

THE INCOME TAX APPELLATE TRIBUNAL
"K" Bench, Mumbai
Before Shri B.R. Baskaran (AM) & Shri Ramlal Negi (JM)

I.T.A. No. 3712/Mum/2016 (Assessment Year 2010-11)

M/s. Information System Resource Centre Pvt. Ltd. (Now amalgamated with Larsen & Toubro Infotech Ltd.) L&T Technology Centre Gate No. 5, Saki Vihar Road Powai, Mumbai-400 072. PAN : AAACI3613G (Appellant)	Vs.	ACIT Circle- 2(2)(1) Aayakar Bhavan M.K. Road Mumbai-400020. (Respondent)
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Assessee by	Shri Arun Chhabra
Department by	Shri V. Jenardhanan
Date of Hearing	22.5.2018
Date of Pronouncement	22.5.2018

ORDER

Per B.R. Baskaran (AM) :

The appeal filed by the assessee is directed against the order dated 29.2.2016 passed by the learned CIT(A)-56, Mumbai and it relates to A.Y. 2010-11.

2. The grounds urged by the assessee give rise to following issues :
 - (a) Transfer pricing adjustment on belated realization of receivable from associated enterprises.
 - (b) Computation of book profit u/s. 115JB of the Act.
3. The assessee is engaged in the business of software development. The TPO noticed that the assessee has supplied goods on credit to its associated enterprises and the same has been realised belatedly. Accordingly, the TPO made the transfer pricing adjustment by computing interest on the delayed realization of receivable. Besides the above, while computing book profit u/s 115JB of the Act, the Assessing Officer added "gross amount of income tax" debited to profit and loss account to the Net profit, instead of adding "net amount of income tax" debited to profit and loss account. The assessee

challenged both the issues by filing appeal before the learned CIT(A) but did not get relief. Hence, the assessee has filed this appeal before the Tribunal.

4. At the time of hearing both the parties agreed that the first issue is covered by the decision dated 29.5.2015 rendered by the Coordinate Bench in the assessee's own case relating to A.Y. 2007-08 passed in ITA No. 7757/Mum/2012 and C.O. No. 282/Mum/2013. For the sake of convenience, we extract below the operative portion of the order passed by the Coordinate Bench:-

11. We have considered the rival submissions as well as the relevant material on record. In the present case, the sale transaction of the assessee with its A.E. have been accepted by the Transfer Pricing Officer / Assessing Officer at arm's length and no adjustment has been made in respect of the sale transaction. However, the Transfer Pricing Officer has made the adjustment on account of credit period provided by the assessee to the A.E. on realisation of sale proceeds. At the outset, we note that an identical issue has been considered by the co- ordinate bench of the Tribunal, Mumbai Benches, in Goldstar Jewellery Ltd. (supra), vide Para- 8, held as under:-

"8. We have considered the rival submissions and relevant material on record. The assessee has reported international transaction in its TP report regarding sale to its AE from manufacture of jewellery units and diamond trading unit. The TPO accepted the price charged by the assessee from AE at arm's length. However, the TPO has made the adjustment on account of notional interest for the excess period allowed by the assessee to AE for realization of dues. The TPO applied 18.816% per annum as arm's length on the over due amounts of AE and proposed adjustment of Rs. 2,49,95,139/-. The DRP though concurred with the view of the Assessing Officer/TPO on the issue of international transaction, however, the adjustment was reduced by applying the interest rate of 7% instead of 18.816% applied by the TPO. The first issue raised by the assessee is whether the aggregate period extended by the assessee to the AE which is more than the average credit period extended to the non-AE would constitute international transaction. We are of the view that after the insertion of explanation to section 92B(1), the payment or deferred payment or receivable or any debt arising during the course of business fall under the expression international transaction as per explanation. Therefore, in view of the expanded meaning of the international transaction as contemplated under

clause (i) (e) of explanation to section 92B(1), the delay in realization of dues from the AE in comparison to non-AE would certainly falls in the ambit of international transaction. However, this transaction of allowing the credit period to AE on realization of sale proceeds is not an independent international transaction but it is a closely linked or continuous transaction along with sale transaction to the AE. The credit period allowed to the party depends upon various factors which also includes the price charged by the assessee from purchaser. Therefore, the credit period extended by the assessee to the AE cannot be examined independently but has to be considered along with the main international transaction being sale to the AE. As per Rule 10A(d) if a number of transactions are closely linked or continuous in nature and arising from a continuous transactions of supply of amenity or services the transactions is treated as closely linked transactions for the purpose of transfer pricing and, therefore, the aggregate and clubbing of closely linked transaction are permitted under said rule. This concept of aggregation of the transaction which is closely linked is also supported by OECD transfer pricing guidelines. In order to examine whether the number of transactions are closely linked or continuous so as to aggregate for the purpose of evaluation what is to be considered is that one transaction is follow-on of the earlier transaction and then the subsequent transaction is carried out and dependent wholly or substantially on the earlier transaction. In other words, if two transactions are so closely linked that determination of price of one transaction is dependent on the other transaction then for the purpose of determining the ALP, the closely linked transaction should be aggregated and clubbed together. When the transaction are influenced by each other and particularly in determining the price and profit involved in the transactions then those transactions can safely be regarded as closely linked transactions. In the case in hand the credit period extended to the AE is a direct result of sale transaction. Therefore no question of credit period allowed to the AE for realization of sale proceeds without having sale to AE. The credit period extended to the AE cannot be treated as a transaction stand alone without considering the main transaction of sale. The sale price of the product or service determined between the parties is always influenced by the credit period allowed by the seller. Therefore, the transaction of sale to the AE and credit period allowed in realization of sale proceeds are closely linked as they are inter linked and the terms and conditions of sale as well as the price are determined based on the totality of the transaction and not on individual and separate transaction. The approach of the TPO and DRP in analyzing the credit period allowed by the assessee to the AE without considering the main international transaction being sale to the AE will give distorted result by disregarding the price

charged by the assessee from AE. Though extra period allowed for realization of sale proceeds from the AE is an international transaction, however, for the purpose of determining the ALP, the same has to be clubbed or aggregated with the sale transactions with the AE. Even by considering it as an independent transaction the same has to be compared with the internal CUP available in the shape of the credit allowed by the assessee to non AE. When the assessee is not making any difference for not charging the interest from AE as well as non AE then the only difference between the two can be considered is the average period allowed along with outstanding amount. If the average period multiplied by the outstanding amount of the AE is at arm's length in comparison to the average period of realization and multiplied by the outstanding from non AEs then no adjustment can be made being the transaction is at arm's length. The third aspect of the issue is that the arm's length interest for making the adjustment. Both the TPO and DRP has taken into consideration the lending rates, however, this is not a transaction of loan or advance to the AE but it is only an excess period allowed for realization of sales proceeds from the AE. Therefore, the arm's length interest in any case would be the average cost of the total fund available to the assessee and not the rate at which a loan is available. Accordingly, we direct the Assessing Officer/TPO to re-do the exercise of determination of ALP in terms of above observation."

12. Thus, it is clear that the Tribunal has taken a view that the transaction of allowing the credit period to the A.E. on realisation of sale proceeds has to be considered along with the main international transaction in respect of sale to A.E. A similar view has been taken by the Tribunal, Delhi Bench, in *Kusum Healthcare Pvt. Ltd.* (supra), wherein the Tribunal, vide Para-7 to 10, held as under:-

"7. We have heard rival submissions and perused the material on record. An uncontrolled entity will expect to earn a market rate of return on its working capital investment independent of the functions it performs or products it provides. However, the amount of capital required to support these functions varies greatly, because the level of inventories, debtors and creditors varies. High levels of working capital create costs either in the form of incurred interest or in the form of opportunity costs. Working capital yields a return resulting from a) higher sales price or b) lower cost of goods sold which would have a positive impact on the operational result. Higher sales prices acts as a return for the longer credit period granted to customers. Similarly in return for longer credit period granted, a firm should be willing to pay higher purchase price which adds to the cost of goods sold. Therefore, high levels accounts

receivable and inventory tend to overstate the operating results while high levels of accounts payable tend to understate them thereby necessitating appropriate adjustment. The appropriate adjustments need to be considered to bring parity in the working capital investment of the assessee and the comparables rather than looking at the receivable independently. Such working capital adjustment takes into account the impact of outstanding receivables on the profitability. In this regard, the reliance is placed on the following rulings wherein the need to undertake working capital adjustment has been appreciated by the Hon'ble Tribunals : • Mercer Consulting India Pvt. Ltd. [TS-170-ITAT-2014(DEL)] • Mentor Graphics (Noida) Private Limited [109 ITD 101] • Egain communication (P) Ltd. [ITA No. 1685/PN/2007] • Sony India (Pvt.) ltd. [2011-TII-43-ITAT-DEL-TP] • Capgemini India Private Limited [TS-45-ITAT-2013(Mum)-TP]

8. In view of the above, a working adjustment appropriately takes into account the outstanding receivable. Therefore, the assessee has undertaken a working capital adjustment to reflect these differences by adjusting for differences in working capital and thereby, profitability of each comparable company. Accordingly, while calculating the working capital adjusted, operating margin on costs of the comparable companies, the impact of outstanding receivables on the profitability has been taken into account. If the pricing/profitability of the assessee are more than the working capital adjusted margin of the comparables, then additional imputation of interest on the outstanding receivables is not warranted. 9. The assessee had undertaken a working capital adjustment for the comparable companies selected in its transfer pricing report which was also submitted with the Ld. TPO. A snapshot of the result is provided below:

Segment Name	Appellant's Margin (OP/TC)	Working capital adjusted margins of comparables (OP/TC)
Manufacturing activity	46.33%	11.84%
Trading activity	17.44%	8.36

10. The above analysis empirically demonstrates that the differential impact of working capital of the vis-a-vis its comparables has already been factored in the pricing/profitability of the assessee which is more than that working capital adjusted margin of the comparables. Hence, any further adjustment to the margins of the assessee on the pretext of outstanding receivables is unwarranted and wholly unjustified.”

13. Following the orders of the Tribunal, we set aside this issue to the record of the Assessing Officer / Transfer Pricing Officer and direct to re-do the exercise of determination of arm's length price in the light of the above decisions of the Tribunal. The grounds raised in this cross objection are allowed for statistical purposes.

5. Consistent with the view taken by the Coordinate Bench in assessee's own case for A.Y. 2009-10, we restore this issue of transfer pricing adjustment to the file of the Assessing Officer/TPO with similar directions.

6. The next issue relates to computation of book profit u/s. 115JB of the Act. In the profit and loss account, under the head 'provision for taxation', the assessee disclosed gross amount of tax ₹ 281.52 lakhs and reduced therefrom deferred tax and MAT credit amounting to ₹ 9.42 lakhs and ₹ 10.17 lakhs respectively. Accordingly, the net amount debited to profit and loss account was ₹ 261.93 lakhs (281.52 (-) 9.42 (-) 10.17). However, while computing book profit, the Assessing Officer began the computation by taking the figure of "profit after tax", to which he added gross amount of "Provision for tax" of ₹ 281.52 lakhs, instead of adding the net amount of ₹ 261.93 lakhs. The learned CIT(A) also upheld computation made by the Assessing Officer.

7. The Learned AR submitted that the assessee has split the amount of "Provision for tax" to give more clarity and ultimately the net amount of ₹ 261.93 lakhs only was reduced from "Profit before tax figure". Accordingly, he submitted that the Assessing Officer should have added net amount of ₹ 261.93 lakhs to the figure of "Profit after tax" while computing book profit.

8. We have heard learned DR and perused the record. We find merit in the contentions of the assessee. We noticed that the assessee has shown gross amount of ₹ 281.52 lakhs and reduced deferred tax and provision for tax of ₹ 9.42 lakhs and ₹ 10.17 lakhs there from. So, in effect, what was debited to the profit and loss account was only the net amount of ₹ 261.93 lakhs. Hence, while computing book profit, the Assessing Officer should have added net

amount of ₹ 261.93 lakhs only. Accordingly, we set aside the order passed by the learned CIT(A) on this issue and direct the Assessing Officer to add only net amount of income tax debited to profit and loss account.

9. In the result, appeal filed by the assessee is treated as allowed for statistical purposes.

Order has been pronounced in the Court on 22.5.2018.

Sd/-
(RAMLAL NEGI)
JUDICIAL MEMBER

Sd/-
(B.R.BASKARAN)
ACCOUNTANT MEMBER

Mumbai; Dated : 22/5/2018

Copy of the Order forwarded to :

1. The Appellant
2. The Respondent
3. The CIT(A)
4. CIT
5. DR, ITAT, Mumbai
6. Guard File.

//True Copy//

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BY ORDER,

(Senior Private Secretary)
ITAT, Mumbai