

**IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCH "B", HYDERABAD**

**BEFORE SHRI P. MADHAVI DEVI, JUDICIAL MEMBER AND
D.S. SUNDER SINGH, ACCOUNTANT MEMBER**

(THROUGH VIDEO CONFERENCE)

**ITA No. 2228/Hyd/2017
Assessment Year: 2013-14**

OSI Systems Pvt. Ltd., vs. Dy. Commissioner of Income-
Hyderabad. tax, Circle – 16(2),
Hyderabad.

PAN – AAACO 4438M

(Appellant)

(Respondent)

Assessee by : Shri Ajit Tolani &
Shri Darpan Kirpalani
Revenue by : Shri YVST Sai

Date of hearing : 09-11-2020
Date of pronouncement : 18-11-2020

ORDER

PER D.S. SUNDER SINGH, A.M.

This appeal is filed by the assessee against the order passed u/s 143(3) rws 92CA(3) rws 144C(5) of the IT Act, 1961, dated 26/10/2017.

2. All the grounds raised in this appeal are related to charging of interest on outstanding receivables.

3. The TPO found that the taxpayer had outstanding receivables of Rs. 59,17,71,560/- as at the end of the year. The TPO asked the assessee to submit the details and proposed to charge notional interest @ 14.5% as applicable on deposits rates of State Bank of

India (in short SBI) for adjustment. The assessee objected the proposed adjustment stating that receivables were related to international transactions undertaken by the assessee and are not in the nature of any advance/loans as mentioned in the income tax act (in short act). It was further stated that the company is fully funded entity and the sales and receivables are running accounts. The assessee further submitted before the TPO that it does not bear the working capital risk, which require charging of notional interest. The taxpayer relied on the cases of Pegasystems Worldwide India Pvt.Ltd. for AY 2009-10, ITA No.1758 & 1936/Hyd/2014, Evonik Degussa India P.Ltd., ITA No. 7653/Mum/2011, and Indo American Jewellery Ltd., ITA No. 5872/Mum/2009.

3.1 The TPO was not convinced with the submissions of the assessee in view of introduction of clause 'c" to Explanation to section 92B clarifying that all the transactions of capital financing including long term and short term borrowings and receivables or any debt arising during the course of business w.e.f 01/04/2002 by finance act 2012. Thus, the TPO held that imputation of interest on receivables as international transaction and accordingly, rejected the contentions of the assessee and suggested adjustment for of Rs. 6,54,11,154/- u/s 92CA(3) of the IT Act.

3.2 Accordingly, the AO issued draft assessment order proposing to make the adjustment u/s 92CA(3) of the Act to the extent of Rs. 6,54,11,154/-, as suggested by the TPO and in response to which, the

assessee filed objections before the Ld. Dispute Resolution Panel(DRP).

3.3 The Ld. DRP upheld the adjustment proposed by the TPO on the ground that interest on receivables would constitute separate international transactions. The DRP observed that the Ld. TPO charged the interest till the date of passing the order, which was not proper, and directed the Assessing officer(AO) to charge the interest till the end of the Financial Year(FY) relevant to Assessment year(AY). The Ld. DRP further directed the AO to restrict the adjustment for delay in payment till the end of FY and also to consider the invoice raised in the earlier FY also, in respect of which payments were received during the FY relevant to the impugned AY and compute the ALP.

3.4 The assessee also raised objections with regard to netting of outstanding payables of Rs. 13,08,87,984/- against the outstanding receivables from its AE. The DRP noted that the assessee was to furnish the details of such payables along with terms and conditions of agreement. Since the assessee failed to furnish any such information, the DRP rejected the contention of the assessee with regard to netting of outstanding payables against outstanding receivables.

3.5 Accordingly, the AO passed final assessment order and made the adjustment of Rs. 3,44,83,411/- u/s 92CA(3) of the Act, against which, the assessee filed appeal before the Tribunal.

4. Before us, the Id. AR of the assessee argued that assessee has adopted TNMM as Most appropriate method and the margin of the assessee was more than the comparable companies, therefore, argued that interest on receivables subsumed in the working capital adjustments, thus, no separate adjustment is required on account of interest on receivables. The assessee further submitted that against the margins ranging from 0.84% to 17.85% of comparable companies, the assessee's margin was 5.63% and 22% as per the details given below:

Particulars		Mfg	SDS	ITES	Trading	Total
Sales	A	327311992	218910676	68836166	191732383	806791217
Operating Cost	B	268295716	177932133	52536734	180932235	679696818
Profit	C= A-B	59016276	40978543	16299432	10800148	127094399
OP/OC%	D=	22.00	23.03	31.02		18.70
	C/B%					
	E=					
OP/OR%	C/A%				5.63	15.75
Compara-ble margin						
OP/OC%	F	(0.84)	15.69	17.85		
OP/OR%	G				2.24	

4.1 The assessee further submitted that the excess profit earned by the assessee was Rs. 8,77,55,919/-, which takes care of of the adjustments that are required to be made to determine ALP in

imputing the interest and, thus, argued that no separate adjustment is required to be made on account of imputation of interest on receivables. The assessee further argued that transaction is not covered in the definition of international transaction as defined u/s 92B of the Act, since, the same was on account of international transactions and not a separate transaction of financing. Accordingly, the Ld.A.R submitted that there is no case for making adjustment and requested to set aside the orders of lower authorities and allow the appeal of the assessee.

4.2. Alternatively, the Id. AR also submitted that AO/TPO imputed the interest @ 14.5%, which is at SBI Fixed deposit rates/lending rates and allowed the credit period of 30 days. He, therefore, requested to change the interest as per LIBOR rate, since, the assessee has receivables in foreign exchange and allow credit period of 120 days against 30 days allowed by the assessee. The Id. AR further argued that outstanding payables required to be netted against outstanding receivables for computing the interest.

5. Per contra, the Id. DR submitted that capital financing is separate international transaction and with the introduction of clarificatory amendment to explanation to section 92B, receivables arising during the course of business are required to be included in the international transaction. In the instant case, there was a substantial delay of 353 days in realizing the debts, therefore argued that as per section 92B, interest on receivables is required to be

included for the purpose of imputation interest on receivables and adjustment is required to be made. He further argued that interest on receivables cannot be clubbed with the software development services or any other activity of the assessee such as sale or purchase. Ld. DR relied on the decision of the Techbooks International Pvt. Ltd., ITA No. 6102/Del/2016 dated 06/07/2020 and BT e-Serve (India) Pvt.Ltd., ITA No. 6690/Del/2016, dated 19/06/2018 and argued that the DRP has rightly upheld the order of TPO and no interference is called for.

6. We have heard the rival contentions and perused the material on record. In the instant case, there were receivables outstanding as at the end of the year to the extent of Rs. 59,17,71,560/- and the delay was around 353 days as submitted by the Id. DR. Though, the assessee is having huge margin and the sale price is at arm's length, subsequent to the introduction of clause 'c' to explanation of section 92B, receivables constitute separate international transaction. The issue, whether the debts arising out of trading transactions constitute advances or not was considered by the Ld. DRP in it's order in detail in page nos. 5 &6 of the DRP order placing reliance on the decision of coordinate bench of ITAT, Bangalore in Logix Microsystems Ltd. Further, as per the amendment made to Explanation to section 92B, it is clearly clarified that any type of advance, payment or default payments or receivables or any debit arising during the course of business constitute international transactions. For the sake of clarity

and convenience, we extract clause (c) of explanation to section 92B, which as under:

“(c) capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business”.

6.1 From the plain reading of clause (c) of Explanation to section 92B, it is clear that any debt arising during the course of business constitute international transaction. No separate treatment was given for the trading transactions. Similarly, the contention of the Ld.AR if the international transaction at ALP, no separate adjustment is required to be made on account of outstanding deferred receivables has no basis and the same was not specifically excluded in the meaning of international transaction. Therefore, even though trading transactions are at ALP, with the introduction of amendment to Explanation to section 92B, we are of the considered opinion that interest is required to be imputed on outstanding receivables if the same are realized beyond the agreed period as per the terms and conditions of the agreement. The Ld. DRP rejected the contention of the assessee with regard to deferred receivables in it's order in page No.3 &4 placing reliance on the decision of coordinate bench of ITAT in Bechtel India Pvt Ltd in ITA No. 6530/Del/2016, dated 16/05/2017.

6.2 Ld. AR relied on the decision of CCL Products India Ltd., ITA No.348 of Vizag Bench order dated 03/04/2019. In the said order, the CIT(A) has given a finding that receivables were received in a reasonable period and there was no delay, whereas, no such finding was given in the instant case by the Id. DRP/TPO. As submitted by the Ld.DR the realization was made beyond 353 days which is abnormal under any circumstances. Therefore, the case law relied upon by the assessee in the case of CCL Products India Ltd. is not applicable to the case of assessee. The Id. AR also relied upon the decision of ITAT, "A' bench, Hyderabad in the case of M/s Value Labs Technologies, ITA No. 1921/Hyd/2018 dated 04/09/2020 wherein, the Hon'ble Tribunal has taken a view that no adjustment is required if the delay is between 90 and 120 days. In the instant case, as submitted by the Id. DR, the delay was around 353 days. Therefore, the Value Lab's case is also not helpful to the case of the assessee.

6.4 The Id. DR relied on the decision of Techbooks International Pvt. Ltd. (supra), wherein the ITAT, Delhi confirmed the decision of DRP in imputing the interest on delayed receipts. Similarly, the Id. DR relied also on the decision of BT e-Serve (India) Pvt. Ltd. (supra), wherein, the coordinate bench of ITAT, Delhi held that even the outstanding receivables partake the character of capital financing and consequently, overdue outstanding is an international transaction in ITA No.565/2015 dated 30/10/2017 Delhi Bench in para No 22 for the

A.Y. 2011-12. For the sake of clarity and convenience, we extract para 22 of the order of the coordinate bench, as under:

“22. We have carefully considered the rival contentions. The service agreement dated 01st August 2009 is placed at page No. 294 to 311 of paper book. The service fees are governed by clause 4 of the agreement. According to clause No. 4.9 subsequent to confirmation of the invoices it is provided that the paying party will pay the invoice amount to the invoicing party in accordance with the BT group policy for the settlement of intra-group transaction. Schedule 1 of that agreement is with respect to the services, Schedule -2 is with respect to BTGS transfer pricing policy. According to para No. 3.4 of that policy the service fee for the provision and receipt of services are calculated in the order that BT, BT Ltd and OPCO receive an arm’s length return for the services provided and received. Therefore, according to that policy it is evident that the policy of the group is to charge the services at arm’s length. In this background it needs to be examined that whether a third party in a given circumstances would allow it’s outstanding to drift to such an extent. The apparent answer to this query would be emphatic „No“. Further on reading the transfer pricing study report prepared by the assessee, in the credit and collection risk it has been mentioned that when an entity supplies products or services to a customer in advance of customer payment, the firm runs the risk that the customer will fail to make payment. BT e-serv provides service for in house consumption and invoices its AEs. It bears no credit and collection risk since it received charges from its AEs. Therefore it is evident that assessee has not stated credit and collection risk in its TP report. Looking at the period of outstanding invoices it is apparent that it is the not the case of mere sale but it is a case of sales as well as loan to its AE in the form of overdue outstanding receivables. The argument that assessee is an interest free entity and does not pay any interest and therefore no interest shall be imputed in the outstanding invoices is also devoid of merit because it is not a case of allowance of interest expenditure in the hands of the assessee but an “international transaction” to be benchmarked at arm’s length. It is a case of determination of arm’s length price of a transaction. Undoubtedly the receivable or any other debt arising during the course of the business is included in the definition of „capital financing” as an „international transaction” as per explanation 2 to section 92B of the Act w.e.f. 01.04.2002 inserted by the Finance Act 2012. Therefore, even the outstanding receivable partake the character of capital financing and consequently, overdue outstanding is an “international transaction”. The natural corollary would be of imputing interest on such „capital financing”, if same is not charged at arm’s length. Therefore, we reject the contention of the assessee that outstanding receivable is not an „international transaction” and therefore, hence, according to us, interest on it requires to be imputed. Now the next question arises is that if outstanding receivables are within the

terms of agreement of rendering of services than it may be argued that interest on such outstanding is already covered in the sale price of the goods. Naturally such is not the case of the assessee before us as some of the outstanding are for more than 300 days. Decision relied upon by the Id AR in the case of Ameriprice and Bechtel are distinguishable on the facts as they had credit period as per agreement but in case of assessee it is not so. The arguments that master circular of RBI does not prescribe any conditions for repatriation of exports proceeds for SEZ, it cannot be said that for determining ALP of export receivable, which becomes capital financing, if outstanding is beyond agreed or reasonable time limit, does not have any impact on the benchmarking of the same, as the purposes of RBI policy and Income Tax Act are on different footings. However, even if the agreement does not specify the term of the payment even then assessee must be given benefit of credit period which is accepted business practice in the trade. Before the Id Transfer Pricing Officer as well as before the Id DRP the assessee could not establish what is the accepted business practice in its trade about the credit period and what the group policy is in this regard. Therefore, there cannot be any grievance where the Id Transfer Pricing Officer has considered as 30 days credit period. Even before us this credit period was not challenged. In view of this we do not find any infirmity in the order of the Id Transfer Pricing Officer of considering 30 days as normal credit period. The subsequent question arises about the benchmarking analysis and computing the arm's length price. In the present case the Id Assessing Officer has computed interest @14.88% applying the CUP method using external CUP. Before us as well as before the Id DRP the assessee could not demonstrate how the method employed by the Id Transfer Pricing Officer using external CUP is erroneous. In view of this we do not have any hesitation in confirming the Transfer Pricing adjustment made by the Id. Transfer Pricing Officer on outstanding receivable beyond 30 days credit period applying the interest rate of 14.88% p.a. and computing the interest receivable at Rs. 31577050/-. In the result, grounds Nos. 10 to 12 of the grounds of the appeal are dismissed."

6.5 On similar facts, the coordinate bench of this tribunal in the case of Infor (India) Pvt. Ltd. ITA No. 1689/Hyd/2019, order dated 19/10/2020 held that with the introduction of Explanation to section 92B, interest on receivables constitute international transaction and separate adjustment is required to be made on account of interest on delayed payments. Therefore we, hold that the Ld.DRP/TPO/AO is

justified in imputing the interest on deferred receivable as international transaction accordingly we, uphold the order of the DRP/AO and dismiss the assessee's appeal in these grounds.

6.6 The next issue is rate of interest on receivables. In the instant case, the receivables represent the trade receipts and the same are required to be received in foreign exchange. The Tribunal in the case of M/s Value Labs Technologies Vs. ITO, ITA No. 1919/Hyd/2017 for AY 2013-14, vide order dated 05/04/2019 has held that in the case of export turnover, which required to be received in foreign exchange, the international transaction shall be considered at LIBOR + 200 basis points rate after the expiry of credit period. Further, in the case of Cambridge Technology Enterprises Ltd., Vs. DCIT, ITA No. 208/Hyd/2018 for AY 2013-14, vide order dated 19/11/2019, the Tribunal held that notional interest has to be charged at LIBOR + interest rates as the receivables are in foreign exchange. Therefore, respectfully following the view taken by the coordinate benches of ITAT in the said cases, we hold that interest rate should be charged on receivables at LIBOR + 200 points. Accordingly, we direct the AO/TPO to charge interest at LIBOR + 200 basis points.

6.7 Similarly, in respect of credit period, TPO has allowed 30 days and no agreement was placed by the assessee before us. However, in the case of M/s Value Labs(Supra), on which reliance was placed by the assessee, this Tribunal held that interest to be charged in the

case of delay between 90 to 120 days and in the case of Infor (India) Pvt Ltd, ITAT allowed 90days. Considering the facts and merits of the case , we hold that 120 days is reasonable period in this case, hence, we direct the AO/TPO to allow 120 days credit period and charge interest over and above the outstanding period of 120 days .

6.8. As regards netting of interest, the Id. counsel argued that interest on payables is to be netted against the outstanding receivables. This issue has been considered by the DRP and in the absence of details, the assessee's request for adjustment was rejected. No details are furnished by the assessee even before us with regard to netting of payables against receivables. We, therefore, reject the ground of the assessee on this issue of netting out of payables against the receivables.

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

Pronounced in the open court on 18th November, 2020

Sd/-
(P. MADHAVI DEVI)
JUDICIAL MEMEBR

Sd/-
(D.S. SUNDER SINGH)
ACCOUNTANT MEMBER

Hyderabad, Dated: 18th November, 2020.

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Copy to:

- 1) *OSI Systems Pvt. Ltd., 4th Floor, Orion Block, the VIT Park, Plot No. 17, Software Units Layout, Madhapur, Hyderabad – 500 081*
- 2) *DCIT, Circle – 16(2), IT Towers, AC Guards, Masab Tank, Hyderabad – 500 004*
- 3) *DRP – 1, Bengaluru*
- 4) *Pr. CIT – 4, Hyderabad.*
- 5) *The Departmental Representative, I.T.A.T., Hyderabad.*
- 6) *Guard File.*