

**IN THE INCOME TAX APPELLATE TRIBUNAL VIRTUAL COURT  
"B", BENCH MUMBAI**

**BEFORE SHRI C.N.PRASAD, JM**

**&**

**SHRI M.BALAGANESH, AM**

**ITA No.2280/Hyd/2017  
(Assessment Year :2013-14)**

M/s.Commvault Systems (India) Pvt. Ltd., 5 <sup>th</sup> Floor, Plot No.39, Phase-II, Block-A Ananth Info Park Hitech City, Madhapur, Hyderabad	Vs.	Deputy Commissioner of Income Tax, Circle-1(2), B-Block, 7 <sup>th</sup> Floor, I.T. Towers A.C.Guards, Masab Tank Hyderabad – 500 004
<b>PAN/GIR No.AACCC3708L</b>		
<b>(Appellant)</b>	..	<b>(Respondent)</b>

Assessee by	Shri Darpan Kirpalani (AR)
Revenue by	Shri Y V S T Sai (CIT DR)
<b>Date of Hearing</b>	<b>31/08/2020</b>
<b>Date of Pronouncement</b>	<b>26/11/2020</b>

**आदेश / O R D E R**

**PER M. BALAGANESH (A.M):**

This appeal in ITA No.2280/Hyd/2017 for A.Y.2013-14 preferred by the order against the final assessment order passed by the Assessing Officer dated 26/10/2017 u/s.143(3) r.w.s.144C of the Income Tax Act, hereinafter referred to as Act, pursuant to the directions of the Id. Dispute Resolution Panel (DRP in short) u/s.144C(5) of the Act dated 14/09/2017 for the A.Y.2013-14.

2. The assessee has raised the following grounds with regard to transfer pricing matters:-

**GENERAL GROUND**

1. Erred in assessing the total income of the Appellant at Rs.7,81,70,207 as against Rs.3,54,02,309 as computed by the Appellant in its return of income.

**TRANSFER PRICING MATTERS**

**A. In relation to the software development services undertaken by the Appellant**

***Rejection of transfer pricing documentation maintained***

1) Rejection of the transfer pricing documentation maintained by the assessee in accordance with the provisions of the Act read with the Income Tax Rules, 1962 ("Rules") and undertaking a fresh economic analysis during the course of assessment proceedings and accordingly making an adjustment of Rs.1,93,66,256/- to the international transactions of providing software services to its AE;

***Rejection of use of multiple year data***

2. Rejecting the use of multiple year data and using data for the FY 2012-13 only; Use of additional filters

3. Inter-alia use of the following additional/modified filters in undertaking the comparative analysis and rejecting comparable companies having:

- (a) Different financial year-end; and
- (b) Export sales less than 75% of the sales

***Selection of companies***

4. Not undertaking an objective comparative analysis and inter-alia selecting the following companies without appreciating that the same are not functionally comparable to the Appellant:

- a) Infobeans Technologies Limited;
- b) Larsen & Toubro Infotech Ltd;
- c) Persistent Systems Ltd; Rejection of comparables

5. Not undertaking an objective comparative analysis and inter-alia rejecting the following comparable companies identified by the Appellant:

- a) Akshay Software Technologies Limited
- b) Caliber Point Business Solutions Limited (Seg)

- c) CAT Technologies Limited
- d) Cigniti Technologies Limited
- e) Evoke Technologies Private Limited
- f) Helios & Matheson Information Technology Limited
- g) Maveric Systems Limited
- h) R Systems International Limited (Segmental)
- i) Sasken Communication Technologies Limited (Seg)
- j) Zylog Systems India Ltd Provision for doubtful debts

6. Considering the provision for doubtful debts in the comparable companies as non-operating in nature while computing the operating margins of comparables.

**Error in margin computation**

7. Erred in not incorporating the Hon'ble DRP directions to consider the correct segmental margins of the following companies:  
a) Mindtree Ltd.

**Adjustment for risk differences**

8. Not adjusting the net margins of the comparable companies selected taking into account the functional and risk differences between the international transaction of the Appellant and the comparable companies in accordance with the provisions of Rule 10B(1)(e) of the Rules;  
Negative Working Capital Adjustment

9. Without prejudice to the above, making a negative working capital adjustment to the arm's length margin determined without appreciating the fact that the Company does not bear any working capital risks.

**B. In relation to the software distribution activity undertaken by the Appellant**

10. A) Not appreciating the fact that the Transfer Pricing regulations can't be applied to the distribution activity or services provided when no payments have been made to the AE towards software licenses.

B) Determining ALP at the rate of 0.89% by making adjustments of Rs. 1,61,80,646.

**Re-Characterisation of the activities undertaken by the Appellant**

11. Re-characterising the Distribution activities of Appellant to a Service Provider disregarding the following facts and thereby making appellant earn notional income/ profit:

- Sales are made and revenue earned by Appellant from third party customer and not from AEs;
- Appellant carries out functions of distributor and also takes risks of a distributor including credit risks;
- Appellant charges VAT / Sales Tax to third party customers in line with distributor and the service provider is not required to pay VAT / Sales Tax;

12. Disregarding the Inter-company Transfer Pricing methodology for recovery of losses incurred by the Appellant in the initial years of distribution.

**Rejection of use of multiple year data**

13. Rejecting the use of multiple year data and using data for the FY 2012-13 only Selection of most appropriate method

14. Rejection of RPM and selection of TNMM as the most appropriate method for determination of ALP for distribution activity.

**Selection of companies**

15. Not undertaking an objective comparative analysis and inter-alia selecting the following companies without appreciating that the same are not functionally comparable to the Appellant:

- a) Integra Telecommunication and software Ltd
- b) Sonata Information Technology Ltd
- c) Unisys software & holding industries Ltd (Seg)

**Rejection of comparables**

16. Without prejudice to the above grounds, not undertaking an objective comparative analysis and inter-alia rejecting the following comparables:

- a) Avance Technologies Ltd
- b) Empower industries India Ltd
- c) Tera Software Ltd (Seg)

**Adjustments for the differences in Risks**

17. Not adjusting the net margins of comparable companies for the functional and risk differences in accordance with the provisions of rule 10B(1)(e) of the Rules.

**C. Imputing interest on outstanding receivables**

18. Erred in making TP adjustment by imputing interest at rate charged by SBI on short term fixed deposits on outstanding receivables relating to

*provision of software services to Associated Enterprise's (AE's) as on March 31st 2013.*

*(i) Not appreciating that the instant transaction is not covered in the definition of international transaction as defined u/s 92B of the Act in the facts and circumstances of the case.*

*(ii) Not appreciating the facts and circumstances surrounding the receivables and re-characterising the outstanding receivables as unsecured loans advanced to AEs.*

*(iii) Not appreciating the fact that the receivables are consequential/ closely linked to the principle transaction of provision of software services and hence have been aggregated for determination of ALP under TNMM.*

*(iv) Not appreciating the fact that under TNMM, the impact of outstanding receivables on the working capital adjustments have already been taken into account in determining the arm's length margin hence there is no need of imputing interest on outstanding receivables again.*

**19.** *Without prejudice to the above, not undertaking an objective economic analysis to determine the arm's length price of the outstanding receivables by*

*(i) Not appreciating that the receivables due from overseas AE's are in foreign currency and hence interest, if any, is to be benchmarked with the rates prevalent in the international market for foreign currency loans, (i.e. at USD "LIBOR plus").*

*(ii) Determining the arm's length credit period as 30 days without any basis and imputing interest on credit period provided for the invoices raised relating to provision of services.*

3. The brief facts of the appeal are that CommVault India, a wholly owned subsidiary of CommVault International B.V, Netherlands, Associated Enterprises (AE) is engaged in providing software development and related support services in the field of unified data storage solutions.

3.1. The company has the following two business segments:

- **STPI business:** The Company provides software development and technical support services to AEs from its centre at

Hyderabad. The company is remunerated at a cost plus mark-up of 15% for software development and 20% for technical support services.

- **Non STPI business:** The Company imports and distributes the software licenses and maintenance contracts to third parties in India. During the year under consideration the company received the software license free of cost.

3.2. The Ld. TPO passed his order proposing transfer pricing adjustment to the price received by the assessee as below:

- In relation to provision of software development services, the Ld. TPO has rejected the TP study maintained by the assessee stating that the information or the data used in the computation of the arm's length price in the TP Study is unreliable and incorrect and has conducted fresh search to determine arm's length price of the assessee's international transactions.
- Thereafter, the Ld. TPO determined the arm's length margin at 19.78 % (post Working Capital Adjustment of 0.18%) vis-à-vis the assessee's margin at 15.21% and accordingly determined the differential adjustment to the price received by the assessee at INR 1,87,83,546.

3.3. In relation to Distribution Activity, the Ld. TPO has determined Arm's Length Price for the transaction stating that the arrangement is nothing but in the nature of services rendered. Thereafter, arrived at arm's length margin as 1.37 % vis-à-vis the assessee's margin at -22.62% and accordingly, determined the differential adjustment to the price received by the assessee at INR 1,66,53,598.

3.4. Further, the Ld. TPO computed interest at the rate of 14.45% on outstanding receivables from AE and made adjustment of INR 1,81,65,019.

3.5. The assessee preferred objections before the Id. DRP against the draft assessment order dated 13/12/2016 passed by the Id. AO. The Id. DRP vide its directions dated 14/09/2017 directed the Id. TPO as under:-

**A. In respect of Software Development Segment:-**

To exclude CTIL Limited from provision of software development segment and for Mindtree Ltd, the Hon'ble DRP has directed to verify the allocation of unallocable expenditure on proportionate basis. The Hon'ble DRP directed the TPO to undertake appropriate working capital adjustment.

**B. In respect of Distribution Segment**

To exclude (i) M/s. Dynacon Technologies Ltd, (ii) M/s. Adtech Systems, (iii) M/s. Trijal Industrial Limited, (iv) M/s. Avarice Technologies Limited, (v) M/s. Tera Software and (vi) M/s. Empower Industries India Limited from Distribution activity.

**C: In respect of Interest on Outstanding Receivables from AE:-**

The Id. DRP directed the Id. TPO to compute ALP at applicable interest rate (short term deposit rates) based on number of days of delay restricted to the relevant assessment year. In other words, the Id. DRP directed the Id. TPO to impute interest of outstanding receivables from AE by applying short term deposit rate interest for the number of days of delay to be charged till the end of the relevant assessment year.

3.6. The Id. AO passed the final assessment order dated 28/10/2016 determining the total income at Rs.4,27,67,898/- under normal provisions of the Act. In the said final assessment order, the Id. AO / TPO did not follow the directions of the Id. DRP to rectify the allocation of margin computation of Mind Tree Ltd., The summary of various adjustments made by the Id. TPO pursuant to the directions of the Id. DRP are as under:-

Particulars	Amount (INR)
Transfer Pricing adjustments on software development services	1,93,66,256
Transfer Pricing adjustments on software distribution services	1,61,80,646
Transfer Pricing adjustments on receivables	72,20,996
Total TP adjustment to Income	4,27,67,898

3.7. The Id. AR before us prayed for exclusion of the three parties in software development (IT Sector) namely (a). L & T Infotech Ltd., (b)Persistent Systems Ltd., (c) CG-VAK Software and Exports Ltd., The Id. AR made arguments independently with regard to exclusion of the aforesaid comparables and placed reliance on various Tribunal orders in support of his contentions. The Id. AR argued that if the aforesaid three comparables alone are excluded then, the adjudication of other comparables in IT segment as raised in the grounds would become irrelevant as assessee would be through with the margins after exclusion

of the aforesaid three comparables. However, he reserved his right to argue the other comparables, if found necessary.

4. Per contra, the Id. DR vehemently objected to the fact that all the comparables raised in the grounds should have been argued by the Id. AR either for its inclusion or exclusion. However, the Id. DR vehemently argued only for inclusion of the aforesaid three comparables (i.e. L & T Infotech Ltd., Persistent Systems Ltd., (c) CG-VAK Software) and stated that he would make his arguments on the other comparables after hearing the Id. AR.

5. We have heard rival submissions and perused the materials available on record. In respect of arguments advanced by both the parties on the transfer pricing adjustment made in the IT segment. With regard to stand taken by the Id. AR that if three comparables i.e. Persistent Systems, L & T and CG VAK alone are excluded from the list of comparables, the assessee would be through with its margin even after including the various comparables and after rejecting various comparables chosen by the assessee is concerned, we hold that once these three comparables alone are excluded if the assessee would be through with its margin, then there is no need to adjudicate the other comparables as it would be waste of time and the entire adjudication would be only academic in nature. Hence, we are inclined to reject the argument advanced by the Id. DR in this regard and take up the aspect of exclusion of these three comparables alone for our adjudication at this stage.

5.1. Ld. TPO included L&T Infotech as comparable which was duly objected before the Ld. DRP that the company is into various lines of diverse service offerings and develops products like Unitrax, AccuRASI and it also has high risk profile, intangibles and huge brand value.

5.2. The Id. DRP did not agree with the arguments of the assessee that L & T Infotech Ltd., is into different functions and though it is engaged in IT services, segmental revenues denote income received from services cluster, industrials cluster and telecom cluster. The Id. DRP held that all the services rendered by then fall only under the ambit of software development services and hence, it is a valid comparable.

5.3. We have gone through the financial statements of L & T Infotech Ltd., and we find that the said company generates revenue from three clusters namely service cluster, industrials cluster and telecom cluster and also develops products like Unitrax, AccuRASI. From the perusal of the annual report of the said comparable, we also find that the said company has got high risk profile, intangibles and huge brand value unlike the assessee company.

5.4. We find the exclusion of this comparable to a software development service provider was a subject matter of adjudication by the Co-ordinate Bench of this Tribunal for A.Y.2013-14 on functional comparability itself , among others, in the case of EPAM Systems India Pvt. Ltd., vs. ACIT in ITA No.2122/Hyd/2017 dated 20/11/2018 wherein it was held as under:-

*“17. As far as the L & T Infotech is concerned, the assessee’s objections are that the it is a giant company with a turnover of Rs. 3613 Crs and has a significant brand value and in RPT schedule there is revenue from sale of services as well as products. Further, under operating expenses there are costs of bought-out items for resale of products and therefore, in the absence of segmental details, it cannot be considered as a comparable. In support of this contention, Learned Counsel for the Assessee placed reliance upon the following decisions:-*

*(i) Saxo India (P) Ltd vs. ACIT – ITA No. 6148/Del/2015*

*(ii) Electronic Arts Games India (P) Ltd vs ACIT – ITA No.444/Hyd/2017*

(iii) *Agilis Information Technologies Intl. P. Ltd vs. ITO –ITA No. 1063/Del/2016*

(iv) *Alcatel-Lucent India Ltd vs. DCIT – ITA No.6856/De/2015*

18. *We have gone through the financial results of this company which are placed at 1116 of the paper book and find that the revenue from IT services of this company for the relevant assessment years is Rs. 3613 Crs and that it has huge intangibles. This company has been considered by the coordinate Bench of the Tribunal at Delhi and also the Hon'ble High Court in various decisions and in the case of PCIT vs. Saxo India (P) Ltd (supra), the Hon'ble High Court has held that this company cannot be compared to the assessee therein, particularly when its segmental data was not available. The relevant para of Delhi High Court judgment is reproduced here under for ready reference:*

*“10. On a comparison with the data available and made available, undoubtedly, the object of the statute is to "pull in transactions which otherwise escaped the radar of tax assessment under one head or the other. The transfer pricing methodology - shorn of its details is an attempt by each nation to locate the incidents of income which would be subjected to levy within its jurisdiction where international transactions are involved. This exercise does not compare with other income assessments where the methodology adopted in their domestic jurisdiction will differ".*

*The TNMM method depends on accurate data with respect to all the three elements - wherever they apply. In the Comparable Uncontrolled Price (CUP) method - which is premised upon the elements in Rule 10B(1)(a), the methodology adopted is the price charged or paid for property transfer or services provided in the Comparable Uncontrolled transaction. Therefore, the nature of the transaction and the appropriate filter determines the elements that are to be considered in TNMM. Therefore, the costs, sales and assets employed wherever relevant are to be applied. From this perspective, the revenue's contention that segmental data was available, cannot be accepted. The mere availability of proportion of the turnover allocable for software product sales per se cannot lead to an assumption that segmental data for relevant facts was available to determine the profitability of the concerned comparable.”*

19. *Respectfully following the same, we direct the TPO / A.O. to exclude L & T Infotech from the final list of comparables.”*

5.5. We also find that the said comparable is having huge turnover of Rs.3613 Crores. Even on this aspect, the said comparable cannot be held to a valid comparable with that of the assessee engaged in software

development having turnover of Rs 29.84 crores. Respectfully following the aforesaid decision of this Tribunal referred to supra, we direct the Id. TPO to exclude L & T Infotech Ltd., from the final list of comparables.

#### **5.6. Exclusion of Persistent Systems Ltd.,**

The assessee had sought for exclusion of this comparable on the primary ground that the said company is engaged in development of products whereas assessee is engaged in software development. The Id. DRP however, held that the said comparable is engaged in provision of software development services. From the perusal of the annual report of the said comparable, we find that it is engaged in three business activities i.e. product engineering services, platforms and solutions and IP and related business. The annual report also mentions that it is a global company engaged in software products, services and technology innovation and also offers complete project life cycle services. We also find from the perusal of the segmental data of the said comparable, segmental reporting is available only in respect of telecom and wireless division, life science and healthcare division and infrastructure and systems division. The revenue generated exclusively from the software development segment could not be deciphered from the segmental data so as to make it comparable with the financials of the assessee herein. We find that the Co-ordinate Bench of this Tribunal in the case of EPAM Systems India Pvt. Ltd., vs. ACIT in ITA No.2122/Hyd/2017 dated 20/11/2018 for A.Y.2013-14 had held that the said comparable is into both the software products, services and technology innovation and the segmental details are not available. The said decision also states that on perusal of the annual report of the Persistent Systems Ltd., it is evident that the said comparable possesses huge intangibles. It has been categorically held in the aforesaid co-ordinate bench decision of this

Tribunal, that the said comparable is functionally not comparable with the assessee engaged in software development services. We also find that the turnover of the assessee company is Rs.29.84 Crores which is very low when compared to that of Persistent Systems. We find that the turnover of Persistent Systems is more than 10 times higher than the turnover of the assessee company, so even on the aspect of huge turnover, this comparable cannot be held as valid comparable and hence not comparable with the assessee. Respectfully following the aforesaid decision, we direct the Id. TPO to exclude Persistent Systems Ltd., from the final list of comparables.

#### **5.7. Exclusion of CG-VAK Software and Exports Ltd.,**

From the perusal of the annual report of the said comparable, we find that the said company is earning revenue from software services and Business Process Outsourcing (BPO) services and that the segmental data is not available in respect of those transactions. The only segmental data available in the annual report of the said comparable is that of geographical segment i.e. revenue generated by the said company as a whole in North America and rest of the world. We find what is required for the purpose of comparability is that segmental revenue, segmental profits, segmental expenses should be available for software development services. In the absence of such segmental data of the said comparable, it could be safely concluded that the said comparable is not a valid comparable. We also find that the Co-ordinate Bench decision of this Tribunal for A.Y.2013-14 itself in the case of EPAM Systems India Pvt. Ltd., vs. ACIT in ITA No.2122/Hyd/2017 dated 20/11/2018 had also held that the said comparable is to be excluded due to non-availability of segmental information and hence, not comparable to the assessee engaged in software development. Respectfully following the same, we

direct the Id. TPO to exclude CG-VAK Software and Exports Ltd. from the final list of comparables.

**5.8. Computation Error in Segmental Margin in the case of Mind Tree Ltd.,:-**

The Id. TPO had computed the margin of Mind Tree Ltd., (segmental data alone) at 20.23%. The Id. AR before us submitted that the correct margin of the said company is 18.18% and the difference arose on account of non-allocation of unallocable expenses to the segments. This point was also pointed out by the assessee before the Id. DRP and the Id. DRP directed the Id. TPO to examine above segment and allocate the unallocable expenses, if it was not already allocated. The Id. TPO erroneously applied the incorrect margin computation in the case of Mind Tree Ltd., while passing the order pursuant to the directions of the Id. DRP. The Id. AR before us furnished the workings of the correct net margins to be adopted for Mind Tree Ltd., after allocating unallocated expenses and pleaded that the said working be restored to the file of the Id. TPO for his verification. The Id. DR also fairly agreed for restoration of the same. Hence, we deem it fit and appropriate to remand inclusion of Mind Tree Ltd., in the list of comparable for the limited purpose of verification of the margins. The workings furnished by the assessee before us should be placed before the Id. TPO for his verification and the Id. TPO is hereby directed to examine the same and arrive at the correct margins thereon.

5.9. After exclusion of the aforesaid three comparables i.e. Persistent Systems Ltd., to L & T Infotech Ltd., and CG-VAK Software and Exports Ltd., from the final list of comparables and after considering the correct margins of Mind Tree Ltd., the Id. AR pleaded before us that the adjudication of other comparables (both on inclusion and exclusion)

would be academic in nature as the arithmetic mean of comparables would work out to 15.19% as against assessee's margin at 15.21% and therefore, the entire transactions would be at arm's length. We find lot of force in the said argument of the Id. AR and accordingly, hold that the adjudication of other comparables would be purely academic in nature and hence, we refrain to give our opinion on the same. The inclusion and exclusion of any other comparable other than above four i.e. Persistent Systems, L & T Infotech, CG-VAK Software and Mind Tree Ltd., are hereby left open. The Id. TPO is hereby directed to re-compute the arithmetic mean of the comparables by following the same:-

- (a) After excluding Persistent Systems Ltd., L & T Infotech Ltd., and CG-VAK Systems and Exports Ltd.,
- (b) After re-computing correct margin of Mind Tree Ltd.,
- (c) After making working capital adjustments for the final list of comparables.

5.10. The various grounds raised by the assessee in ground No. A are disposed off in the aforesaid manner.

6. The ground No. B raised by the assessee is with regard to arm's length pricing adjustment made in the software distribution activity undertaken by the assessee.

6.1. The Company has started distribution of software products of CommVault Inc from 1st April 2010. Since this year being one of the initial years of distribution activity, the Company has incurred losses. As per the agreement entered between Commvault India and the AE, the AE shall not charge any amount towards cost of license if the operating cost of Commvault India is more than the revenue earned from distribution of

software products. Accordingly, the AE has not charged any amount towards the license fee to Commvault India during the year under consideration.

6.2. In relation to activity of purchase of software for distribution, the Ld. TPO has held that the company is not acting as a distributor but rendering service to its AE by selling licenses on behalf of the AEs. The Id. TPO observed that the AE has supplied products free of cost to assessee for sale in India. This transaction was not reported in TP document as the receipt of products was free of cost and the sales were made to domestic parties. Accordingly, the assessee had treated the same as not falling within the definition of international transaction. The Id. TPO examined the distribution and license agreement dated 01/04/2010 and the terms and conditions agreed upon thereon. From the same, he concluded that even though the cost price as nil, but the product has a price. Therefore, the transaction of purchase is an international transaction with the AE in which the purchase cost is nil. He observed that if no cost is paid towards the licenses, then it can also be assumed that sales are made on behalf of the AE. The Id. TPO observed that the licenses are given free of cost to the company and the percentage of profits are to be shared after absorption of the losses for the assessee. He concluded that this arrangement is nothing but in the nature of services rendered. He also observed that if cost of software is nil, the assessee is losing a mark up on such cost and thereby double benefit is accruing to the AE i.e. one being not compensating the assessee on the cost incurred and the other being not owning up the losses and allowing it to remain in India.

6.3. Assessee in response to show-cause notice replied that no cost has been paid for supply of software by the AE and that assessee is only acting as a captive distributor and not distributing on behalf of its AE. It

was stated that assessee company has started distribution of software products of Commvault INC for which there is a separate team of 6 employees and the office is located in Mumbai. It was also stated that this being the second year of distribution activity, the company has incurred losses in the said segment. As per the agreement, the AE will not charge any amount towards cost of licenses if the operating cost is more than the revenue earned. It was submitted that the company has started earning profits from F.Y.2013-14 however, AE has not charged any amount towards license in view of the losses incurred by the assessee in the earlier years. In other words, the AE had given time to the assessee to absorb all the losses incurred by it in the distribution segment and thereafter start making payment for the cost of licenses.

6.4. The Id. TPO however, did not heed to the aforesaid contentions of the assessee and proceeded to carryout the fresh search of comparables using public data base and arrive at the arithmetic mean of the comparables at 1.37% of revenue by adopting Profit Level Indicator (PLI) as operating profit divided by operating revenue (OP/OR). The assessee had shown margin at -22.70% in respect of this segment. Accordingly, the Id. TPO made adjustment of Rs.1,66,53,598/- by working out as under:-

Operating Cost	-	Rs.6,94,16,582/-
Arm's length Margin	-	1.37%
Arm's length Price (100 + AALM x OC)	-	Rs.7,03,67,589/-
Price received	-	5,37,13,991/-
Adjustment	-	Rs.1,66,53,598/-

The aforesaid working and the action of the Id. TPO was upheld by the Id. DRP.

6.5. The Id. AR vehemently argued that adoption of re-sale price method (RPM) would be ideal to benchmark the transactions carried out by the assessee with regard to the software distribution activity as against the Transaction Net Margin Method (TNMM) adopted by the Id. TPO and upheld by the Id. DRP. The Id. DR also agreed for adoption of resale price method in the instant case. We find as per 10B(1)(b) of the Income Tax Rules, re-sale price method could be applied where the property or service purchased from Associated Enterprises are resold to an unrelated enterprise. The facts of the assessee's case squarely fit into this parameter as assessee herein has purchased the software free of cost from its AE and had sold it to unrelated parties in India. Hence, we hold re-sale price method should be the most appropriate method in the instant case. Moreover, the re-sale price method is traditional transaction method which would always be preferable to transactional profit method like profit split method and TNMM.

6.6. Yet another excruciating fact which is relevant to be addressed in the instant case is that the arm's length price adjustment should be restricted only to the value of international transaction. Admittedly, the international transaction involved in the distribution segment is purchase of software by the assessee from the AE. Since the assessee is not making any payment to its AE for the software supplied to it, the value of international transaction had to be concluded as zero and consequently the transfer pricing adjustment thereon also would be only zero. The arm's length price adjustment should be restricted only to the value of international transactions and cannot be done at entity level is no longer res integra in view of the decision of the Hon'ble Bombay High Court in

the case of CIT vs. Phoenix Mecano (India) Pvt. Ltd., reported in 414 ITR 704 and in the case of CIT vs. Thyssen Krupp Industries Pvt. Ltd., reported in 381 ITR 413 (Bom) and CIT vs. Tara Jewels Export P. Ltd., reported in 381 ITR 404 (Bom).

6.7. In any case we find that the issue in dispute is squarely covered by the Co-ordinate Bench of this Tribunal in assessee's own case for the A.Y.2011-12 in ITA No.343/Hyd/2016 dated 11/04/2018 wherein this Tribunal after examining the nature and terms of the distribution agreement had held that assessee's functional profile is akin to a distributor and not a service provider. The relevant observations are made in para 10 of the said order which are not reproduced herein for the sake of brevity.

6.8. In view of the aforesaid observations, and respectfully following the judicial precedents hereinabove, we direct the Id. TPO to delete the adjustment made in the sum of Rs.1,66,53,598/- in the software distribution segment. Accordingly, the various grounds raised in ground No.B are disposed off in the aforesaid manner.

7. The ground No.C raised by the assessee is with regard to adjustment made by imputing interest on outstanding receivables.

7.1. The Id. TPO observed in his order that assessee had shown outstanding receivables from its AE's at Rs.14,51,64,506/-. The Id. TPO directed the assessee to submit details of invoices raised and its corresponding realization with dates. The Id. TPO observed that assessee had realized its receivables from its AE beyond the grace period of 30 days allowed as per the service agreement. This tantamounted to capital financing by the assessee to its AE as substantial amount of funds of the

assessee were blocked with its AE. The Id. TPO also referred to introduction of Clause C of Explanation in Section 92B(2) wherein under the category of "Capital Financing" , debt arising during the course of business was also sought to be included as part of capital financing and thereby constituting a separate international transaction warranting imputation of interest for the delayed period. The Id. TPO applied the interest rate of 14.45% and calculated interest for the delayed period beyond 30 days till the date of realization of the invoices which even went beyond the end of financial year relevant to assessment year under consideration and made an adjustment of Rs.1,81,65,019/-.

7.2. The Id. DRP upheld the observations made by the Id. TPO in principle. The assessee had pleaded before the Id. DRP that since working capital adjustment has been granted to the assessee on its core software development segment, aspect of outstanding receivables and the imputation of interest thereon gets subsumed in the working capital adjustment itself and no separate adjustment need to be made thereon. The Id. DRP rejected the plea of the assessee that working capital adjustment would take into account the impact of outstanding receivables.

7.3. With regard to another argument made by the assessee that it has no borrowings on which interest is payable, hence, there cannot be any imputation of interest of its outstanding receivables, is concerned, the Id. DRP placed reliance on the decision of the Co-ordinate Bench of Delhi Tribunal in the case of Bechtel India Pvt.Ltd., in ITA No.6530/Del/2016 dated 16/05/2017 reported in 85 Taxmann.com 121 for A.Y.2012-13 wherein it was categorically held that interest on delayed realization of receivables is a separate international transaction and therefore, requires separate benchmarking and it has nothing to do with the operations of

the assessee company involving debt free funds. The Id. DRP placed reliance on this decision and rejected the plea of the assessee.

7.4. With regard to yet another argument advanced before the Id. DRP that once the pricing of international transactions has been accepted for ALP test, the Id. TPO should not go into the question of parking of funds with its AE by way of outstanding receivables, is concerned, the Id. DRP placed reliance on the Co-ordinate Bench decision of Bangalore Tribunal in the case of Logix Micro Systems Ltd., in ITA No.423 and 524/Bang/2009 dated 07/10/2010 reported in 42 SOT 525 and held that the potential loss arising to the assessee by way of parking of funds with the AE is definitely a factor to be considered while evaluating financial impact of the international transactions concluded by the assessee with its AE. Accordingly, the Id. DRP rejected the plea that the issue on deferred receivables cannot be looked into once the pricing of the services transaction have been accepted to be at ALP.

7.5. With regard to yet another crucial argument advanced by the assessee that it is a policy of the assessee that it had not charged any interest on the outstanding receivables from its AE and it had not paid any interest on the outstanding payables to its AEs and that service agreement does not provide for charging of any interest for the delayed realization, is concerned, the Id. DRP placed reliance on the Co-ordinate Bench decision of the Delhi Tribunal in the case of Tech Books International (P) Ltd., vs. DCIT reported in 63 Taxmann.com 114 for A.Y.2010-11 dated 06/07/2015 and dismissed the said argument of the assessee. The said decision of the Delhi Tribunal categorically held that in para 13.3 of its order that the agreement does not provide for charging any interest on late realization of invoice value and hence no interest can be charged, deserves the fate of dismissal under the transfer pricing

provisions. Chapter X of the Act had been enshrined to determine the income from an international transaction at ALP, being in the same manner as is determined between two independent parties. It means that if an income is not charged or under charged by an Indian entity from its foreign AE, which ought to have been properly charged if the transaction had been between two independent parties, then such under charged or uncharged income needs to be brought to tax by determining the ALP of the international transaction giving rise to such income.

7.6. With regard to objection raised by the assessee before the Id. DRP that the Id. TPO erred in applying the domestic prime lending rate of 14.45% for the purpose of imputation of interest on outstanding receivables, the Id. DRP observed that the short term fixed deposit rate given by the State Bank of India for various periods shall be applicable ALP interest rate to be applied on the deferred receivables from AE. The Id. DRP also directed the Id. TPO to calculate the interest for the delayed period up to the end of the year only i.e. up to 31/03/2013 only.

7.7. Pursuant to the directions of the Id. DRP, the Id. AO passed a final assessment order on 26/10/2017 reducing the adjustment on account of deferred receivables to Rs.72,20,996/-.

7.8. Before us, the Id. AR reiterated the same arguments that were advanced by the assessee before the Id. DRP by placing reliance on the Co-ordinate Bench decision of this Tribunal in the case of Value Labs LLP vs. ACIT in ITA Nos. 1909 and 1910/Hyd/2017 dated 09/07/2020 and also the decision of the Hon'ble Delhi High Court in the case of CIT vs. Kusum Healthcare Pvt. Ltd., in ITA No.765 of 2016 dated 25/04/2017. The crux of the argument of the Id. AR are as follows:-

- a. As per consistent policy adopted by the assessee, the assessee does not charge interest on delayed receivables from its AE and does not pay any interest on the delayed payables to the AE.
- b. There is no provision for charging any interest on the delayed realization of invoice as per the service agreement entered with AE.
- c. Since working capital adjustment has been granted by the Id. TPO, the aspect of outstanding receivables gets automatically subsumed thereon and hence, there is no need to make separate adjustment by way of imputing interest on outstanding receivables.
- d. No interest is charged by the assessee from its non-AEs also as per its consistent policy.

7.9. Per contra, the Id. DR vehemently objected to the various arguments advanced by the Id. AR and submitted that all the arguments advanced by the Id. AR herein had already been adjudicated by the Id. DRP together with the supporting case laws thereon. He vehemently argued that the Hon'ble Delhi High Court in the case of Kusum Healthcare had only held that once working capital adjustment is given, the aspect of outstanding receivables has been taken care and accordingly it gets subsumed. The said decision does not talk about the delayed realization of invoices by the assessee from its AEs during the year. Hence, imputation of interest need to be made for the said delay in respect of invoices realized during the year beyond the agreed credit period. The Id. DR also argued that the submission made by the Id. AR that assessee is not charging any interest from its non-AEs requires to be rejected in view of the fact that assessee herein is only a captive service provider and has got absolutely no non-AEs to cater or having any transactions thereon.

7.10. The Id. DR fairly agreed that adoption of interest rate for imputation of interest on deferred receivables by applying LIBOR rate + 200 basis points instead of short term deposit granted by SBI directed by the Id. DRP.

7.11. We have heard rival submissions and perused the materials available on record. It is not in dispute that assessee in the instant case had realized invoices on its AEs beyond the agreed credit period as per the service agreement. The realization of invoices were made with abnormal delay. This, in our considered opinion, tantamount to indirect funding made by the assessee to its AEs by allowing the AE to utilize funds of the assessee as per its whims and fancies. Merely because the assessee is a debt free company, it cannot allow its funds to be utilized by its AE for an indefinite period of time beyond the agreed credit period. We find that Clause-C of Explanation to Section 92B of the Act has been introduced in the statute by the Finance Act 2012. For the sake of convenience, Clause C of relevant explanation is reproduced hereunder:-

*“(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;”*

7.12. The aforesaid clause C states “capital financing” to include “debt arising during the course of business”. Manifestly, in the instant case, the deferred receivables falls squarely within the ambit of debt arising during the course of business which is included in the category of expression “capital financing” under clause C of Explanation of Section 92B of the Act. Hence, we hold that the outstanding receivables from AE constitute a separate international transaction and on which interest is to be imputed

thereon and consequently ALP adjustment to be made. Hence, the primary argument made by the Id. AR that the adjustment made on account of outstanding receivables cannot be construed as an international transactions is hereby rejected and dismissed.

7.13. The crucial point is with regard to rate of interest to be applied for the purpose of imputation and calculation of arm's length price adjustment account. Since, the assessee had to receive its outstanding receivables from its AE in foreign currency, it would be just and fair to adopt LIBOR rate + 200 basis points for the purpose of imputation of interest beyond the agreed credit period as per the agreement till the date of realization or till the end of the Financial year, whichever is earlier.

7.14. It is not in dispute that the working capital adjustment had been indeed granted by the Id. TPO in the instant case which is evident in page 15 and 16 of his order under the heading working capital adjustment in para 4.1 thereon. Hence, by applying the ratio of the Hon'ble Delhi High Court in the case of Kusum Healthcare referred to supra, no imputation of interest on outstanding receivables could be made thereon. However, in respect of invoices raised in earlier years, where the amounts were realized during the year under consideration but beyond the agreed credit period, imputation of interest by applying LIBOR + 200 basis points is to be made from 1<sup>st</sup> of April 2012 till the date of realization of debts. In respect of invoices raised during the year, where the amounts were realized during the year itself, but beyond the agreed credit period, imputation of interest by applying LIBOR +200 basis points is to be made from the date of expiry of agreed credit period from the date of raising the invoice and the same is to be charged till the date of realization of debts. We hold that the decision of the Hon'ble Delhi High Court in Kusum

Healthcare talks about only outstanding receivables at the end of the year i.e. to say when working capital adjustment is given to the assessee, no separate adjustment need to be made on the outstanding receivables at the end of the year. In our considered opinion, the decision of Hon'ble Delhi High Court does not speak about the invoices that were realized from the AE beyond the agreed credit period during the year. Hence, it could be safely concluded that the decision of the Hon'ble Delhi High Court in Kusum Healthcare does not give any finding with regard to invoices realized during the year from AE. To that extent alone, we are giving our independent finding by treating that as a separate international transaction and directing the Id. TPO to charge interest by applying LIBOR + 200 basis points in the aforesaid manner.

7.15. With regard to argument advanced by the Id. AR that as per the consistent policy adopted by the assessee that he does not charge any interest from its AEs on outstanding receivables and similarly does not pay any interest on outstanding payables to AE is concerned, and also on the point of the service agreement not providing for any clause on the chargeability of interest for delayed realization is concerned, we hold that the parties i.e. assessee and its AE cannot have any clause specifically or by conveniently not providing for any clause in the agreement, which act detrimental to the interests of the revenue. In other words, any understanding or arrangement between the assessee and its AE which is detrimental to revenue or against the principles of scheme of Chapter X of the Income Tax Act, 1961, cannot come to the rescue of the assessee. Hence, merely because, there is no provision for chargeability of interest in the agreement entered with AEs for delayed realization and merely because assessee does not pay any interest to its AEs on the payables, the revenue cannot be deprived of its legitimate share in accordance with

the scheme of Chapter X of the Act and the purpose behind the provisions of Chapter X.

7.16. With regard to arguments advanced by the Id. AR that assessee has been consistently not charging interest on its outstanding receivables from both AEs and non-AEs is concerned, we find that assessee is a captive service provider and does not have any non-AEs at all to carryout transactions with non-AEs. Hence, this argument of the Id. AR deserves to be dismissed summarily. Accordingly, the reliance placed by the Id. AR on the decision of the Hon'ble Bombay High Court in the case of CIT vs. Indo American Jewellery Ltd., reported in 223 Taxmann 8 together with Mumbai Tribunal decision in the case of Unilever India Exports Ltd. (ITA No. 2096/Mum/2017) dated 31/07/2019; Suashish Diamonds Ltd (ITA No. 7058, 7508/Mum/2014) dated 31/05/2019; Lintas India Private Limited (ITA No 2024/Mum/2007) dated 09/11/2012) and the decision of Ahmedabad Tribunal in Mastek Limited (ITA No. 3120/Ahd/2010) dated 29/02/2012 does not come to the rescue of the assessee as in all these cases, the assessee had transactions with AEs as well as non-AEs and consistently assessee had not charged interest from both. Hence, we hold that the aforesaid cases are factually distinguishable with that of the assessee.

7.17. To sum up, we hold that the outstanding receivables from AEs would constitute a separate international transaction on which imputation of interest is to be made by applying LIBOR + 200 basis points as under:-

a. In respect of invoices raised in earlier years by the assessee on its AEs, where the amounts were realized during the year under consideration but beyond the agreed credit period, imputation of interest is to be made from first day of April till the date of realization of debts.

b. In respect of invoices raised during the year on its AEs, where the amounts were realized during the year itself but beyond the agreed credit period, imputation of interest is to be made from the date of expiry of agreed credit period till the date of realization of debts.

7.18. Ground 'C' raised by the assessee on the aspect of transfer pricing adjustment on account of imputing interest of outstanding receivables are disposed off in the aforesaid manner.

8. Ground No.20 raised by the assessee is with regard to chargeability of interest u/s.234B of the Act which is consequential in nature.

9. Ground No.21 raised by the assessee is with regard to initiation of penalty proceedings u/s.271(1)(c), 272BA and 271AA of the Act which would be premature for adjudication at this stage.

**10. In the result, appeal of the assessee is partly allowed for statistical purposes.**

Order pronounced in the open court on this 26/11/2020

**Sd/-**  
**(C.N. PRASAD)**  
JUDICIAL MEMBER

**Sd/-**  
**(M.BALAGANESH)**  
ACCOUNTANT MEMBER

Mumbai; Dated 26/11/2020  
KARUNA, *sr.ps*

**Copy of the Order forwarded to :**

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

//True Copy//

BY ORDER,

(Asstt. Registrar)  
**ITAT, Mumbai**