

**IN THE INCOME TAX APPELLATE TRIBUNAL  
“C”BENCH: BANGALORE**

**BEFORE SHRI GEORGE GEORGE K., JUDICIAL MEMBER  
AND  
SHRI B.R. BASKARAN, ACCOUNTANT MEMBER**

IT(TP)A No.84/Bang/2017
Assessment Year : 2012-13

M/s. IDS Software Solutions India Pvt. Ltd. Salarpuria Ascent, Ground Floor No.77, Koramangala Industrial Layout, Jyothi Nivas College Road Bengaluru 560 095  <b>PAN NO :AABCI2430G</b>	<b>Vs.</b>	ACIT Circle-3(1)(1) Bengaluru
<b>APPELLANT</b>		<b>RESPONDENT</b>

<b>Appellant by</b>	:	Shri K.R. Vasudevan, A.R.
<b>Respondent by</b>	:	Shri Pradeep Kumar, D.R.

Date of Hearing	:	11.03.2021
Date of Pronouncement	:	11.03.2021

**ORDER**

**PER B.R. BASKARAN, ACCOUNTANT MEMBER:**

The assessee has filed this appeal challenging the assessment order dated 21.11.2016 passed by the A.O. u/s 143(3) r.w.s. 144C of the Income-tax Act,1961 ['the Act' for short] in pursuance of directions given by Ld. Dispute Resolution Panel (DRP). At the time of hearing, the Ld. A.R. submitted that the assessee is pressing ground No.12 relating to exclusion of 2 comparable companies and ground No.13 relating to negative working capital adjustment made by the TPO. All other grounds were not pressed by Ld. A.R. The Ld A.R further submitted that the additional grounds do not require

adjudication, if the assessee gets relief in respect of above said two issues.

2. The assessee is wholly owned subsidiary of IDS Inc. and it is engaged in the business of providing software development services in the field of leasing, loan accounting and portfolio management solutions. It has entered into agreement for provision of software development services to its A.Es, viz., IDS Inc. & IDS U.K. The assessee selected TNM method as most appropriate method and profit level indicator as OP/OC. The TPO rejected transfer pricing study of the assessee. The TPO selected following 10 companies as comparable companies, which gave average margin of 22.63%:-

<i>Sl.No.</i>	<i>Name of the taxpayer</i>	<i>OP/OC</i>
1	<i>Datamatics Global Services Ltd.</i>	<i>14.57%</i>
2	<i>Genesys International Corpn. Ltd.</i>	<i>30.09%</i>
3	<i>ICRA Techno Analytics Ltd.</i>	<i>17.24%</i>
4	<i>Infosys Ltd.</i>	<i>43.10%</i>
5	<i>Larsen &amp; Toubro Infotech Ltd.</i>	<i>25.47%</i>
6	<i>Mindtree Ltd.</i>	<i>15.01%</i>
7	<i>Persistent Systems Ltd.</i>	<i>27.20%</i>
8	<i>R.S. Software (India) Ltd.</i>	<i>15.34%</i>
9	<i>Sasken Communication Technologies Ltd.</i>	<i>12.15%</i>
10	<i>Spry Resources India Pvt. Ltd.</i>	<i>26.18%</i>
	<b><i>Average</i></b>	<b><i>22.63%</i></b>

3. After adding negative working capital of 2.35%, the TPO arrived at the adjusted margin of 24.98%. Accordingly, he made transfer pricing adjustment of Rs.1.43 crores.

4. The Ld. DRP excluded 6 comparables and retained 4 comparables, viz., Larsen & Toubro Infotech Ltd., Persistent Systems Ltd., Mind Tree Ltd. & R.S. Software.

5. In this appeal, the assessee seeks exclusion of Larsen & Toubro Infotech Ltd. and Persistent Systems Ltd. The Ld. A.R.

submitted that both the above said companies have been excluded by the coordinate bench in the case of EMC Software & Services (India) Pvt. Ltd. (107 Taxmann.com 367).

6. We heard Ld. D.R. on this issue and perused the record. We notice that the coordinate bench, in the case of EMC Software & Services (India) Pvt. Ltd. (supra) has excluded the above said companies by following the decision rendered by the Delhi Bench of Tribunal in the case of Agilis Information Technologies (India) Pvt. Ltd. (2018) 89 Taxmann.com 440. The discussion made in respect of these two companies in the case of Agilis Information Technologies (India) Pvt. Ltd. are extracted below:-

*“(b) Larsen & Toubro Infotech Ltd., was excluded from the list of comparable companies by relying on the decision of the Delhi Bench of ITAT in the case of Saxo India (P) Ltd. v. ACIT (2016) 67 taxmann.com 155 (Del-Tri). The discussion is contained in paragraphs 4.8 to 4.10 of the Tribunal’s order. The Tribunal held that L&T Infotech Ltd., was a software product company and segmental information on SWD services was not available. The Tribunal also noticed that the appeal filed by the revenue against the tribunal’s order was dismissed by the Hon’ble Delhi High Court in ITA No.682/2016.*

*(c) Persistent Systems Ltd., was excluded from the list of comparable companies on the ground that this company was a software product company and segmental information on SWD services was not available. The Tribunal in coming to the above conclusion referred to the decision rendered by ITAT Delhi Bench in the case of Cash Edge India Pvt. Ltd. v. ITO ITA No.64/Del/2015 order dated 23.9.2015 and the decision of Hon’ble Delhi High Court in the case of Saxo India Pvt. Ltd. (supra). The findings in this regard are contained in Paragraphs 4.14 to 4.16 of its order.”*

Following the decision rendered by the coordinate benches, we direct exclusion of Larsen & Toubro Infotech Ltd. and Persistent Systems Ltd. from the list of comparable companies.

7. The next issue urged by the assessee relates to consideration of negative working capital while making Transfer Pricing adjustment.

It is the plea of the assessee that the negative working capital should be ignored. We notice that the issue relating to negative working capital has been examined by the co-ordinate bench of Tribunal in the case of ACIT vs. M/s e4e Business Solutions India P Ltd (ITA No.2900/Bang/2018) and it was held that negative working capital adjustment is not required in the case of a captive service provider, since it is fully insulated by its AE against working capital risks. The relevant observations made by the co-ordinate bench are extracted below:-

*“12. The third issue is with regard to grant of negative working capital adjustment. Working capital adjustment is made for the time value of money lost when credit period is given to customers. It is the submission of the ld. counsel for the assessee in this case that the assessee is a captive unit which is entirely funded by the AE. The assessee has no borrowings and is fully compensated by the parent on a total cost plus. The assessee has no working capital risk - in other words, it is a risk-insulated service provider to the parent. The only customer of the company is its parent company. The ld. counsel for the assessee has relied on a host of ITAT decisions, the main decision being that of M/S. Software AG Bangalore Technologies Pvt. Ltd.(supra) which in turn has relied on the decision of ITAT Hyderabad in the case of Adaptec (India) Private Limited and contended that no negative working capital adjustment is called for. The ld.DR’s reliance is on the decision in the case of Technotree Convergence P. Ltd. (supra) wherein it was held that negative working capital adjustment has to be allowed.*

*13 Comparables chosen operate under varied economic conditions. Therefore, while comparing a company to that of similar companies, it is necessary to undertake comparability adjustments. **Balance sheet adjustments are intended to account for different levels of inventories, receivables, payables, interest rates etc. The most common balance sheet adjustments made to reflect different levels of accounts receivable, account payable and inventory are known as working capital***

*adjustments. As mentioned by the OECD, comparability adjustments should not be performed on a routine or mandatory basis but rather on a case by case basis depending on the facts and circumstances. Economic rationale of Working capital of a business is the capital used in its day-to-day trading operations. Working capital is affected by numerous business incidences. It is very common for tested party and each of the potential comparables to differ materially in the amount of working capital (inventory, accounts receivables and payable). Such differences are mainly caused due to differences in the terms of purchase and sale, levels of inventory etc. For example: If the business advances a trade credit of (say) 60 days, its cash gets locked up for 60 days and reduces the working capital. It will have to borrow from open market to meet its working capital requirement, and hence incur expenses. Similarly, if it avails of trade credit of 60 days, it has surplus cash at its disposal. It will need to borrow less money to fund operational requirements. Hence, working capital position affects the additional cost incurred by a business by way of interest on borrowing from the open market. Working capital adjustments seeks to adjust for the differences in time value of money between tested parties and potential comparables with an assumption that differences should be reflected in profits Working capital adjustment has a strong rationale in economic theory. It facilitates to increase the comparability between the tested party and comparables working in an industry which is competitive. Working capital adjustment can work out to be positive or negative. A positive working capital adjustment (WCA) will tend to reduce the arm's length PLI while a negative WCA will tend to increase the arm's length PLI.*

14. We find that the facts of the Assessee's case are similar to that of the case of the Bangalore ITAT in the case of M/S.Software AG Bangalore Technologies Pvt.Ltd. and therefore we are inclined to delete the negative working capital adjustment. In determining ALP under TNMM, the correct approach would be to look at the costs incurred by the assessee only and should not impute any additional cost as done by TPO, which indirectly

*enhances the ALP artificially. The contrary view expressed in decision cited by the learned DR takes the view that Working capital adjustment is required in all cases as any credit extended to customers will result in cash locked up and will result in the assessee borrowing money from the banks and incur additional cost towards interest on these borrowings which cost will have effect on the price charged. It is the reasoning in these decisions that under TNM method that every ingredient of profit margins of comparable companies are analysed, whether it is positive or negative. The decision proceeds on the basis of effect on price owing to working capital requirement. We are of the view that working capital adjustment itself is computed on the basis of outstanding current assets and liabilities at the year end. It means that other things being equal, an entity having higher working capital will incur more interest cost which will reduce profitability. Hence no importance shall be given to pricing aspect. Since the assessee does not have any working capital risk, the question of negative working capital does not arise.”*

Following the above said decision, we direct the AO/TPO not to make negative working capital adjustment.

8. Since we have allowed relief to the assessee in respect of both the issues discussed above, as mentioned by Ld A.R, we are not adjudicating the additional grounds urged by the assessee.

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

Order pronounced in the open court on 11<sup>th</sup> Mar, 2021

**Sd/-**  
**(George George K.)**  
**Judicial Member**

**Sd/-**  
**(B.R. Baskaran)**  
**Accountant Member**

Bangalore,  
Dated 11<sup>th</sup> Mar, 2021.  
VG/SPS

**Copy to:**

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

By order

Asst. Registrar, ITAT, Bangalore.