

IN THE INCOME TAX APPELLATE TRIBUNAL  
“A” BENCH : BANGALORE

BEFORE SHRI N V VASUDEVAN, VICE PRESIDENT  
AND SHRI G MANJUNATHA, ACCOUNTANT MEMBER

IT(TP)A No.677/Bang/2016
Assessment year : 2011-12

iPass India Private Limited, Level 5, Prestige Solitaire, No.6, Brunton Road, Bangalore – 560 025. <b>PAN: AABCG 3659H</b>	Vs.	The Income Tax Officer, Ward 3(1)(4), Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	Shri Chavali Narayan, CA
Respondent by	:	Shri C.H. Sundar Rao, CIT(DR-I), ITAT, Bangalore.

Date of hearing	:	21.10.2019
Date of Pronouncement	:	25.10.2019

**ORDER**

*Per N V Vasudevan, Vice President*

This appeal by the assessee is against the final order dated 29.01.2016 of the ITO, Ward 3(1)(4), Bangalore passed u/s. 143(3) r.w.s. 144C of the Income-Tax Act, 1961 [“the Act”] relating to assessment year 2011-12.

2. The issue projected by the assessee in the various grounds of appeal filed before the Tribunal is with regard to the addition of Rs.2,10,63,030 consequent to determination of arm’s length price (ALP) of an international transaction of rendering software development services by

the assessee to its Associated Enterprise (AE) under the provisions of section 92 of the Act.

3. The assessee was incorporated on 21.12.2000 as a wholly owned subsidiary of GoRemote International Corporation, USA which was subsequently acquired by iPass US in February, 2006. The assessee provides software development services (SWD services) to iPass US and is remunerated on cost + 16% mark up basis for the above services. In this appeal, there is no dispute with regard to comparable companies chosen by the TPO and confirmed by the DRP. The only issue that was pressed for adjudication was ground No.8 raised by the assessee in the grounds of appeal, which reads as follows:-

“8. The Id. AO/TPO erred. in law and in facts, by providing the negative working capital adjustment of without appreciating the fact that the Assessee is a captive service provider of the AE.

The Id. AO/TPO erred. in law and in facts, by adopting an inconsistent approach in restricting the working capital benefit and by not providing a lower cap on negative working capital adjustment. In this regard, the Assessee prays that since the working capital benefit is restricted, there should also be a lower cap on working capital adjustment at zero percent, and accordingly there should not be a negative working capital adjustment.”

4. The TPO after choosing comparable companies arrived at the arm's length mean margin on cost of comparable companies at 24.82%. He then computed the working capital adjustment to be made to those margins by comparing the working capital requirements of the assessee as well as the comparable companies. By doing so, the TPO arrived at a negative working capital adjustment of (-) 5.80%. This was added to the arm's length mean margin of the comparable companies and the ALP was determined by the TPO as follows:-

Arm's Length Mean Margin on cost	24.82%
Less: Working capital adjustment (As per Annex. C)	- 5.80%
Adjusted margin	30.62%
Operating Cost	171,434,124
Arms Length Price (ALP) 1 (130.62% of Operating Cost)	223,826,253
Price received	202,864,223
<b>Shortfall being adjustment u/s. 92CA</b>	<b>21,063,000</b>

5. Insofar as the adjustment on account of working capital is concerned, the assessee submitted before the DRP that the assessee was captive service provider of the AE. The assessee submitted that it is not an entrepreneur, but a captive service provider; all expenses incurred are recovered along with a mark-up. Further, the Assessee does not have borrowings from AEs or third parties. Relevant extracts of the financial statement of the Assessee were furnished as follows:-

SOURCES OF FUNDS			
Shareholders' Funds			
Share Capital	1	11,976,710	11,976,710
Reserves and surplus	2	203,970,758	170,619,427
<b>TOTAL</b>		<b>215,947,468</b>	<b>182,596,137</b>

Schedule 9: Current Liabilities		
Sundry Creditors		
Total outstanding dues of Micro and Small Enterprises (Refer Note 10 to Schedule 14)	-	-
Total outstanding dues of other creditors	12,995,591	15,080,742
Dues to related parties – iPass Inc. USA*	26,883,658	26,895,538
Deferred Revenue	12,284,376	-
Other Liabilities	3,156,607	2,362,317
	<b>55,320,607</b>	<b>44,338,597</b>

\* Liability is related to financial years 2008-09 and 2009-10 towards expatriate services cross charged. The company is making arrangements for payments after taking necessary approvals.

6. The assessee placed reliance on the decision of the ITAT Hyderabad Bench in the case of *Adaptec (India) Pvt. Ltd. v. ACIT, ITA No.206/Hyd /2014* wherein it was held that when business is carried on without working capital risk by the assessee and when comparable companies have such risk, working capital adjustment, if at all, has to be made only on a positive adjustment and has to be made to the comparables so that they are brought on par with the assessee. The Tribunal therefore held that negative working capital adjustment to the arithmetic mean margin on comparables should not be made. This argument did not find favour with the DRP and the DRP upheld the action of TPO with the following observations:-

“ We perused the Annexure-C of the order of the TPO in which the negative working capital adjustment at – 5.80% has been arrived at in applying the similar principles which have been applied in the preceding assessment year which resulted in positive working capital adjustment. The assessee cannot take a contradictory stand by accepting the positive working capital adjustment in the preceding year (which resulted in reduction of adjustment u/s 92CA) and not accepting the negative working adjustment computed on the same principles (which resulted in enhancement of adjustment u/s 92 CA of the Income Tax Act) for the current assessment year. The TPO has applied a consistent approach, which cannot be faulted with. As regard to the reliance of the assessee, on the decision of the Hon'ble ITAT, Benqaluru in the case of *Lam Research (India) Private Ltd*, is concerned, it appears to us that the issue of allowing the positive working capital adjustment in the preceding assessment year, was not before the Hon'ble ITAT and therefore, the Hon'ble ITAT has not examined the issue of consistency in allowing the working capital adjustment. The objection is therefore not acceptable, however, the mean of working capital adjustment, has to be

modified by the TPO based on the comparable retained, on giving effect to the directions contained in this order.”

7. Aggrieved by the aforesaid order of DRP, the assessee raised ground No.8 before the Tribunal.

8. At the time of hearing, it was brought to our notice by the Id. counsel for the assessee that identical issue had come up for consideration in assessee's own case for the AY 2012-13 in ITA No.2093/Bang/2017 and the Tribunal by its order dated 19.7.2019 was pleased to hold that negative working capital adjustment should not be made. The following were the relevant observations of the Tribunal:-

“12. Ground No. 1 is general in nature and therefore do not require any adjudication.

13. Both parties submitted that only effective ground in revenue's appeal is in respect of Ground No. 2-4 is in respect of negative working capital adjustment worked out by the Ld. AO/TPO.

14. Ld.AR submits that this issue stands covered in favour of assessee by decision of this Tribunal in case of F & F India Private Limited in ITA No.195/Bang/2016 & 495/Bang/2017 for assessment year 2011-12 and 2012-13 passed on 03/07/19.

14.1 Ld. CIT DR placed reliance upon the authorities below however could not controvert that this issue is covered by decisions relied upon by Ld.AR.

We have perused the submissions advanced by Ld sides in the light of records placed before us.

14.2 We have also perused the decision relied upon by Ld. counsel. It is observed that this issue has been decided by this Tribunal in F & F India Pvt.Ltd.,(Supra) 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 its 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 03.08.2012 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 this 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."

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”.

Respectfully following the same we direct Ld.AO to grant working capital adjustment as discussed hereinabove.

Accordingly this ground raised by revenue stands dismissed.

In the result, the appeal filed revenue stands dismissed. ”

9. Following the aforesaid decision of the Tribunal and also taking note of the fact that the facts and circumstances in the present assessment year being similar, we direct the AO not to make any negative working capital adjustment as directed by the Tribunal in assessee’s own case for the AY 2012-13. Ground No.8 is accordingly treated as allowed.

10. In the result, the appeal of the assessee is partly allowed.

Pronounced in the open court on this 25<sup>th</sup> day of October, 2019.

Sd/-

Sd/-

( G MANJUNATHA )  
ACCOUNTANT MEMBER

( N V VASUDEVAN )  
VICE PRESIDENT

Bangalore,

Dated, the 25<sup>th</sup> October, 2019.

/ Desai Smurthy /

Copy to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.
6. Guard file

By order

Assistant Registrar,  
ITAT, Bangalore.