

**IN THE INCOME TAX APPELLATE TRIBUNAL  
KOLKATA 'C' BENCH, KOLKATA**

**(Before Sri J. Sudhakar Reddy, Accountant Member & Sri S.S. Godara, Judicial Member)**

**ITA No. 2378/Kol/2017  
Assessment Year: 2013-14**

**Redtech Network India Private Limited.....Appellant**  
**Godrej Waterside**  
**5<sup>th</sup> Floor**  
**Unit-504**  
**Sector-V**  
**Salt Lake City**  
**Kolkata - 700 091**  
**[PAN : AABCB 5398 ]]**

**Vs.**

**Asstt. Commissioner of Income Tax, Circle-2(2), Kolkata.....Respondent**

**Appearances by:**

*Shri Ajit Korde, Advocate, appeared on behalf of the assessee.*

*Dr. P.K. Srihari, CIT Sr. D/R, appearing on behalf of the Revenue.*

Date of concluding the hearing : October 14<sup>th</sup>, 2019

Date of pronouncing the order : November 27<sup>th</sup>, 2019

**ORDER**

**Per J. Sudhakar Reddy, AM :-**

This appeal filed by the assessee is directed against the order of Assessing Officer passed u/s 143(3) r.w.s. 144C(5) of the Income Tax Act, 1961 (the 'Act'), dt. 22/09/2017, for the Assessment Year 2013-14.

2. The assessee company, Redtech Network India Private Limited ('Redtech India'), is a subsidiary of Usha Communications Technology Limited (UCTL), a company registered in the British Virgin Islands. Redtech India, is involved in development of telecommunication billings and customer care software. Marketing and implementation is done through its 100% subsidiary UshaComm Tech Inc. New Jersey, USA (UCT USA).

The assessee company, has been characterised as a "specialised software developer, servicing the telecommunication industry". The AE has been characterised as a company involved in marketing and distribution of Redtech India telecommunication solutions. Considering the fact that Redtech India is a developer of software products, which are marketed and distributed by its AE, most of the market product and service liability risk, R&D risk, credit risk, manpower risk, foreign exchange risk and capacity utilization risk are borne by Redtech India.

3. The Assessing Officer in the impugned assessment order determined the total income of the assessee company at Rs.5,92,58,090/-, as against the total income of Rs.48,26,110/- declared by the assessee company in its return of income for the Assessment Year 2013-14 e-filed on 26/11/2013. While doing so, the Assessing Officer made an addition/adjustment under the Transfer Pricing (TP) provisions of Rs.3,19,39,211/- on the following three international transactions:-

- a) Software Development Services
- b) Outstanding receivable in excess of 60 days.
- c) Guarantee fees paid to the Associate Enterprises (AEs)

The Assessing Officer further disallowed the claim of write off, of long term investment, and also made disallowance u/s 14A of the Act. He disallowed the claim of bad debts.

4. Aggrieved the assessee is before us on the following grounds:-

***“1. Erroneous determination of arm's length price in relation to software development services***

*1.1. On the facts and circumstances of the case and in law, the AO/ TPO erred in not following the directions of the DRP and erroneously included comparable companies for the purpose of computing the arm's length price*

*1.2. On the facts and circumstances of the case and in law, the AO/ TPO erred in not being consistent in the interpretation of the DRP directions and cherry picked comparable companies while giving effect to the directions for computing the arm's length price*

*1.3. Without prejudice to the above, on the facts and circumstances of the case, the AO/ TPO and the DRP erred in law by rejecting comparable companies selected by the Appellant in the transfer pricing report for the international transactions of the Appellant*

*1.4. Without prejudice to the above, on the facts and circumstances of the case, the AO/ TPO and the DRP erred in selecting certain comparable companies which have different functional and risk profile as compared to the Appellant;*

*1.5. Without prejudice to the above, on the facts and circumstances of the case and in law, the AO/ TPO and the DRP erred in rejecting / modifying the filters applied by the Appellant for determining the comparability analysis*

***2. Erroneous transfer pricing adjustment on account of outstanding receivable in excess of 60 days considering it as deemed loan to its AE***

*2.1. On the facts and circumstances of the case and in law, the AO/ TPO and DRP erred in treating accounts receivable as a separate international transaction and treating the same as deemed loan on which notional interest was charged;*

2.2. *On the facts and circumstances of the case and in law, the AO/ TPO and DRP erred in not appreciating the fact that transaction of receivable and payables has already been benchmarked with the international transaction of "Sale of software development services" after undertaking financial adjustments as warranted by Indian TP regulations;*

2.3. *Without prejudice to the above, on the facts and circumstances of the case and in law, the AO/ TPO and DRP erred in applying an ad-hoc credit spread of 6.00% on the alleged Loan;*

2.4. *Without prejudice to the above, on the facts and circumstances of the case, the AO/ TPO and DRP erred in considering an ad-hoc average credit period of the Industry without any basis to determine the outstanding receivable on which adjustment was made on account of notional interest;*

**3. The learned DRP and TPO/ AO erred in making transfer pricing adjustment on account of the guarantee fees paid to the associated enterprise**

3.1. *On the facts and circumstances of the case and in law, the AO/ TPO and DRP erred in concluding that the corporate guarantee issued by the Appellant in favor of AE is an international transaction*

3.2. *On the facts and circumstances of the case and in law, the AO/ TPO and DRP erred in not appreciating the fact that corporate guarantee extended to AE is in the nature of shareholder's activity and results in direct and proximate benefit to Appellant;*

3.3. *Without prejudice to the above contentions, on the facts and circumstances of the case and in law, the AO/ TPO and DRP erred in arbitrarily levying a guarantee commission of 3% and consequently making a transfer pricing adjustment;*

3.4. *Without prejudice to the above contentions, on the facts and circumstances of the case and in law, the AO/ TPO and DRP erred in arbitrarily rejecting the CUP analysis as provided by Appellant without any basis i.e. a rate of 1.5% which would have paid to its bank for identical arrangement under similar circumstances;*

**Corporate Tax grounds**

**4. Erroneous disallowance in relation to bad debt and write off of sundry balances/advances totalling to INR 19,21,498**

4.1. *On the facts and circumstances of the case and in law, the AO/ TPO and DRP erred in not appreciating that the bad debts and sundry advances written off are business losses incurred by the Appellant in the course of business and thus deductible under section 37 of the Act while computing the income for the subject year.*

**5. Initiation of penalty proceedings**

5.1. *The Appellant submits that based on the facts and the circumstances of the case, there was no basis for the AO to propose to initiate penalty proceedings under section 271(1) (C) of the Act.*

*The Appellant submits that the above grounds are independent and without prejudice to one another.*

*The Appellant desires leave to add to or alter, by deletion, substitution or otherwise, any or all of the above grounds of objections, at any time before or during the hearing of the Appeal.*

4.1. The assessee further raised the following two additional grounds of appeal:-

“2.5. For similar nature of third party receivables if there is no change of interest, then the transaction with the AE would meet the arm’s length requirement vis-a-vis . the transactions with the unrelated third parties.

2.6. Without prejudice to the ground above and Ground 2 originally filed before ITAT, the appellant humbly submit that computation of average days of realization period of receivables for the final list of comparable companies should be considered as the bench mark credit period for determination of arm’s length price.”

5. We have heard Shri Ajit Korde, the Id. Counsel appearing on behalf of the assessee and Dr. P.K. Srihari, Id. CIT, D/R, on behalf of the revenue.

5.1. The Id. Counsel for the assessee filed a compilation paper book as well as detailed chart. He argued the matter at length. He relied on a number of case-law in support of his contentions, with which we would be dealing in due course. The Id. CIT D/R relied extensively on the order of the TPO as well as the DRP and controverted the arguments of the Id. Counsel for the assessee.

6. On careful consideration of the facts and circumstances of the case, perusal of the papers on record, orders of the authorities below as well as case law cited, we hold as follows:-

7. We first take up the issue of TP adjustment made on the international transactions of software development services. We find that the TPO has not complied with the binding directions of the DRP on the issue of exclusion of comparables, E-Infochip Ltd. and Thirdware Solutions Ltd. The assessee has contended that no segmental data is available in the case of both these companies which were chosen as comparable companies by the TPO. Thus, it is the case of the assessee that these companies should be excluded from the list of comparables for the purpose of computing ALP. Reliance was placed on the decision of the Kolkata Bench of the Tribunal in the case of *Philips India Limited vs. DCIT in IT No. 2489/Kol/2017, order dt. 04/04/2018*, wherein under similar circumstances these companies were excluded from the list of comparables.

The Id. D/R, could not demonstrate that segmental data was available in the case of both these companies i.e., E-Infochip Ltd. and Thirdware Solutions Ltd. Thus, the

contention of the assessee that annual report provides segmental details only on the basis of geographical markets and does not have segmental data of software services and software products or ITeS, is not controverted by the ld. D/R. Under these circumstances, the directions of the DRP, which are binding on the TPO has to be implemented.

8. This Bench of the Tribunal in the case of *Philips India Ltd. (Supra)*, at para 13 & 13.1., has held as follows:-

*“13. We have heard the rival submissions. The ld AR before us stated that out of the total 8 comparables chosen by the ld TPO finally , if the comparables of E.-Infochips Bangalore Ltd and Thirdware Solutions Ltd are excluded, then the assessee's margin would be at ALP when compared to that of other comparables, subject to variation of (+) / (-) 5% and subject to working capital adjustments to be given for the remaining 6 comparables. The ld DR argued that let this issue be sent back to the file of the ld TPO to verify the services rendered by these two companies to prove the arguments of the ld AR. We find that the annual reports of the respective two comparables are very much on record and there is no need to send back the same to the file of the ld TPO for his verification. These annual reports were also placed before the lower authorities and objections were also filed by the assessee. The same were completely ignored by the ld TPO while finalizing the list of comparables. We find that the ld DRP had directed the ld TPO to include E- Infochips Bangalore Ltd only if the segmental data is available for the same. But the ld TPO misconstrued the said direction by holding that since the segmental data is not available for E-Infochips Bangalore Ltd, the same is eligible to be included as comparable. This understanding of the ld TPO is unwarranted and is against the directions of the ld DRP. We also find that the ld AR placed on record that the said company has significant related party transactions of 24.55% on total operating revenues. Moreover, the ld AR also pointed out that the said comparable is engaged in sale of products, software development and IT enabled services and hence segmental data would be very crucial for comparison of the margins with the assessee for software development alone. Moreover the said company had incurred significant expenditure on account of R&D during the year. The details are enclosed in pages 1098 to 1105 of the paper book. Moreover, the said comparable had been excluded by the order of this tribunal in assessee's own case for the Asst Year 2011-12. Hence we hold that the said company is functionally not comparable and hence deserves to be excluded from the final list of comparables.*

*13.1. With regard to Thirdware Solutions Ltd, the said company is engaged in the provision of information technology enabled services (ITES) along with software product development and provision of software development services. Segmental break up of revenue attributable to software development services and ITES is not available. The said company has significant related party transactions of 23.13% on total operating revenues. The details are enclosed in pages 1115 to 1120 of the paper book. In view of these distinguishing features vis a vis the assessee company, we hold that the same is not functionally comparable and in the absence of segmental data for determining the margin derived on account of software development services and by applying RPT filter, the said comparable deserves to be excluded from the final list of comparables.”*

9. Consistent with the view taken therein, we direct the exclusion of both these companies from the list of comparable companies for the purpose of computation of ALP of the international transaction in relation to software development services. The assessee claims that, the TP adjustment made in this regard would have to be deleted, if these two companies are excluded from the list of comparable companies. The TPO may verify this claim of the assessee and allow the claim if found correct. **In the result, this ground of the assessee is allowed for statistical purposes.**

10. Ground No. 2 is on the issue of TP adjustment made on account of outstanding receivable in excess of 60 days, considering the outstanding receivable as a deemed loan to AE.

10.1. The contentions of the assessee are as follows:-

- a) The recovery of the debt itself is doubtful and hence charge of interest cannot be made.
- b) The assessee had not charged interest on delayed payments from unrelated third parties. Hence if an internal CUP is applied, no TP adjustment can be made.
- c) Adjustment made on account of outstanding receivables, is subsumed while computing work-in-capital adjustment.
- d) Without prejudice to the above, the revenue is in error in applying an arbitrary adhoc rate of interest of 6% (six percent).
- e) Without prejudice, benchmark credit period has to be computed after considering and factoring the credit period given to the third party or the credit period of the comparable companies selected.

10.2. The ld. D/R opposes these contentions and submission that, while making TP adjustment, real income theory cannot be brought into place. He relied on the judgement of the Special Bench of the ITAT in the case of *Instrumentarium Corporation Ltd. vs. DDIT in ITA No. 1548 & 1549/Kol/2009, for the assessment year 2003-04 & 2004-05*, and submitted that the adjustment is justified. He relied on the order of the Assessing Officer/TPO and prayed that the same may be upheld.

11. We first consider the proposition of law laid down by the Hon'ble Delhi High Court in the case of *Pr. CIT vs. Kusum Health Care Pvt. Ltd. in ITA 765/2016, judgment dt. 25/04/2017*, wherein, it was held as follows:-

*"10. The Court is unable to agree with the above submissions. The inclusion in the Explanation to Section 92B of the Act of the expression "receivables" does not mean that de hors the context every item of "receivables" appearing in the accounts of an entity, which may have dealings with foreign AEs would automatically be characterised as an international transaction. There may be a delay in collection of monies for supplies made, even beyond the agreed limit, due to a variety of factors which will have to be investigated on a case to case basis. Importantly, the impact this would have on the working capital of the Assessee will have to be studied. In other words, there has to be a proper inquiry by the TPO by analysing the statistics over a period of time to discern a pattern which would indicate that vis-à-vis the receivables for the supplies made to an AE, the arrangement reflects an international transaction intended to benefit the AE in some way.*

*11. The Court finds that the entire focus of the AO was on just one AY and the figure of receivables in relation to that AY can hardly reflect a pattern that would justify a TPO concluding that the figure of receivables beyond 180 days constitutes an international transaction by itself. With the Assessee having already factored in the impact of the receivables on the working capital and thereby on its pricing/profitability vis-à-vis that of its comparables, any further adjustment only on the basis of the outstanding receivables would have distorted the picture and re-characterised the transaction. This was clearly impermissible in law as explained by this Court in **CIT v. EKL Appliances Ltd. (2012) 345 ITR 241 (Delhi)**."*

11.1. The Hyderabad 'A' Bench of the Tribunal in the case of *Hexagon Capability Center India Pvt. Ltd. vs. ACIT* reported in [2019] 102 taxmann.com 461 (Hyderabad - Trib.), held as follows:-

*"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 (P.) Ltd., (supra)* 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 (P.) Ltd. v. Asstt. CIT [2017] 87 taxmann.com 131 (Hyd. - Trib.) Co-ordinate Bench of this Tribunal has followed the decision of the Hon'ble Delhi High Court in the case of Kusum Healthcare (P.) 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."*

12. Consistent with the view taken therein, we uphold the contention of the assessee that the working capital adjustment in this case, subsumes the adjustment that is required to be made on account of interest on outstanding receivables. Hence, this adjustment made by the TPO is hereby deleted and this Ground of the assessee is allowed. The other arguments raised by the assessee are left open for adjudication at the proper time.

13. The third adjustment made is with respect to the international transaction of guarantee fees paid to Associate Enterprises (AEs).

14. After hearing rival contention, we find that the assessee has offered 1.5% as corporate guarantee to its AEs, which is based on an internal CUP, which is the guarantee rate charged by the IDBI to the assessee company. Even under the Safe Harbor Rules, if the guarantee is provided to a subsidiary and the commission or fee declared is at the rate not less than one per cent per annum on the amount of guarantee. In this case, 1.5% rate of commission is charged by the assessee. In our view, this should be considered as at arm's length. The TPO has determined the ALP at three per cent, on an adhoc basis. After considering the facts and circumstances of the case, we direct the deletion of this adjustment as in our view. In the result, this ground of the assessee is allowed.

15. We now take up the corporate grounds i.e., disallowance of bad debt and write off of sundry balances/advances.

15.1. The assessee had claimed an amount of Rs.12,72,479/-, as a deduction on account of bad debts written off and Rs.49,96,733/- as a deduction on account of sundry balances written off. The Assessing Officer disallowed these amounts on the ground that

the assessee has not substantiated the same. He held that the assessee has to prove that the debts are connected with the business and profession and that they should be routed through the profit and loss account. The assessee claims that both these conditions have been fulfilled by it.

The DRP held as follows:-

*“Against the disallowance the assessee moved before the Hon’ble DRP-2, New Delhi who in its decision dated 09.08.2017 observed that:-*

*The claim of Rs.12,647/- regarding employees having left with balances cannot be termed as revenue expenditure. No supporting evidence was provided. Similarly, no supporting evidence was provided for intra group receivable of Rs.3,48,645/-. For the amount receivable of Rs.15,60,871/- from clients also, the year in which the amount was offered for tax is not given. The three amounts have been rightly disallowed by the AO, in absence of details.*

*Regarding the claim of Rs.43,47,715/-, the ‘A’ submitted that it was the amount of input credit of CENVAT which cannot be utilized by the assessee being an export oriented company. The amount is therefore excess input credit amount. By writing it off, the ‘A’ is also waiving off any probability of utilizing the credit in case of any change of circumstances. In view of the submission of the ‘A’, the AO is directed to allow the amount after verifying the total written off till A.Y. 2013-14.*

*Subsequently, the assessee vide its letter dated 05.09.2017 provided the details and documents showing the amount of service tax receivables written off by the assessee during F Y 2012-13.*

*The submission of the assessee has been perused and it is found that the assessee has written off an amount of Rs.43,47,714/- towards service tax receivables during F Y 2012-13. Considering the same and the direction of the Hon’ble DRP-2, New Delhi, the claim of the assessee is partially allowed and disallowance of write-off of bad debt and sundry balances is restricted to Rs.19,21,498/- (Rs.62,69,212- Rs.43,47,714).”*

15.1.1. Thus, the Assessing Officer in the final assessment order restricted the disallowance to Rs.12,647/- being amounts paid to employees, which cannot be recovered and amount of Rs.3,48,645/- receivable from group entities and an amount of Rs.15,60,871/- receivable from clients.

In our view, the receivables from clients and intra group entities have definitely been routed through the profit and loss account. Otherwise they would not be trade receivables. The balances in employee accounts, who have left are also not receivables.

15.2. The Hon'ble Supreme Court in the case of *TRF India vs. CIT (2010) 323 ITR 397 (SC)* has held as follows:-

*“Section 36(1)(vii) of the Income-tax Act, 1961 - Bad debts - Assessment years 1990-91, 1993-94 and 1994-95 - Whether after 1-4-1989, it is not necessary for assessee to establish that debt, in fact, has become irrecoverable; it is enough if bad debt is written off as irrecoverable in accounts of assessee - Held, yes - Whether where Assessing Officer had not examined whether, in fact, bad debt or part thereof was written off in accounts of assessee, matter was to be remitted back to Assessing Officer for de novo consideration of above mentioned aspect only”*

16. Respectfully following the propositions of law laid down by the Hon'ble Supreme Court, we delete the disallowance in question and allow this ground of the assessee.

17. In the result, appeal of the assessee is allowed.

***Kolkata, the 27<sup>th</sup> day of November, 2019.***

***Sd/-***  
**[S.S. Godara]**  
Judicial Member

Dated : 27.11.2019  
{SC SPS}

***Sd/-***  
**[J. Sudhakar Reddy]**  
Accountant Member

*Copy of the order forwarded to:*

**1. Redtech Network India Private Limited**  
**Godrej Waterside**  
**5<sup>th</sup> Floor**  
**Unit-504**  
**Sector-V**  
**Salt Lake City**  
**Kolkata – 700 091**

**2. Asstt. Commissioner of Income Tax, Circle-2(2), Kolkata**

3. CIT(A)-

4. CIT- ,

5. CIT(DR), Kolkata Benches, Kolkata.

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By order

Assistant Registrar  
ITAT, Kolkata Benches