IN THE INCOME TAX APPELLATE TRIBUNAL
"B" BENCH : BANGALORE

BEFORE SHRI ABRAHAM P. GEOGE, ACCOUNTANT MEMBER
AND SHRI VIJAY PAL RAO, JUDICIAL MEMBER

IT(TP)A No.1628/Bang/2014
Assessment year : 2010-11

The Deputy Commissioner of Income Tax, Circle 6(1)(2), Bangalore.	Vs.	M/s. Software AG Bangalore Technologies Pvt. Ltd., Exora Business Park, Wing B, 1st Floor, Electra, Marathahalli – Sarjapura Outer Ring Road, Bangalore – 560 103. **PAN:** AAACW 5438M
APPELLANT		RESPONDENT

CO No.72/Bang/2015 [in IT(TP)A No.1628/Bang/2014]
Assessment year : 2010-11

M/s. Software AG Bangalore Technologies Pvt. Ltd., Bangalore – 560 103. **PAN:** AAACW 5438M	Vs.	The Deputy Commissioner of Income Tax, Circle 6(1)(2), Bangalore.
CROSS OBJECTOR		RESPONDENT

Revenue by	:	Shri Saravanan, Jt. CIT(DR)
Assessee by	:	Shri Chavali Narayan, CA

Date of hearing	:	21.03.2016
Date of Pronouncement	:	31.03.2016

ORDER

Per Vijay Pal Rao, Judicial Member

This appeal by the Revenue and Cross Objection by the assessee are directed against the order dated 12.11.2014 of the CIT(Appeals)-IV, Bangalore for the assessment year 2010-11.

2. The Revenue has raised the following grounds:-

1. The order of the CIT (A) is opposed to law and the facts and circumstances of the case.

2. The CIT(A) erred in directing the AO to follow the ratio laid down by the Hon'ble Court in the case of Tata Elxsi Limited 349 ITR 98 and exclude the tele-communication expenses incurred in foreign currency from the total turnover also while computing the deduction u/s 10A of the I.T. Act, without appreciating the fact that there is no provision in Section 10A that such expenses should be reduced from the total turnover also, as clause(iv) of the explanation to Section 10A provides that such expenses are to be reduced only from the export turnover also.

3. The CIT(A) erred in not appreciating the fact that the jurisdictional High Court's decision in the case of Tata Elxsi Limited 349 ITR 98 has not been accepted by the department and an appeal has been filed before the Hon'ble Supreme Court.

4. The CIT (A) erred in law as well as on facts in holding that, as the working capital adjustment provided by the TPO has negative impact on adjusted margin, the assessee is entitled to risk adjustment as per prevailing norms, which shall be worked out by the TPO and granted to the assessee without appreciating that risk adjustment could not be allowed in the absence of specific difference in risk and its impact on profit margin when TP regulations in India are against making any assumptions in respect of any adjustments and such risk adjustment cannot be provided without making necessary assumptions.

5. For these and such other grounds that may be urged at the time of hearing, it is humbly prayed that the order of the CIT(A) be reversed and that of the Assessing Officer be restored.

6. The appellate craves to add, to alter, to amend or delete any of the grounds that may be urged at the time of hearing of the appeal.

3. Ground No.1 is general in nature and does not require any specific adjudication.

4. Ground Nos.2 & 3 are regarding exclusion of telecommunication expenses incurred in foreign currency from the export turnover as well as from total turnover.

5. We have heard the ld. DR and the ld. AR as well as considered the material on record. At the outset, we note that this issue is covered by the Hon'ble jurisdictional High Court in the case of ACIT v. Tata Elxsi Ltd., 349 ITR 49 [Karn], wherein the Hon'ble High Court has held as under:-

> "**10.** The Bombay High Court had an occasion to consider the meaning of the word 'total turnover' in the context of Section 10-A, in the case of *CIT* v. *Gem Plus Jewellery India Ltd.* [2011] 330 ITR 175 [2010] 194 Taxman 192 (Bom.). Interpreting sub-Section (4) of Section 10-A, it is held as under:

$$\text{Profits derived from export of articles or things or Computer software} = \frac{\text{Profits of the business of the undertaking} \times \text{Export turnover in respect of the articles or things or computer software}}{\text{Total turnover of the business carried on by the undertaking}}$$

> "Under sub-section (4) the proportion between the export turnover in respect of the articles or things, or, as the case may be, computer software exported, to the total turnover of the business carried over by the under-taking is applied to the profits of the business of the undertaking in computing the profits of the business of the undertaking in computing the profits derived from export. In other words, the profits of the business of the undertaking are multiplied by the export turnover in respect of the articles, things or, as the case may be, computer software and divided by the total turnover of the business carried or by the

undertaking. The formula which is prescribed by sub-section (4) of section 10A is as follows:

The total turnover of the business carried on by the undertaking would consist of the turnover from export and the turnover from local sales. The export turnover constitutes the numerator in the formula prescribed by sub-section (4). Export turnover also forms a constituent element of the denominator inasmuch as the export turnover is a part of the total turnover.

The export turnover, in the numerator must have the same meaning as the export turnover which is a constituent element of the total turnover in the denominator. The legislature has provided a definition of the expression "export turnover" in *Explanation 2* to section 10A by which the expression is defined to mean the consideration in respect of export by the undertaking of articles, things or computer software received in, or brought into India by the assessee in convertible foreign exchange but so as not to include *inter alia* freight, telecommunication charges or insurance attributable to the delivery of the articles things or software outside India. Therefore in computing the export turnover the Legislature has made a specific exclusion of freight and insurance charges.

The submission which has been urged on behalf of the Revenue is that while freight and insurance charges are liable to be excluded in computing export turnover, a similar exclusion has not been provided in regard to total turnover. The submission of the Revenue, however, misses the point that the expression "total turnover" has not been defined at all by Parliament for the purposes of section 10A. However the expression "export turnover" has been defined. The definition of "export turnover" excludes freight and insurance. Since export turnover has been defined be Parliament and there is a specific exclusion of freight and insurance, the expression "export turnover" cannot have a different meaning when it forms a constituent part of the total turnover for the purposes of the application of the formula. Undoubtedly, it was open to Parliament to make a provision to the contrary. However, no such provision having been made, the principle which has been enunciated earlier must prevail as a matter of correct statutory interpretation. Any other interpretation would lead to an absurdity. If the contention of the Revenue were to be accepted, the same expression *viz.* "export turnover" would

> have a different connotation in the application of the same formula. The submission of the Revenue would lead to a situation where freight and insurance, though it has been specifically excluded from "export turnover" for the purposes of the numerator would be brought in as part of the "export turnover" when it forms an element of the total turnover as a denominator in the formula. A construction of a statutory provision which would lead to an absurdity must be avoided."

The special bench of the Tribunal, in the case of *ITO* v. *Sak Soft Ltd.* [2009] 313 ITR (AT) 353/ 30 SOT 55 (Chennai) also had an occasion to consider the meaning of the word 'total turnover'. After referring to the various judgments of the High Court as well as the Supreme Court held as under:

> "53. For the above reasons, we hold that for the purpose of applying the formula under sub-section (4) of Section 10-B, the freight telecom charges or insurance attributable to the delivery of articles or things or computer software outside India or the expenses, if any, incurred in foreign exchange in providing the technical services outside India are to be excluded both from the export turnover and from the total turnover, which are the numerator and the denominator respectively in the formula."

The formula for computation of the deduction under Section 10-A would be as under:

$$\frac{\text{Profits of the business X export turnover}}{\text{Total turnover}}$$

From the aforesaid judgments, what emerges is that, there should be uniformity in the ingredients of both the numerator and the denominator of the formula, since otherwise it would produce anomalies or absurd results. Section 10-A is a beneficial section. It is intended to provide incentives to promote exports. The incentive is to exempt profits relatable to exports. In the case of combined business of an assessee, having export business and domestic business, the legislature intended to have a formula to ascertain the profits from export business by apportioning the total profits of the business on the basis of turnovers. Apportionment of profits on the basis of turnover was accepted as a method of arriving at export profits. In the ease of Section 80HHC, the export profit is to be derived from the total business income of the assessee, whereas in Section 10-A,

the export profit is to be derived from the total business of the undertaking. Even in the case of business of an undertaking, it may include export business and domestic business, in other words, export turnover and domestic turnover. The export turnover would be a component or part of a denominator, the other component being the domestic turnover. In other words, to the extent of export turnover, there would be a commonality between the numerator and the denominator of the formula. In view of the commonality, the understanding should also be the same. In other words, if the export turnover in the numerator is to be arrived at after excluding certain expenses, the same should also be excluded in computing the export turnover as a component of total turnover in the denominator. The reason being the total turnover includes export turnover. The components of the export turnover in the numerator and the denominator cannot be different. Therefore, though there is no definition of the term 'total turnover' in Section 10-A, there is nothing in the said Section to mandate that, what is excluded from the numerator that is export turnover would nevertheless form part of the denominator. Though when a particular word is not defined by the legislature and an ordinary meaning is to be attributed to the same, the said ordinary meaning to be attributed to such word is to be in conformity with the context in which it is used. When the statute prescribes a formula and in the said formula, 'export turnover' is defined, and when the 'total turnover' includes export turnover, the very same meaning given to the export turnover by the legislature is to be adopted while understanding the meaning of the total turnover, when the total turnover includes export turnover. If what is excluded in computing the export turnover is included while arriving at the total turnover, when the export turnover is a component of total turnover, such an interpretation would run counter to the legislative intent and impermissible. If that were the intention of the legislature, they would have expressly stated so. If they have not chosen to expressly define what the total turnover means, then, when the total turnover includes export turnover, the meaning assigned by the legislature to the export turnover is to be respected and given effect to, while interpreting the total turnover which is inclusive of the export turnover. Therefore, the formula for computation of the deduction under Section 10-A, would be as under:

$$\text{Profits of the business of the undertaking} \times \frac{\text{Export turn over}}{\text{(Export turnover + domestic turn over)}} \quad \text{Total Turn Over}$$

> **11.** In that view of the matter, we do not see any error committed by the Tribunal in following the judgments rendered in the context of Section 80HHC in interpreting Section 10-A when the principle underlying both these provisions is one and the same. Therefore, we do not see any merit in these appeals. The substantial question of law framed is answered in favour of the assessee and against the revenue."

6. Following the judgment of Hon'ble jurisdictional High Court in the case of *Tata Elxsi Ltd. (supra)*, we do not find any error or illegality in the impugned order of the CIT(A), *qua* this issue.

7. Ground NO.4 is regarding direction of the CIT(Appeals) to provide risk adjustment.

8. The TPO while determining the arm's length price (ALP) has considered a negative working capital adjustment and consequently increased the PLI of the comparables. On appeal, the CIT(Appeals) held that once the TPO has granted working capital adjustment which is negative adjustment made by the TPO, then the TPO shall look into this matter and take rectificatory action. In case if the TPO finds that working capital adjustment remains negative, then she was directed to grant risk adjustment in that case. Thus, the CIT(A) has passed the directions subject to the reconsideration of the working capital adjustment and held that if the working adjustment is still found to be negative, then the risk adjustment should be granted.

9. Before us, the Id. OR has submitted that when the TPO has granted the working capital adjustment and assessee has not given the working of risk adjustment, then the CIT(A) is not justified in directing the TPO to grant risk adjustment.

10. On the other hand, the Id. AR has submitted that once the assessee has claimed risk adjustment and the TPO has examined the working capital adjustment, then the claim of the assessee of risk adjustment was required to be examined and granted by the TPO.

11. We have considered the rival submissions as well as relevant material on record. There is no dispute that the assessee has not given the working of risk adjustment before the TPO. Therefore, the TPO did not work out any risk adjustment. On appeal, the CIT(Appeals) has directed the TPO to consider the case of risk adjustment if the working capital adjustment is found to be negative. We find that when the TPO has worked out the working capital adjustment on her own and not accepted the claim of the assessee, then by applying the principle of consistency, the risk adjustment of the assessee was also required to be considered by the TPO, though the assessee might have been asked to furnish the relevant details and working. Since in this case, the TPO herself has worked out the working capital adjustment, therefore, we direct the TPO to consider the claim of risk adjustment subject to filing of details by the assessee. Accordingly, we modify the finding of the CIT(Appeals), qua the decision.

12. In the Cross Objection, the assessee has raised various grounds, however, at the time of hearing, the Id. AR of assessee has submitted that the only effective grounds which are prayed by the assessee are ground Nos.5 & 6 in respect of the directions given by the CIT(Appeals) for reconsideration of working capital adjustment, even if it found negative.

13. We have heard the Id. AR and the Id. DR as well as considered the relevant material on record. The Id. AR of the assessee has submitted that when the assessee has not claimed any working capital adjustment, then the TPO cannot make a negative adjustment on account of working capital. He has further contended that when the assessee has not used any borrowed funds for working capital purpose, then the TPO is not justified in making a negative working capital adjustment. In support of this contention, he has relied upon the decision of the Hyderabad Bench of the Tribunal dated 25.3.2015 in the case of *Adaptec (India)* P. *Ltd. v. ACIT, ITA No.206/Hyd/2014* and submitted that the Tribunal has held that when the assessee is a captive service provider running its business without any working capital risk, then there is no need for making any negative working capital adjustment.

14. On the other hand, the Id. DR has relied upon the order of the TPO.

15. Having considered the rival submissions and on careful perusal of the record, we find that the Hyderabad Bench of the Tribunal in the case of

Adaptec (India) P. *Ltd. (supra)* has considered identical issue in paras 10 & 11 as under:-

> "10. Ground No.8 pertains to the issue of negative working capital. As briefly stated above, after arriving at the arithmetic mean of all comparables at 22.03%, the A.O. worked out negative working capital adjustment of 3.22% thereby, making arms length price at 25.25%. Even though, DRP refused to interfere with the objections of the assessee in its order, we were informed that DRP has directed the *TPO*/*A.O.* not to make any negative working capital adjustment in some of the cases in the next assessment year, in the cases of Market Tools Research P. Ltd., and Mega Systems Worldwide India P. Ltd., assessee placed on record copies of orders of DRP. In that DRP considered the issue and directed the TPO as under:
>
> > "14. Ground No.11 : Negative Working Capital adjustment - Making a negative working capital adjustment without appreciating the fact that the company does not bear any working capital risks. On this issue, the assessee submitted as under:
> >
> > "The learned TPO determined the ALP for the international transactions with A.Es by making a negative working capital adjustment for the differences in working capital between the assessee and the companies considered as comparables. The assessee does not agree with the learned TPO as :
> >
> > - The company does not bear any working capital risk since it is been fully funded by it's A.E. from its inception and has no working capital contingencies.
> > - The company has never taken any loans till date from the date of incorporation nor has incurred any expense for meeting the working capital requirement."
> >
> > We have gone through the submissions and the order of the TPO. The assessee pleaded that the DRP has acceded such a plea in some other case. On examination, we find that the DRP, Hyderabad in the case of Cordys Software India P. ltd., for A.Y. 2008-09 in its directions dated 3·08.2012 has given a finding as under:

"7.7.4 Thus, working capital adjustment is made for the time value of money lost when credit time is provided to the customers. The applicant is not an entrepreneur but a captive service provider. Its entire funding needs are provided by the A.E. This being so, the applicant does not stand to lose anything as it is compensated on a total cost plus basis. The TPO probably was carried away by the large amount of receivables appearing in the books of the applicant. But the applicant is running its business without any working capital risk while comparable companies have such a risk for them. If at all any working capital adjustment is to be made to t his situation, only a positive adjustment has to be made to the comparables so that they are brought on par with the applicant. In view of the same, the Panel directs that negative working capital adjustment to the arithmetic mean margin of the comparables shall not be made."

In view of the above, the Panel directs that negative working capital adjustment to the arithmetic mean margin of the comparables shall not be made."

11. In view of the above, we are of the opinion that assessee's case being similar, there is no need for making any negative working capital adjustment when assessee does not carry any working capital risk. In fact, TPO should have done necessary working capital adjustment to the profits of the selected comparables so as to make them comparable to the assessee. In view of this, we direct the TPO not to make negative working capital adjustment."

16. There is no allegation in the case of the assessee that the assessee has used any borrowed fund for working capital or there is any risk of money lost in credit time provided to the customers. Accordingly, following the order of the coordinate Bench of the Tribunal cited above, we hold that negative working capital adjustment is not justified in the case of the assessee.

17. In the result, the appeal and the Cross Objection are partly allowed.

Pronounced in the open court on this 31st day of March, 2016.

Sd/-	Sd/-
(ABRAHAM P. GEORGE)	(VIJAY PAL RAO)
Accountant Member	Judicial Member

Bangalore,
Dated, the 31st March, 2016.

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2. Respondents
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.
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By order

Assistant Registrar,
ITAT, Bangalore.