred to the provisions⁶ of the Act and observed that while section 10A provides that sale proceeds should be brought in India in convertible foreign exchange within six months from the end of the previous year⁷, provisions related to modified return provide that if an APA contains a clause departing from the normal provisions, APA shall prevail over normal provisions.

The ITAT, thus, held that in the instant case, since the taxpayer has realised payment within a month from the APA, it would be eligible for deduction under section 10A.

Our comments

This decision benefits the taxpayers and confirms that deduction under section 10A can be availed if the additional income is billed and collected within the timeframe mentioned in the APA.

³ Under section 92C(4)/92CA(4)

⁴ Section 92CD(2)

⁵ Even though Section 92CD(1) provides a time of three months for filing the modified return, the clause inserted by CBDT was to only let the taxpayer avail relevant deductions connected with the realization of foreign exchange.

⁶ Section 10A(3) read with Section 92CD

⁷ or within such further period as the Competent authority may allow. Competent authority refers to any authority authorised for regulating payments and dealings in foreign exchange.

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