IN THE INCOME TAX APPELLATE TRIBUNAL

"C" BENCH : BANGALORE

BEFORE SHRI B.R. BASKARAN, ACCOUNTANT MEMBER AND

SHRI PAVAN KUMAR GADALE, JUDICIAL MEMBER

ITA No. 801/Bang/2016
Assessment Year : 2011-12

M/s. Microfinish Pumps Private Limited, Special Plot, Industrial Estate, Gokul Road, Hubli – 580 030. **PAN: AABCM5152B**	vs.	The Assistant Commissioner of Income Tax, Circle – 2 (1), Hubli.
APPELLANT		RESPONDENT

Assessee by	:	Shri Ravishankar S.V, Advocate
Revenue by	:	Dr. P.V. Pradeep Kumar, Addl. CIT (DR)

Date of hearing	:	28.03.2019
Date of Pronouncement	:	30.04.2019

O R D E R

Per Shri Pavan Kumar Gadale, Judicial Member

The assessee has filed an appeal against the order of CIT(A), Hubli passed u/s. 143(3) and 250 of IT Act dated 30.12.2015.

2. The assessee has raised the following grounds of appeal.

"*Being aggrieved by the order passed by the Learned Commissioner of Income-tax (Appeals), Hubli, {hereinafter referred to as "the CIT(A)"} your Appellant submits, among others, following grounds for your sympathetic consideration :-*

1. Ld. CIT(A) erred in confirming and not deleting disallowance of Rs. 4,86,000/- u/s 40(a)(i) of the Act.

2. Ld. CIT(A) erred in confirming disallowance of Rs. 5,47,627/- being income received from venture capital fund.

3. Ld. CIT(A) erred in confirming disallowance of Rs. 1,95,493/- under Section 14A read with Rule 8D.

4. Ld. CIT(A) further erred in confirming addition of Rs. 1,917/- made

by AO based on reconciliation difference between books and report in 26AS.

The Appellant craves leave to add to, alter or amend any of the grounds of appeal."

3. Brief facts of the case are the assessee is engaged in the manufacture of engineering goods and filed the return of income on 29.09.2011 disclosing total income of Rs. 10,05,10,019/- and the Return of income was processed u/s. 143(1) and subsequently the case was selected for scrutiny and notice u/s. 143(2) of the Act was issued and ld. AR of assessee appeared and produced Books of account and other details. The Assessing Officer on verification of the financial statements and P&L account found that the assessee has paid fees for professional and technical services to non-resident M/s. Intelliquip LLC, USA without deduction of TDS and the Assessing Officer applied the provisions of section 40(a)(i) of the Act. The assessee filed explanations on 29.01.2014 and on 13.03.2014 referred at page nos. 2 to 5 of the assessment order. The AO was not satisfied with the submissions for non-deduction of tax and referred to the provisions of section 195 of the Act and DTAA and other relevant provisions and made disallowance of fees. Similarly the assessee has received Rs. 5,47,627/- from investment made in Venture Capital Fund viz. Indiareit Fund and claimed exempt u/s. 10(23FB) and the assessee has filed the letter dated 29.01.2014. Whereas the Assessing Officer is not satisfied with the explanations and dealt on the provisions and brought to tax Rs. 5,47,627/-.

4. In the course of hearing, the assessee filed letter dated 13.03.2014 and explanations that there are no borrowed funds used for the purpose of investments. But the Assessing Officer is of the considered opinion that investments cannot be made without expenditure and applying the provisions u/s. 14A Rule 8D worked out the disallowance of Rs. 1,95,493/- and with other addition of Rs. 1,917/- due to difference in the reconciliation of details furnished in connection with interest receipts as per 26AS and the interest accounted in the Books of account and assessed total income of Rs. 10,17,41,056/- and passed the order u/s. 143(3) dated 17.03.2014.

Whereas aggrieved by the order the assessee filed an appeal before the CIT(A) and CIT(A) having considered the grounds of appeal and submissions and finding of AO dealt on the issues independently and confirmed all the additions made by the AO and dismissed the appeal.

5. Aggrieved by the order, the assessee filed an appeal with the Tribunal. Before us, the ld. AR of assessee appeared in respect of disallowance of payment made to non-residents of Rs. 4,86,000/-, the ld. AR of assessee emphasized that the provisions of section 40(a)(i) does not apply as the payment are covered by section 90(2) of the Act and DTAA. Hence no TDS is required and also there is no need to obtain a certificate from the Assessing Officer under provisions of section 195(2) of the Act. The ld. AR of assessee supported his arguments in Paper Book with the invoices in respect of payments made outside the country. On the second issue of disallowance of income of Rs. 5,47,627/- received from Venture Capital Fund, the ld. AR of assessee submitted that the income from Venture Capital Fund is exempted u/s. 10(23FB) and the Annual Report of the assessee company disclosed these facts. The ld. AR of assessee submitted that the lower authorities failed to appreciate that the fund itself is taxed in the same manner and to the same extent as to the beneficiaries and there is no liability in the hands of the investor. Whereas in respect of disallowance u/s. 14A made by the Assessing Officer the assessee has not incurred any expenditure for earning such dividend income and no establishment expenditure is incurred for managing investments and in respect of difference is reconciliation as per Form 26AS and as per books of account the ld. AR of assessee submitted that the assessee has accounted the interest income based on the bank certificate and prayed for allowing the appeal.

6. Contra, the ld. DR of the revenue supported the orders of CIT(A) and referred to the findings of CIT(A) at page no. 4 of the order in respect of disallowance for non-deduction of TDS on payments to non-residents and supported the orders of the lower authorities.

7. We heard the rival submissions and perused the record. On the first disputed issue of disallowance u/s. 40(a)(ia) for non-deduction of TDS, the ld. AR of assessee made submissions that the assessee company has selected Intelliquip LLC to develop software for selection of pumps and the non-resident company has developed similar software for US and other European companies which are working satisfactorily. The software takes into consideration all the variables and gives many options for final selection based on parameters and usage of the software help the assessee company able to select the pump which is faster, accurate and optimum and payment of Rs. 4,86,000/- to Intelliquip LLC is towards quarterly subscription fees of USD 2700 per quarter for accessing the server of Intelliqip for the pump data as explained. The ld. AR of assessee demonstrated his stand by referring to the invoices at page nos. 37 to 40 of the paper book where the payments are in the nature of subscription fee by Intelliquip in its bills and cannot be categorized as fees and such payment paid for accessing and using the software developed by the said party for selecting the pump data which could have been done manually by the as on its own but the manual selection of data requires more time. The ld. AR of assessee referred to the Article 12 of DTAA between India and USA in respect of Royalties and Fees for Included Services arising in a contracting State (India) and paid to a resident of the other Contracting State [USA] and as per clause 2 of the Article, the said payments may also be taxed in the contracting state at certain prescribed rates provided the nature of payment falls into the said category. Therefore the payments is not in the nature of fees including services is covered under Article 12 of DTAA and same falls under Article 7 as business profit and Intelliquip non-resident company does not have any permanent establishment in India and therefore it is not taxable in India. We consider the submissions and facts of the case and of the substantiate opinion that the payments made by the assessee are in the nature of subscription fees and on verifying the invoices demonstrated by the ld. AR of assessee. Prima facie the payment is for the usage of data by the assessee. Therefore we are of the opinion that the payments as discussed in the above paragraphs is non-taxable in India and therefore no TDS is deducted and in the nature of

subscription, therefore we set aside the order of CIT(A) on this ground and direct the Assessing Officer to delete the addition.

8. On the second disputed issue of taxing the income from Venture Capital Fund u/s. 10(23FB), we found that assessee has made investment in a Venture Capital Fund. During the year the assessee received Rs. 5,47,627/- towards investment from said fund and claimed exempt u/s. 10(23FB) and we considered necessary to refer to the provisions of section 115U of the Act and the provisions of section 10(23FB) which are as under.

> "***Tax on income in certain cases.***
>
> ***115U.*** *(1) Notwithstanding anything contained in any other provisions of this Act, any income accruing or arising to or received by a person out of investments made in a venture capital company or venture capital fund shall be chargeable to income-tax in the same manner as if it were the income accruing or arising to or received by such person had he made investments directly in the venture capital undertaking.*
>
> *(2) The person responsible for crediting or making payment of the income on behalf of a venture capital company or a venture capital fund and the venture capital company or venture capital fund shall furnish, within such time as may be prescribed, to the person who is liable to tax in respect of such income and to the prescribed income-tax authority, a statement in the prescribed form and verified in the prescribed manner, giving details of the nature of the income paid or credited during the previous year and such other relevant details as may be prescribed.*
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> *(3) The income paid or credited by the venture capital company and the venture capital fund shall be deemed to be of the same nature and in the same proportion in the hands of the person referred to in sub-section (1) as it had been received by, or had accrued or arisen to, the venture capital company or the venture capital fund, as the case may be, during the previous year.*
>
> *(4) The provisions of Chapter XII-D or Chapter XII-E or Chapter XVII-B shall not apply to the income paid by a venture capital company or venture capital fund under this Chapter.*
>
> *(5) The income accruing or arising to or received by the venture capital company or venture capital fund, during a previous year, from investments made in venture capital undertaking if not paid or credited to the person referred to in sub-section (1), shall be deemed to have been credited to the account of the said person on the last day of the previous year in the same proportion in which such person would have been entitled to receive the income had it been paid in the previous year.*
>
> *(6) Nothing contained in this Chapter shall apply in respect of any income, of a previous year relevant to the assessment year beginning on or after the 1st day of April, 2016, accruing or arising to, or received*

by, a person from investments made in a venture capital company or venture capital fund, being an investment fund specified in clause (a) of the Explanation 1 to section 115UB.

Explanation 1.—For the purposes of this Chapter, "venture capital company", "venture capital fund" and "venture capital undertaking" shall have the meanings respectively assigned to them in clause (23FB) of section 10.

Explanation 2.—For the removal of doubts, it is hereby declared that any income which has been included in total income of the person referred to in sub-section (1) in a previous year, on account of it having accrued or arisen in the said previous year, shall not be included in the total income of such person in the previous year in which such income is actually paid to him by the venture capital company or the venture capital fund.

"***(10)(23FB)*** *any income of a venture capital company or venture capital fund from investment in a venture capital undertaking :*

Provided *that nothing contained in this clause shall apply in respect of any income of a venture capital company or venture capital fund, being an investment fund specified in clause (a) of the Explanation 1 to section 115UB, of the previous year relevant to the assessment year beginning on or after the 1st day of April, 2016.*

Explanation.—For the purposes of this clause,—

(a) "venture capital company" means a company which—

(A) has been granted a certificate of registration, before the 21st day of May, 2012, as a Venture Capital Fund and is regulated under the Securities and Exchange Board of India (Venture Capital Funds) Regulations, 1996 (hereinafter referred to as the Venture Capital Funds Regulations) made under the Securities and Exchange Board of India Act, 1992 (15 of 1992); or

(B) has been granted a certificate of registration as Venture Capital Fund as a sub-category of Category I Alternative Investment Fund and is regulated under the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012 (hereinafter referred to as the Alternative Investment Funds Regulations) made under the Securities and Exchange Board of India Act, 1992 (15 of 1992), and which fulfils the following conditions, namely:—

(i) it is not listed on a recognised stock exchange;

(ii) it has invested not less than two-thirds of its investible funds in unlisted equity shares or equity linked instruments of venture capital undertaking; and

(iii) it has not invested in any venture capital undertaking in which its director or a substantial shareholder (being a beneficial owner of equity shares exceeding ten per cent of its equity share capital) holds, either individually or collectively, equity shares in excess of fifteen per cent of the paid-up equity share capital of such venture capital undertaking;

(b) "venture capital fund" means a fund—

(A) operating under a trust deed registered under the provisions of the Registration Act, 1908 (16 of 1908), which—

(I) has been granted a certificate of registration, before the 21st day of May, 2012, as a Venture Capital Fund and is regulated under the Venture Capital Funds Regulations; or

(II) has been granted a certificate of registration as Venture Capital Fund as a sub-category of Category I Alternative Investment Fund under the Alternative Investment Funds Regulations and which fulfils the following conditions, namely:—

(i) it has invested not less than two-thirds of its investible funds in unlisted equity shares or equity linked instruments of venture capital undertaking;

(ii) it has not invested in any venture capital undertaking in which its trustee or the settler holds, either individually or collectively, equity shares in excess of fifteen per cent of the paid-up equity share capital of such venture capital undertaking; and

(iii) the units, if any, issued by it are not listed in any recognised stock exchange; or

(B) operating as a venture capital scheme made by the Unit Trust of India established under the Unit Trust of India Act, 1963 (52 of 1963);

(c) "venture capital undertaking" means—

(i) a venture capital undertaking as defined in clause (n) of regulation 2 of the Venture Capital Funds Regulations; or

(ii) a venture capital undertaking as defined in clause (aa) of sub-regulation (1) of regulation 2 of the Alternative Investment Funds Regulations;

(23FBA) any income of an investment fund other than the income chargeable under the head "Profits and gains of business or profession";

(23FBB) any income referred to in section 115UB, accruing or arising to, or received by, a unit holder of an investment fund, being that proportion of income which is of the same nature as income chargeable under the head "Profits and gains of business or profession".

Explanation.—For the purposes of clauses (23FBA)and (23FBB), the expression "investment fund" shall have the meaning assigned to it in clause (a) of the Explanation 1 to section 115UB;"

9. While reading the provisions, we found that the income received from the Venture Capital Fund is exempted. We found that the assessee has made investments into the Venture Capital fund and received profits which are exempted. The ld. CIT(A) though considered the aspects of Joint venture but dealt only on the findings of the Assessing Officer by treating the same as

income of the assessee and the observations of the ld. CIT(A) that the assessee could not satisfy with evidence i.e. how the assessee is entitled to claim exemption; Even before us the assessee has not filed any information in respect of investment made in Joint Venture and no material filed, we found that this issue has to be verified and examined and accordingly we restore this issue for limited purpose to the file of Assessing Officer and allow the ground of appeal for statistical purposes.

10. In respect of disallowance u/s. 14A of the Act, the ld. AR of assessee submitted that the assessee has total investments of Rs. 4,89,18,387/- out of which Rs. 4,89,07,787/- are investments which yielded dividend income and exempted from tax. The assessee has made investment in shares in Flowserve Microfinish Pumps Pvt Ltd. The assessee has not borrowed the funds for making investments and such investments are out of the internal accruals. The contentions of the ld. AR of assessee that the assessee has Reserves of Rs. 49.87 Crores as on 31.03.2011 and the investments in shares yielded only dividend income. Hence there is no disallowance as no expenditure was incurred for earning such income. The ld. AR of assessee relied on the decision of the Hon'ble Karnataka High Court rendered in the case of Pragathi Krishna Gramin Bank Vs. JCIT as reported in [2018] 95 taxmann.com 41 (Karnataka) which reads as under.

> "*Section 14A of the Income-tax Act, 1961, read with Rule 8D of the Income-Tax Rules, 1962 - Expenditure incurred in relation to income not includible in total income (Conditions precedents) - Assessment years 2011-12 and 2012-13 - Whether expenditure for earning exempted income has to have reasonable proportion to exempted income - Held, yes - Whether thus, where Assessing Authority as well as Appellate Authority disallowed expenses incurred by assessee bank in earning exempt income in excess to actual exempt income, same was per se absurd and hypothetical and therefore, matter was to be remanded back to Assessing Authority - Held, yes [Para 15] [Matter remanded/in favour of assessee]*"

11. We find that disallowance u/s. 14A r.w. Rule 8D as per the ratio of decision shall be on a reasonable proportion to exempted income and we restore this issue to the file of AO to recompute the disallowance after verification of

details and accordingly the ground of appeal is allowed for statistical purposes.

12. The last disputed issue of disallowance of Rs. 1,917/-, we found that the assessee could produce any new evidence in regard to the difference in Form 26AS. Accordingly, we confirm the action of the CIT(A) and dismiss this ground of appeal of the assessee

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

Order pronounced in the open court on the date mentioned on the caption page.

Sd/-	Sd/-
(B.R. BASKARAN)	(PAVAN KUMAR GADALE)
Accountant Member	Judicial Member

Bangalore,
Dated, the 30th April, 2019.
/MS/

Copy to:

1. Appellant	4. CIT(A)
2. Respondent	5. DR, ITAT, Bangalore
3. CIT	6. Guard file

By order

Assistant Registrar,
Income Tax Appellate Tribunal,
Bangalore.