

**IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCH "K", MUMBAI**

**BEFORE SHRI G.S. PANNU, ACCOUNTANT MEMBER AND
SHRI AMARJIT SINGH, JUDICIAL MEMBER**

ITA NO. 1145/MUM/2014 : (A.Y : 2009-10)

M/s. Agilisys IT Services India Pvt. Ltd., 201-202, Windfall, Sahar Plaza Complex, J.B. Nagar, M.V. Road, Andheri (E), Mumbai 400 059 (Appellant)
PAN : AABCN0192Q

Vs. ITO-9(2)(3), Mumbai
(Respondent)

ITA NO. 1136/MUM/2014 : (A.Y : 2009-10)

DCIT-9(1), Mumbai
(Appellant)

Vs. M/s. Agilisys IT Services India Pvt. Ltd., 201-202, Windfall, Sahar Plaza Complex, J.B. Nagar, M.V. Road, Andheri (E), Mumbai 400 059 (Respondent)
PAN : AABCN0192Q

**Assessee by : Shri Ronak Doshi
Revenue by : Shri N.K. Chand &
Shri Mohammed Rizwan**

Date of Hearing : 21/10/2016

Date of Pronouncement : 31/10/2016

ORDER

PER G.S. PANNU, AM :

These are cross-appeals filed by the assessee and the Revenue against the order of CIT(A)-15, Mumbai dated 02.12.2013, pertaining to

the Assessment Year 2009-10, which in turn has arisen from the order passed by the Assessing Officer dated 30.12.2011 under section 143(3) of the Income Tax Act, 1961 (in short 'the Act').

2. The Grounds of appeal raised by the assessee and Revenue in their respective appeals are as under :-

ITA No. 1145/Mum/2014 (Assessee's appeal)

*"GROUND 1 : ADDITION ON ACCOUNT OF ARM'S LENGTH ADJUSTMENT
RS.15,82,891/-*

1. *On the facts and in circumstances of the case and in law, the Id. CIT(A) erred in confirming the action of Income-tax officer – 9(2)(3) ["the AO"] by treating the outstanding debtors balance as at the year end as an 'international transaction' u/s 92B and thereby computed arms length price u/s 92C(3) by making addition of notional interest.*
2. *The Id. CIT(A) failed to appreciate and ought to have held that the continuing debit balance with Associated Enterprises ("AE") does not constitute an "international transaction" as defined u/s 92B of the Act.*
3. *Without prejudice, since the Appellant does not have practice of charging interest on overdue payments from third party, there is no requirement for charging the same to the AE.*
4. *Without prejudice, the Id. CIT(A) failed to appreciate and ought to have held that even if the outstanding receivable constitute an 'international transaction', after reducing the adjustment as a percentage of turnover, still the margin of Appellant are more than comparables and hence, no further addition is called for u/s 92C(3) of the Act.*

5. *The Appellant humbly prays that the order of the Id. CIT(A) be set aside and the adjustment on account of arm's length price adjustment be deleted."*

ITA No. 1136/Mum/2014 (Revenue's appeal)

- "1. *Whether on the facts and in the circumstances of the case and in law, the Id. CIT(A) was right in directing the assessing officer to workout interest in respect of Arm's Length Adjustment as per Reserve Bank of India's Master Circular dated 01.07.2007 on external commercial Borrowing by adopting rate of interest 6 months LIBOUR plus 200 basis point on such delayed receivables as against the rate of interest adopted by the Assessing Officer at 7.00% being short term deposit rate as per State Bank of India ?*
2. *The appellant prays that the order of the CIT(A) on the grounds be set aside and that of the Assessing Officer be restored."*
3. As the aforesaid respective Grounds of appeal show, the singular dispute arises from an addition of Rs.15,82,891/- made by the Assessing Officer on account of notional interest on the outstanding debit balances with associated enterprises by treating the same as an 'international transaction' in terms of Sec. 92B of the Act. In other words, grievance of the assessee is that income-tax authorities have erred in treating the outstanding debtor balances as at the end of year as an 'international transaction' u/s 92B of the Act and thereby computing arm's length price adjustment u/s 92C(3) of the Act by making an addition of notional interest thereof.
4. Briefly put, the relevant facts are that the assessee is a company incorporated under the provisions of Companies Act, 1956 and is, *inter-*

alia, engaged in the business of software development services. For the Assessment Year 2009-10 it filed a return of income declaring total income of Rs.6,85,482/- under the normal provisions of the Act after claiming deduction u/s 10A of the Act amounting to Rs.1,63,23,157/- and it offered tax on book profit of Rs.1,49,18,266/- u/s 115JB of the Act since tax computed u/s 115JB of the Act was more than the tax computed under the normal provisions of the Act. Be that as it may, for the present purpose, we are concerned with an addition of Rs.15,82,891/- made by the Assessing Officer on account of notional interest on continuing debit balances of the associated enterprises. The facts relevant for the said controversy are as follows. Assessee is rendering software development services to its associated enterprises at cost + mark-up of 15% and it has been pointed out that revenue earned from the associated enterprises constitute more than 90% of its total revenue. The transaction of providing software development services to its associated enterprises was benchmarked by the assessee for determination of its arm's length price in terms of Sec. 92(1) of the Act on the basis of Transactional Net Margin Method (TNMM) at the entity level. The assessee had determined its entity level margin of 9.19% and after benchmarking it with the average margin of the comparables selected, the margins of assessee were found to be favourable and thus, assessee pointed out that the stated value of its international transaction of Provision of software development services to the associated enterprises was at an arm's length price. Notably, the average margin of the comparable concerns was computed at 3.53%. The aforesaid position canvassed by the assessee has not been disputed by the Assessing Officer. So however, the Assessing Officer noted that

assessee was having continuing debit balances of associated enterprises on which no interest was charged. The Assessing Officer notes that similar situation had prevailed in the earlier Assessment Year of 2008-09 wherein an addition of Rs.46,73,867/- was proposed by the then Transfer Pricing Officer (TPO) on this aspect. Considering the stand in the earlier Assessment Year of 2008-09, Assessing Officer computed an addition of Rs.15,82,891/- being interest chargeable on the continuing debit balances of the associated enterprises, calculated @ 7%, which was the short term deposit rate of State Bank of India. The aforesaid dispute was carried in appeal by the assessee before CIT(A) by making varied submissions. Firstly, the plea was that continuing debit balances with associated enterprises does not constitute 'international transaction' within the meaning of Sec. 92B of the Act and therefore no adjustment was necessitated; secondly, it was pointed out that the assessee-company does not have the practice of charging interest on overdue payments even from third parties and therefore there was no requirement of charging interest from the associated enterprises; and thirdly, that even if the outstanding debit balances due from associated enterprises is taken as an 'international transaction' within the meaning of Sec. 92B of the Act then, even after reducing the notional interest from the value of sales effected, the basic transaction of providing software development services to the associated enterprises remain at arm's length price and hence no addition was warranted separately on this count. The CIT(A) has disagreed with the assessee in principle, but has scaled down the addition. As per the CIT(A), the quantum of addition worked out by the Assessing Officer by applying 7% rate of interest, being the short term deposit rate of State Bank of India, was

wrong and instead, he directed that the adjustment be worked out by applying rate of interest of LIBOR + 200 basis points on the amount of delayed recovery of receivables from the associated enterprises. In this background, assessee as well as the Revenue are in appeal before us. The assessee, in its Grounds of appeal, has challenged the sustenance of part addition by CIT(A), whereas Revenue is in appeal challenging the action of CIT(A) in scaling down the addition. Since the cross-disputes relate to the same issue, they are being taken up together.

5. Insofar as appeal of Revenue is concerned, the grievance is against action of CIT(A) in holding that the arm's length rate of interest on the continuing debtor balances of associated enterprises be calculated by applying LIBOR + 200 basis points. The stand of Revenue on the other hand is that such interest be calculated by applying 7% rate of interest which is the short term deposit rate of State Bank of India. On this aspect, in our view, the decision of CIT(A) does not need any interference because even if it has to be held that the continuing debit balance is an 'international transaction' within the meaning of Sec. 92B of the Act, the impugned transaction cannot be construed as a domestic borrowing/advancing of money so as to be benchmarked on the basis of domestic bank lending rate. Therefore, in principle, the stand of CIT(A) on this aspect deserves to be upheld and does not require any interference.

6. Pertinently, the substantive dispute is in the appeal of assessee whereby it is canvassed that the impugned transaction reflected by the outstanding debit balances of the associated enterprises cannot be

construed as an 'international transaction' within the meaning of Sec. 92B of the Act. It has also been agitated in the appeal of assessee that there was no practice of charging interest on overdue payments from non-associated enterprises and, therefore, no adjustment is liable to be made on account of notional interest on outstanding receivables from associated enterprises. Another alternative plea that has been raised is to the effect that even if the overdue receivables from associated enterprises constitute an 'international transaction' within the meaning of Sec. 92B of the Act, if the margin of the assessee is calculated after reducing the notional interest, the resultant margin still compares favourably with the average margin of the comparables and no further addition is called for u/s 92C(3) of the Act.

7. The learned representative also brought out that in Assessment Year 2008-09 the Tribunal vide ITA No. 7755/Mum/2012 dated 8.10.2014 has deleted a similar addition on the ground that where there is a uniform policy of not charging interest to both associated enterprises and non-associated enterprises, no adjustment on account of notional interest on outstanding receivables of the associated enterprises is required to be made.

8. At the time of hearing, the learned representative for the assessee also furnished a working whereby it is shown that if the notional interest calculated on the outstanding receivables of associated enterprises is reduced from assessee's margin of 9.19%, the resultant margin compares favourably with the average margin of the comparables selected. In this context, the plea of assessee is that

without admitting that non-charging of interest on continuing debit balances of associated enterprises is an 'international transaction', the arm's length interest on such debit balances be adjusted/reduced from the assessee's margin of 9.19% and the resultant margin would also be favourable in comparison to the average margin of the comparables selected. It has been explained that assessee has given credit period of 45 days to its associated enterprises and with respect to the payments received beyond the credit period, the Assessing Officer had made the adjustment on account of notional interest. The assessee-company has given a working whereby it has adjusted its operating margin of 9.19% by such notional interest calculated either @ 7%, as done by the Assessing Officer, and/or at LIBOR + 200 basis points, as held by the CIT(A). In the former case, the entity level margin would reduce from 9.19% to 7.61% and in the latter case, the entity level margin would reduce from 9.19% to 7.25%. Thus, it is pointed out that in both the situations, the margin of assessee-company is much higher than the comparable concerns, i.e., 3.53% and, therefore, the transaction can be said to be at arm's length and no separate adjustment is required to be made on this count. We find that such a plea of assessee was very much before the Assessing Officer also, as is evident from a copy of communication dated 21.12.2011 addressed to the Assessing Officer, a copy whereof is placed at pages 43 to 46 of the Paper Book. At pages 47 to 49 of Paper Book, the working of notional interest on delayed payment from associated enterprises and also the working of operating profit to operating income of the assessee and the comparable concerns have been placed. The aforesaid material brings out the assertions of assessee that even if the outstanding receivables from the

associated enterprises constitute an 'international transaction', after reducing the adjustment on account of such notional interest out of its margin, the resultant margin of assessee is still more than that of the comparables thereby revealing that no further adjustment is required.

9. The Id. DR has not assailed the factual matrix asserted by the assessee with respect to the alternate plea though he has reiterated that the instant transaction is to be construed as an 'international transaction' within the meaning of Sec. 92B of the Act. In our considered opinion, without going into the controversy as to whether the overdue receivables from associated enterprises constitute an 'international transaction' within the meaning of Sec. 92B of the Act or not, the assessee deserves to succeed on its alternate plea. The aforesaid discussion clearly shows that after factoring in the notional interest calculated with respect to the overdue receivables from associated enterprises, the reduced margin of assessee is more than the average margin of the comparables selected thereby showing that no further adjustment is required to be made to the stated transactions. It is also quite clear that allowing of extended credit period to the associated enterprises is otherwise closely linked to the determination of sale price, which in-turn is the basis to arrive at the margins of the assessee. Thus, on the aforesaid limited aspect, we hold that the addition of Rs.15,82,891/- on account of notional interest chargeable on the outstanding debtors (associated enterprises) balances is not tenable and is directed to be deleted. Thus, assessee succeeds on this aspect.

10. In the result, appeal of assessee is partly allowed, as above.
11. Resultantly, whereas the appeal of Revenue is dismissed, that of the assessee is partly allowed.

Order pronounced in the open court on 31st October, 2016.

Sd/-

(AMARJIT SINGH)
JUDICIAL MEMBER

Sd/-

(G.S. PANNU)
ACCOUNTANT MEMBER

Mumbai, Date : 31st October, 2016

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Copy to :

- 1) The Appellant
- 2) The Respondent
- 3) The CIT(A) concerned
- 4) The CIT concerned
- 5) The D.R, "K" Bench, Mumbai
- 6) Guard file

By Order

Dy./Asstt. Registrar
I.T.A.T, Mumbai