

Income earned by taxpayer through 'on-site' software development work eligible for exemption under section 10A

September 9, 2015

In brief

In a recent decision, the Karnataka High Court (HC) held that exemption under section 10A of the Income-tax Act, 1961 (the Act) was available even if the onsite activities were sub-contracted to an Associated Enterprise (AE) abroad.

In detail

Facts

- The taxpayer¹ was engaged in the business of software development and rendering business process outsourcing services. The taxpayer was a Software Technology Park of India unit (STPI unit), eligible to claim exemption under section 10A.
- The taxpayer had sub-contracted on-site development of software work to its AE abroad while the balance software development work (off-shore work) was carried out by the taxpayer from India.
- The tax officer (TO) denied the exemption claimed by the taxpayer to the extent of the 'on-site' work sub-contracted to the AE.
- On appeal, the Commissioner of Income-

tax (Appeals) (CIT (A)) upheld the TO's order.

- The Income-tax Appellate Tribunal (Tribunal) accepted the taxpayer's claim and allowed exemption under section 10A as claimed.

Proceedings before the HC

Revenue's Contentions

- The taxpayer would not be entitled to exemption under section 10A on income earned from 'on-site' development of software as the work was not carried out by the taxpayer through its personnel. The taxpayer only carried out overall supervision and control of the 'on-site' work.
- Reliance was placed on Circular No. 694 dated 23 November 1994 and Circular dated 17 January 2013 issued by the Central Board of Direct Taxes (CBDT).

- The conditions laid down under section 10A(2) were not satisfied as production of 'on-site' work was not done in a free trade zone, and the work was sub-contracted to an AE abroad.
- The conditions of section 10A need to be strictly construed to claim the benefit.

Taxpayer's Contentions

- The Revenue's assumption that no work under the contract was performed in India was misplaced. The TO had verified and accepted the fact that off-shore work was performed in India.
- The object of introducing section 10A was to encourage exports for generating foreign

¹ TS-497-HC-2015(Karnataka)

exchange. Both 'off-shore' as well as 'on-site' work generated foreign exchange for the country, and hence, the purpose of section 10A would not be defeated by allowing a deduction in respect of these activities.

- The circulars referred to by the Revenue did not mention that the work needed to be carried out by the taxpayer's personnel.
- The provision had to be construed beneficially where conditions provided in section 10A were satisfied.
- Reference was made to Explanation 3 to section 10A which extended the benefit of section 10A exemption to profits derived from 'on-site' development of software outside India

High Court ruling

- The HC accepted the taxpayer's arguments that 'off-shore' work was carried on by it in India and 'on-site' work was undertaken under its supervision and control. The taxpayer had the right to

reject the AE's work that did not conform to specifications agreed under the contract.

- It was wrong to deny benefit under section 10A merely because the 'on-site' work was not done by the taxpayer's personnel.
- The circulars relied on by the Revenue did not specify that the taxpayer's personnel had to be deputed for carrying out the 'on-site' work.
- Explanation 3 enlarged the scope of section 10A to include profits derived from 'on-site' development of software. The HC held that if the Revenue's contention (conditions of section 10A (2) not being satisfied) was accepted, the purpose of inserting Explanation 3 would be defeated.
- As the AE had carried out activities on behalf of the taxpayer (and had no direct dealing with the ultimate customer), it could not be said that there was no nexus between 'off-shore' and 'on-site' development of software.

The takeaways

This judgment of the Karnataka High Court would be useful to companies who have been denied a tax holiday for work sub-contracted outside India.

Companies with units in a Special Economic Zone (SEZ) claiming deduction under section 10AA could also evaluate applicability based on individual facts.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

Tax & Regulatory Services – Direct Tax

Gautam Mehra, *Mumbai*
+91-22 6689 1154
gautam.mehra@in.pwc.com

Rahul Garg, *Gurgaon*
+91-124 330 6515
rahul.garg@in.pwc.com

Kaushik Mukerjee, *Bangalore*
+91-80 4079 6051
kaushik.mukerjee@in.pwc.com

Our Offices

Ahmedabad

President Plaza
1st Floor Plot No 36
Opp Muktidham Derasar
Thaltej Cross Road, SG Highway
Ahmedabad, Gujarat 380054
+91-79 3091 7000

Bangalore

6th Floor
Millenia Tower 'D'
1 & 2, Murphy Road, Ulsoor,
Bangalore 560 008
Phone +91-80 4079 7000

Chennai

8th Floor
Prestige Palladium Bayan
129-140 Greams Road
Chennai 600 006
+91 44 4228 5000

Hyderabad

Plot no. 77/A, 8-2-624/A/1, 4th
Floor, Road No. 10, Banjara Hills,
Hyderabad – 500034,
Andhra Pradesh
Phone +91-40 44246000

Kolkata

56 & 57, Block DN.
Ground Floor, A- Wing
Sector - V, Salt Lake
Kolkata - 700 091, West Bengal
+91-033 2357 9101/
4400 1111

Mumbai

PwC House
Plot No. 18A,
Guru Nanak Road (Station Road),
Bandra (West), Mumbai - 400 050
+91-22 6689 1000

Gurgaon

Building No. 10, Tower - C
17th & 18th Floor,
DLF Cyber City, Gurgaon
Haryana -122002
+91-124 330 6000

Pune

7th Floor, Tower A - Wing 1,
Business Bay, Airport Road,
Yerwada, Pune – 411 006+91-20
4100 4444

For more information

Contact us at
pwctr.knowledgemanagement@in.pwc.com

About PwC

PwC helps organisations and individuals create the value they're looking for. We're a network of firms in 157 countries with more than 195,000 people who are committed to delivering quality in Assurance, Tax and Advisory services.

PwC India refers to the network of PwC firms in India, having offices in: Ahmedabad, Bangalore, Chennai, Delhi NCR, Hyderabad, Kolkata, Mumbai and Pune. For more information about PwC India's service offerings, please visit www.pwc.in.

*PwC refers to PwC India and may sometimes refer to the PwC network. Each member firm is a separate legal entity. Please see www.pwc.com/structure for further details. Tell us what matters to you and find out more by visiting us at www.pwc.in



For private circulation only

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PwCPL, its members, employees and agents accept no liability, and disclaim all responsibility, for the consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it. Without prior permission of PwCPL, this publication may not be quoted in whole or in part or otherwise referred to in any documents.

© 2015 PricewaterhouseCoopers Private Limited. All rights reserved. In this document, "PwC" refers to PricewaterhouseCoopers Private Limited (a limited liability company in India having Corporate Identity Number or CIN : U74140WB1983PTC036093), which is a member firm of PricewaterhouseCoopers International Limited (PwCIL), each member firm of which is a separate legal entity.