

**THE INCOME TAX APPELLATE TRIBUNAL  
HYDERABAD BENCH "A", HYDERABAD**

**BEFORE SMT. P. MADHAVI DEVI, JUDICIAL MEMBER  
AND SHRI B. RAMAKOTIAH, ACCOUNTANT MEMBER**

**ITA Nos.251/Hyd/2016 & 84/Hyd/2017  
Assessment Years: 2011-12 & 2012-13**

M/s Hexagon Capability  
Center India Private  
Limited,  
Hyderabad.

vs. The Asst. Commissioner of  
Income Tax, Circle -2 (2),  
Hyderabad.

PAN – AAACI7746L  
(Appellant)

(Respondent)

**ITA No.258/Hyd/2016  
Assessment Year: 2011-12**

The Asst. Commissioner of  
Income Tax, Circle -2 (2),  
Hyderabad.

M/s Hexagon Capability  
Center India Private  
Limited,  
Hyderabad.

PAN – AAACI7746L

(Appellant)

(Respondent)

Assessee by : Sri Saubhagya Agarwal

Sri Darpan Kirpalani

Revenue by : Shri J. Siri Kumar

Date of hearing : 22-05-2018

Date of pronouncement : 08-06-2018

**ORDER**

**PER B. RAMAKOTIAH, AM:**

These are appeals by Assessee for A.Y 2011-12 and 2012-13, and cross appeal by Revenue for A.Y 2011-12 on the orders of DRP followed by the assessment order u/s 143(3) r.w.s 92CA(4) r.w.s 144C(13) of the IT Act. The issue in these appeals are with reference to transfer pricing

adjustment made on the receivables outstanding at the end of the year by TPO / A.O.

2. Briefly stated, Assessee Company is engaged in Providing Engineering and Geospatial Software that enables customers to visualize complex data. It filed return of income for the A.Y 2011-12 admitting total income of Rs. 17,48,69,830/- and in A.Y 2012-13 returned income of Rs. 12,64,10,490/-. Since the transactions with AE exceeded the limits prescribed the matter was referred to TPO for arriving at the 'Arms Lengths Price' on the international transactions reported. On the software development services, the TPO found that Assessee's profit margin (OP/OC) was at 30.06% and after due analysis of the comparables, TPO determined that Assessee's price received was at arm's length. In A.Y 2012-13 also the TPO arrived at the profit margin @ 18% on the software development services and after analyzing the comparables and their arithmetic mean which was arrived @ 10.19%, the price received by Assessee was held to be at arm's length.

2.1 However, the TPO in both the years has noticed that Assessee has outstanding receivables at the end of the year and following the amendment to the Sec. 92B of the IT Act, he considered the receivables as part of 'international transactions'. Assessee was issued a show cause notice why adjustment should not be made for the outstanding receivables. Assessee objected to the same stating that the explanation to Sec. 92B of the IT Act does not cover the outstanding receivables on services as this is not a capital

financing and further it was submitted that Assessee was fully funded by A.E with no working capital risk and Assessee has not taken any external loans therefore there was no interest payment. It was submitted by Assessee that Assessee is a zero debt company and therefore no interest was charged, not only on the transactions with the A.E but also with third parties. Assessee relied on the decision of ITAT Mumbai in the case of Evonic Debussa India Pvt Ltd., Vs ACIT in ITA No. 7653/Mum/2011. With reference to the contention that outstanding AE receivable towards services was not capital financing u/s 92B of the IT Act, Assessee relied on the coordinate Bench decision in the case of Pegasystems Worldwide India Pvt Ltd., Vs ACIT in ITA nos. 1758 & 1936/Hyd/2014 for A.Y 2009-10. It was further contended that Assessee's price received is considered as arm's length price in which working capital adjustments were also done and therefore the receivables alone cannot be considered as a separate 'international transaction'. It was submitted that receivables cannot be segregated as a distinct transaction to include interest separately and relied in the case of Kusum Healthcare Ltd., Vs ACIT in ITA No. 6814/Del/2014, where the Tribunal held that there can be no separate adjustment on the outstanding receivables. It was contended that since working capital adjustment has already taken into account the outstanding receivables, separate TP adjustment is not warranted. Apart from that Assessee also submitted that average realization period offered on 225 days of the comparable companies should be considered *vis-a-vis* the average realization of Assessee which works out to 168

days (in A.Y 2011-12). Since the average realization period is on par with comparable companies no adjustment is warranted. It was also submitted that no interest charged on receivable from third parties, hence no interest can be charged on outstanding receivables from AE. Without prejudice, if there should be an addition on account of interest, Assessee submitted that should be computed only from the date of outstanding till end of financial year or period of the realization and not till date of actual collection which is beyond the previous year. It is also contested that the rate of interest proposed by the TPO @ 14.75% in the A.Ys 2011-12 and 2012-13 is higher.

3. The TPO, however, rejected the contentions and stating that Sec. 92B of the IT Act has been amended and so the outstanding receivables can be considered as international transaction, further taking a hypothetical situation in which working capital adjustment may not work out properly if the receivables throughout the year are received by the end of the year, TPO rejected the contentions and worked out the interest @ 12% and determined the TP adjustment at Rs. 3,14,06,014 for A.Y 2011-12, an amount of Rs. 3,48,21,575/- @ 14.75% in A.Y 2012-13.

4. Assessee was aggrieved and raised similar objections before the DRP. DRP however rejected the contentions on the issue that outstanding receivables cannot be international transaction but considered the rate of interest and the period of interest levied on the objections raised by Assessee. It directed A.O to work out the rate of

interest @ 5% and also to work out the outstanding amounts from the time of raising the invoice to the time of payment after giving 30 days credit period for A.Y 2011-12. A.O however without undertaking the exercise, repeated the same addition as proposed by TPO.

5. However, in the A.Y 2012-13, the DRP has differed from the findings in A.Y 2011-12 and determined variable rate of interest as can be seen from the DRP order and directed the A.O to work out the adjustment accordingly. However on the reason that Assessee did not submit the information, the same addition as proposed by TPO was made in the final order.

6. Contesting the above issue, Assessee has raised various grounds including that the TPO has not followed the DRP directions.

7. Ld. AR explaining the facts of the case relied on various propositions that outstanding receivables cannot be considered as international transaction as it is an outstanding amount in service area and not part of capital financing. Reiterating the fact that Assessee is a zero debt company, fully funded by AE, no interest liability and assessee also did not charge any outstanding amount even from third parties, therefore question of charging interest on the outstanding amount does not arise. He relied on various case law for propositions on the issue.

*Proposition - I: Outstanding receivables not covered under the definition of international transaction.*

*i. Pregasystems Worldwide India Pvt Ltd. for FY 2009-10 (ITA Nos. 1758 & 1936/Hyd/2014).*

*Proposition –II: Fully funded by AE with no working capital risk and no interest payments.*

- i. Hon’ble Supreme Court ruling in the case of Bechtel India Pvt. Ltd., Vs DCIT (ITA No. 1478/Del/2015).*
- ii. Hon’ble High Court ruling in the case of Bechtel India Pvt. Ltd., Vs DCIT (ITA No. 1478/Del/2015).*
- iii. Bechtel India Pvt. Ltd., Vs DCIT (ITA No. 1478/Del/2015).*

*Proposition – III: Working capital adjustment factors in recievables.*

- i. Hon’ble Supreme Court ruling in the case of Kusum Healthcare Pvt. Ltd. Vs ACIT, Range-5 (ITA No. 6814/Del/2014).*
- ii. Hon’ble High Court ruling in the case of Kusum Healthcare Pvt. Ltd. Vs ACIT, Range-5 (ITA No. 6814/Del/2014).*
- iii. Kusum Healthcare Pvt. Ltd. Vs ACIT, Range-5 (ITA No. 6814/Del/2014).*
- iv. Open Text Corporation India Pvt Ltd., (ITA No. 232/Hyd/2016).*

8. Ld. DR, however, reiterated stand taken by TPO and DRP and referred to the provisions of Sec. 92B of the IT Act.

9. We have considered the rival contentions and perused the paper book placed on record. We find that the issue whether any notional interest is chargeable on receivable has been considered by the Coordinate Bench in the case of Pegasystems Worldwide India Pvt Ltd., cited supra, wherein it was held as under:

*“17.3. We have considered the issue and examined the rival contentions. In the case of Evonik Degussa India P. Ltd., in ITA No. 7653/Mum/2011, it was already held the TP adjustment cannot be made on hypothetical and notional basis, until and unless there is some material on record that there has been under charging of real income. Thus on the facts and*

*circumstances of the case, we are of the opinion that addition on account of notional interest relating to alleged delayed payment in collection of receivables from the AEs is uncalled for on the facts of the present case. Even though DRP tried to distinguish the above decision on facts, as seen from the facts in both the cases, we are of the opinion that the above decision will equally apply to Assessee's case. Assessee has outstanding service charges receivables and as seen from the order of TPO, the outstanding is only from 31- 07-2009. There seems to be no such delay in earlier months. Assessee has no interest liability at all so notional interest cannot be brought to tax under the provisions of TP. As rightly pointed out by the Ld. Counsel, the outstanding receivables on account of services cannot be equated with capital financing as provided for in the Explanation by the amendment by Finance Act, 2012 retrospectively. Even otherwise, as rightly held by the Logix Micro Systems Ltd v. ACIT [42 SOT 525] (supra), TPO should have allowed some interest free period for receiving the outstanding service charges. While acknowledging the order of the ITAT, TPO did not even bother to exclude the reasonable period and levied interest not only from the date of invoice to the date of realization during the year but also for the period beyond 31- 03-2010 in later year. We were informed that no such addition was made in the later year on Assessee's receivables. We are of the opinion that both on the facts of the case and principles of law, there is no need for bringing to tax the notional interest on the outstanding receivables. Accordingly, we allow the grounds 7 & 8 of Assessee and direct AO/ TPO to delete the said addition made”.*

10. Respectfully following the above decision, we hold that the notional interest on outstanding receivables is not chargeable and no TP adjustment can be made.

11. As regards the other contentions, we find that where the working capital adjustment is considered by the A.O, it takes care of the interest on receivables as well. This aspect has been considered by the Tribunal at Delhi in the case of Kusum Healthcare Pvt Ltd., in ITA No. 6814/Del/2014 dated 31.03.2015 which has been

confirmed by the Hon'ble High Court of Delhi and at para 14 of its order has held as under:

*“14. As mentioned earlier, the differential impact of working capital of the assessee vis-à-vis its comparables has already been factored in the pricing/profitability of the assessee and therefore, any further adjustment to the margins of the assessee on the pretext of outstanding receivables is unwarranted and wholly unjustified.”*

12. We find that the Hon'ble High Court of Delhi has confirmed the decision of the ITAT and the SLP filed by the Revenue is pending before the Hon'ble Supreme Court. We find that in the case of EPAM Systems India Pvt Ltd in ITA No. 192/Hyd/2017 dated 24.10.2017, Coordinate Bench of this Tribunal has followed the decision of the Hon'ble Delhi High Court in the case of Kusum Healthcare Pvt Ltd., to hold that working capital adjustment takes into consideration the interest on the receivables as well. Therefore, on this reason also, no TP adjustment is required.

13. In view of the above, we allow the grounds raised by Assessee in both the assessment years and delete the additions so made.

14. Since the very addition is not confirmed, the issue on rate of interest as raised by Revenue in its appeal becomes academic and infructuous. Moreover, we do not see any reason to interfere with the rate of interest also as DRP has considered the issue correctly. There is no merit in the Revenue contentions. Accordingly the Revenue appeal in A.Y 2011-12 is dismissed.

15. In the result Assessee appeals are allowed and Revenue appeal is dismissed.

Pronounced in the open court on 8<sup>th</sup> June, 2018.

**Sd/-**  
**(P. MADHAVI DEVI)**  
**JUDICIAL MEMBER**

**Sd/-**  
**(B. RAMAKOTAIAH)**  
**ACCOUNTANT MEMBER**

Hyderabad, Dated 8<sup>th</sup> June, 2018.

KRK

- 1) *M/s Hexagon Capability Center Ind Pvt Ltd., Plot # 5, Ground 9<sup>th</sup>, 10<sup>th</sup> and 11<sup>th</sup> floors, Divya Sree Trinity Campus, Near Lemon Tree Hotel, Madhapur, Hyderabad.*
- 2) *ACIT, Circle-2(2), Warangal.*
- 3) *Dispute Resolution Panel-1, Bengaluru – 560 001.*
- 4) *The Departmental Representative, I.T.A.T., Hyderabad.*
- 5) *Guard File*