IN THE INCOME TAX APPELLATE TRIBUNAL
"C" BENCH : BANGALORE

BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT
AND SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER

IT(TP)A No.310/Bang/2021
Assessment Year : 2016-17

M/s BORQS Software Solutions Pvt. Ltd., **No.3, Prestige Alkareem,** **Ground Floor, Edward Road,** **Bengaluru-560 052.** **PAN : AADCB 8697 G**	Vs.	The Asst. Commissioner of Income Tax, Circle -1(1)(2), BMTC Building, 80 Feet Road, 6th Block, Near KHB Games Village, Koramangala, Bengaluru-560095.
APPELLANT		RESPONDENT

Appellant by	:	Shri. Tata Krishna, Advocate
Respondent by	:	Shri. Pradeep Kumar, CIT(DR)(ITAT), Bengaluru

Date of hearing	:	14.10.2021
Date of Pronouncement	:	25.10.2021

O R D E R

Per N. V. Vasudevan, Vice President:

This appeal by the Assessee is directed against the order dated 30.03.2021 of the Deputy Commissioner of Income Tax, Circle 1(1)(2), Bangalore, (hereinafter referred to as the Assessing Officer, "AO" in short) passed u/s.143(3) read with Section 144C(13) of the Income Tax Act, 1961 (Act) in relation to AY 2016-2017.

2. The Assessee in engaged in the business of provision of Software Development Services (SWD services), to BORQS, Hong Kong, which is a subsidiary of its wholly owned holding company BORQS INTERNATIONAL HOLDING CORPORATION, Cayman Islands. In

terms of the provisions of Sec.92-A of the Act, the Assessee and its wholly owned holding company and its subsidiary were Associated Enterprises ("AEs"). In terms of Sec.92B(1) of the Act, the transaction of providing SWD Services was an “international transaction” i.e., a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises. In terms of Sec.92(1) of the Act, the any income arising from an international transaction shall be computed having regard to the arm’s length price. In this appeal by the Assessee, the first dispute is with regard to determination of Arms’ Length Price (ALP) in respect of the international transaction of rendering SWD services to the AE.

3. As far as the provision of Software Development services are concerned, the Assessee filed a Transfer Pricing Study (TP Study) to justify the price paid in the international Transaction as at ALP by adopting the Transaction Net Margin Method (TNMM) as the Most Appropriate Method (MAM) of determining ALP. The Assessee selected Operating Profit/Operating Cost (OP/OC) as the Profit Level Indicator (PLI) for the purpose of comparison of the Assessee’s profit margin with that of the comparable companies. The Assessee is a captive service provider and does

not bear any cost of software development and support services. The entire cost of operations is passed on to the AE as cost incurred by the Assessee and is reimbursed by the AE along with mark-up. The OP/OC of the Assessee was arrived at 15 % by the Assessee in its TP study. The operating income was Rs.24,71,71,242/- (+Rs.45,43,304 being gain on foeign exchange fluctuation) and the Operating Cost was Rs.21,44,99,173/-. The Operating profit (Operating income – Operating cost was Rs.3,72,15,373/-. Thus the OP/TC was arrived at 17.35%. The Assessee chose companies who are engaged in providing similar services such as the Assessee. The Assessee identified companies whose average arithmetic mean of profit margin was comparable with the Operating margin of the Assessee. The Assessee therefore claimed that the price it charged in the international transaction should be considered as at Arm's Length.

4. The Transfer Pricing Officer (TPO) to whom the determination of ALP was referred to by the AO, accepted TNMM as the MAM and also used the same PLI for comparison i.e., OP/OC. He also selected comparable companies from database. The TPO on his own identified some other companies as comparable with the Assessee company and arrived at a set of 13 comparable companies. The PLI was reworked by the TPO at 24.83%. The TPO worked out the average arithmetic mean of their profit margins of the 13 comparable companies as follows:

Sl. No.	Company Name	Financial Year wise OP/OC (%)			
		2015-16	2014-15	2013-14	Average
1.	Kals Information Systems Pvt. Ltd.	3.97%	5.77%	16.94%	8.60%
2.	Rheal Software Pvt.	3.20%	2.76%	36.64%	14.50%

	Ltd.				
3.	C G-V A K Software & Exports Ltd.	19.60%	19.87%	13.81%	18.50%
4.	R S Software (India) Ltd.	-2.09%	32.75%	24.14%	20.87%
5.	Larsen & Toubro Infotech Ltd.	26.29%	24.22%	23.54%	24.83%
6.	Nihilent Ltd.	15.94%	29.19%	35.72%	26.36%
7.	Inteq Software Pvt. Ltd.	7.53%	32.14%	45.00% -	28.20%
8.	Persistent Systems Ltd.	26.92%	31.34%	35.64%	30.89%
9.	Infobeans Technologies Ltd.	34.98%	20.78%	41.95%	32.42%
10.	Thirdware Solution Ltd.	23.89%	44.39%	44.68%	36.90%
11.	Infosys Ltd.	38.22%	41.30%	36.28%	38.61%
12.	Aspire Systems (India) Pvt. Ltd.	34.26%	47.56%	38.04%	39.28%
13.	Cybage Software Pvt. Ltd.	62.90%	68.68%	68.82%	66.45%
	35th Percentile				24.83%
	Median				28.20%
	65%th Percentile				32.42%

5. The TPO computed the Addition to total income on account of adjustment to ALP as follows:

"21.4. Computation of Arm's Length Price:

21.4.1 The median of the weighted average Profit Level Indicators is taken as the arm's length margin. Please see Annexure A for details of computation of PLI of the comparables. Based on this, the Arm's Length Price of the services rendered by the Taxpayer to its AE(s) is computed as under:

SWD SEGMENT		
Particulars	**Formula**	Amount (in Rs.)
Taxpayers Operating Revenue	OR	24,71,71,242

Taxpayers Operating Cost	OC	21,44,99,172
Taxpayers Operating Profit	OP	3,26,72,770
Taxpayers PLI	PLI=OP/OC	15.23%
35th Percentile Margin of comaparable set		24.83%
Adjustment Required (if PLI< 35th Percentile)		Yes
Median Margin of comparable set	M	28.20%
Arm's Length Price	ALP=(1+M)*OC	19,72,99,371
Price Received	OR	24,71,71,242
Shortfall being adjustment	ALP-OR	2,78,16,697

*21.4.2 The above shortfall of **Rs. 2,78,16,697/-** is treated as Transfer Pricing adjustment u/s 92CA in respect of software development segment of the Taxpayer's International Transactions."*

Thus a sum of Rs.2,78,16,697/- was added to the total income of the Assessee on account of determination of ALP for provision of SWD services by the Assessee to its AE.

6. The Assessee filed objections before the Disputes Resolution Panel (DRP) against the draft assessment order passed by the AO wherein the addition suggested by the TPO as adjustment consequent to determination of ALP was added to the total income of the Assessee by the AO. The DRP gave certain directions. Based on the directions of the DRP, the AO passed the final order of assessment. To the extent the Assessee did not get relief from the DRP, the Assessee has preferred appeal before the Tribunal.

7. The main grievance of the Assessee projected in the grounds of appeal filed before the Tribunal which was argued before us was (i) choice of comparable companies by the TPO in disregard of the Assessee's claim that the companies chosen had high turnover and hence should not be considered as comparable with the Assessee. The stand of the TPO was affirmed by the DRP against which the Assessee is in appeal (Ground No.8.7) The said ground reads thus:

> *8.7 Without prejudice, the Learned DRP is not justified in upholding the selection of the following companies by the Learned TPO by refusing to adopt the upper turnover filter:*
>
> *(a) Larsen & Toubro Infotech Ltd*
> *(b) Nihilent Ltd.*
> *(c) Persistent Systems Ltd*
> *(d) Aspire Systems (India) Pvt Ltd*
> *(e) Infosys Ltd.*
> *(f) Thirdware Solution Ltd.*
> *(g) Cybage Software Pvt Ltd.*

(ii) exclusion of R.S.Software (India) Ltd., on the ground that the related party transaction is more than 15%; or in the alternative prayer for excluding the operating income and operating expense of FY 2014-15 and FY 2013-14 in computing the weighted average margin for RS Software Ltd, even though the same fails the upper turnover limit of Rs. 200 crores for the above-mentioned years.

(iii) non acceptance of Assessee's claim regarding non inclusion of certain companies comparable company. Inteq Software Pvt.Ltd., and Infobeans Software Ltd..

8. As far as Ground No.8.7 is concerned, the relevant provisions of the Act in so far as comparability of international transaction with a transaction of similar nature entered into between unrelated parties, provides as follows:

Determination of arm's length price under section 92C .

10B . (1) For the purposes of sub-section (2) of section 92C, the arm's length price in relation to an international transaction **[***or a specified domestic transaction***]** shall be determined by any of the following methods, being the most appropriate method, in the following manner, namely :—

(a) to (d)......

(e)transactional net margin method, by which,—

(*i*) the net profit margin realised by the enterprise from an international transaction **[***or a specified domestic transaction***]** entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;

(*ii*) the net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;

(*iii*) the net profit margin referred to in sub-clause (*ii*) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction **[***or the specified domestic transaction***]** and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of

net profit margin in the open market;

(*iv*) the net profit margin realised by the enterprise and referred to in sub-clause (*i*) is established to be the same as the net profit margin referred to in sub-clause (*iii*);

(*v*) the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction **[***or the specified domestic transaction***]**;

(f).....

(2) For the purposes of sub-rule (1), the comparability of an international transaction **[***or a specified domestic transaction***]** with an uncontrolled transaction shall be judged with reference to the following, namely:—

(*a*) the specific characteristics of the property transferred or services provided in either transaction;

(*b*) the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;

(*c*) the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;

(*d*) conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

(3) An uncontrolled transaction shall be comparable to an international transaction **[***or a specified domestic transaction***]** if—

(*i*) none of the differences, if any, between the transactions being compared, or between the

enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market; or

(*ii*) reasonably accurate adjustments can be made to eliminate the material effects of such differences.

9. A reading of Rule 10B(1)(e)(iii) of the Rules read with Sec.92CA of the Act, would clearly shows that the net profit margin arising in comparable uncontrolled transactions has to be adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, which could materially affect the amount of net profit margin in the open market.

10. Chapters I and III of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (hereafter the "TPG") contain extensive guidance on comparability analyses for transfer pricing purposes. Guidance on comparability adjustments is found in paragraphs 3.47-3.54 and in the Annex to Chapter III of the TPG. A revised version of this guidance was approved by the Council of the OECD on 22 July 2010. In paragraph 2 of these guidelines it has been explained as to what is comparability adjustment. The guideline explains that when applying the arm's length principle, the conditions of a controlled transaction (i.e. a transaction between a taxpayer and an associated enterprise) are generally compared to the conditions of comparable uncontrolled transactions. In this context, to be comparable means that:

- None of the differences (if any) between the situations being compared could materially affect the condition being examined in the methodology (e.g. price or margin), or

- Reasonably accurate adjustments can be made to eliminate the effect of any such differences. These are called "comparability adjustments.

11. As far as comparability of companies listed as (a) to (g) in Grd.No.8.7 raised by the Assessee is concerned, the admitted factual position is that the turnover of these companies is more than Rs.200 Crores and the Assessee's turnover is only Rs. 24,71,71,242/-. The TPO excluded from the list of comparable companies chosen by the Assessee in its TP study companies whose turnover was less than Rs.1 Crore. The contention of the Assessee before the DRP was that while the TPO excluded companies with low turnover, he failed to apply the same yardstick to exclude companies with high turnover compared to the Assessee. The reason for excluding companies with low turnover was that such companies do not reflect the industry trend as their low cost to sales ratio made their results less reliable. The contention of the Assessee was that there would be effect on profitability wherever there is high or low turnover and therefore companies with high turnover should also be excluded from the list of comparable companies. The DRP primarily relied on the decision rendered by the Hon'ble Delhi High Court in the case of Chryscapital Investment Advisors India Pvt.Ltd Vs. DCIT 82 Taxmann.com 167(Del), wherein it was held that high turnover ipso facto does not lead to the conclusion that a company which is otherwise comparable on FAR analysis can be excluded and that the effect of such high turnover on the margin should be seen. The DRP therefore held that a company which is otherwise functionally comparable cannot be excluded only on the basis of high turnover. The Assessee has raised Grd.No.4 before the Tribunal challenging the aforesaid view of the DRP.

12. On the issue of application of turnover filter, we have heard the rival submissions. The parties relied on several decisions rendered on the above issue by the various decisions of the ITAT Bangalore Benches in favour of the Assessee and in favour of the Revenue, respectively. The ITAT Bangalore Bench in the case of Dell International Services India (P) Ltd. Vs. DCIT (2018) 89 Taxmann.com 44 (Bang-Trib) order dated 13.10.2017, took note of the decision of the ITAT Bangalore Bench in the case of Sysarris Software Pvt.Ltd. Vs. DCIT (2016) 67 Taxmann.com 243 (Bangalore-Trib) wherein the Tribunal after noticing the decision of the Hon'ble Delhi High Court in the case of Chryscapital (supra) and the decision to the contrary in the case of CIT Vs. Pentair Water India Pvt.Ltd., Tax Appeal No.18 of 2015 dated 16.9.2015 wherein it was held that high turnover is a ground to exclude a company from the list of comparable companies in determining ALP, held that there were contrary views on the issue and hence the view favourable to the Assessee laid down in the case of Pentair Water (supra) should be adopted. The following were the conclusions of the Tribunal in the case of Dell International (supra):

> "41. We have given a very careful consideration to the rival submissions. ITAT Bangalore Bench in the case of *Genesis Integrating Systems (India) Pvt. Ltd. v. DCIT, ITA No.1231/Bang/2010*, relying on Dun and Bradstreet's analysis, held grouping of companies having turnover of Rs. 1 crore to Rs.200 crores as comparable with each other was held to be proper. The following relevant observations were brought to our notice:-
>
> > "9. Having heard both the parties and having considered the rival contentions and also the judicial precedents on the issue, we find that the TPO himself has rejected the companies which .ire (sic) making losses as comparables. This shows that there is a limit for the lower end for identifying the comparables. In such a situation,

> we are unable to understand as to why there should not be an upper limit also. What should be upper limit is another factor to be considered. We agree with the contention of the learned counsel for the assessee that the size matters in business. A big company would be in a position to bargain the price and also attract more customers. It would also have a broad base of skilled employees who are able to give better output. A small company may not have these benefits and therefore, the turnover also would come down reducing profit margin. Thus, as held by the various benches of the Tribunal, when companies which arc loss making are excluded from comparables, then the super profit making companies should also be excluded. For the purpose of classification of companies on the basis of net sales or turnover, we find that a reasonable classification has to be made. Dun & Bradstreet & Bradstreet and NASSCOM have given different ranges. Taking the Indian scenario into consideration, we feel that the classification made by Dun & Bradstreet is more suitable and reasonable. In view of the same, we hold that the turnover filter is very important and the companies having a turnover of Rs.1.00 crore to 200 crores have to be taken as a particular range and the assessee being in that range having turnover of 8.15 crores, the companies which also have turnover of 1.00 to 200.00 crores only should be taken into consideration for the purpose of making TP study."

42. The Assessee's turnover was around Rs.110 Crores. Therefore the action of the CIT(A) in directing TPO to exclude companies having turnover of more than Rs.200 crores as not comparable with the Assessee was justified. As rightly pointed out by the learned counsel for the Assessee, there are two views expressed by two Hon'ble High Courts of Bombay and Delhi and both are non-jurisdictional High Courts. The view expressed by the Bombay High Court is in favour of the Assessee and therefore following the said view, the action of the CIT(A) excluding companies with turnover of above Rs.200 crores from the list of comparable companies is held to correct and such action does not call for any interference."

13. The Tribunal in the case of Autodesk India Pvt.Ltd. Vs. DCIT (2018) 96 Taxmann.com 263 (Banglore-Tribunal), took note of all the conflicting decision on the issue and rendered its decision and in paragraph 17.7. of the decision held as that high turnover is a ground for excluding companies as not comparable with a company that has low turnover. The following were the relevant observations:

> 17.7. We have considered the rival submissions. The substantial question of law (Question No.1 to 3) which was framed by the Hon'ble Delhi High Court in the case of Chryscapital Investment Advisors (India) Pvt.Ltd., (supra) was as to whether comparable can be rejected on the ground that they have exceptionally high profit margins or fluctuation profit margins, as compared to the Assessee in transfer pricing analysis. Therefore as rightly submitted by the learned counsel for the Assessee the observations of the Hon'ble High Court, in so far as it refers to turnover, were in the nature of *obiter dictum*. Judicial discipline requires that the Tribunal should follow the decision of a non-jurisdiction High Court, even though the said decision is of a non-jurisdictional High Court. We however find that the Hon'ble Bombay High Court in the case of *CIT Vs. Pentair Water India Pvt.Ltd. Tax Appeal No.18 of 2015* judgment dated 16.9.2015 has taken the view that turnover is a relevant criterion for choosing companies as comparable companies in determination of ALP in transfer pricing cases. There is no decision of the jurisdictional High Court on this issue. In the circumstances, following the principle that where two views are available on an issue, the view favourable to the Assessee has to be adopted, we respectfully follow the view of the Hon'ble Bombay High Court on the issue. Respectfully following the aforesaid decision, we uphold the order of the DRP excluding 5 companies from the list of comparable companies chosen by the TPO on the basis that the 5 companies turnover was much higher compared to that the Assessee.
>
> 17.8. In view of the above conclusion, there may not be any necessity to examine as to whether the decision rendered in the case of Genisys

Integrating (supra) by the ITAT Bangalore Bench should continue to be followed. Since arguments were advanced on the correctness of the decisions rendered by the ITAT Mumbai and Bangalore Benches taking a view contrary to that taken in the case of Genisys Integrating (supra), we proceed to examine the said issue also. On this issue, the first aspect which we notice is that the decision rendered in the case of Genisys Integrating (supra) was the earliest decision rendered on the issue of comparability of companies on the basis of turnover in Transfer Pricing cases. The decision was rendered as early as 5.8.2011. The decisions rendered by the ITAT Mumbai Benches cited by the learned DR before us in the case of Willis Processing Services (supra) and Capegemini India Pvt.Ltd. (supra) are to be regarded as per incurium as these decisions ignore a binding co-ordinate bench decision. In this regard the decisions referred to by the learned counsel for the Assessee supports the plea of the learned counsel for the Assessee. The decisions rendered in the case of M/S.NTT Data (supra), Societe Generale Global Solutions (supra) and LSI Technologies (supra) were rendered later in point of time. Those decisions follow the ratio laid down in Willis Processing Services (supra) and have to be regarded as per incurium. These three decisions also place reliance on the decision of the Hon'ble Delhi High Court in the case of Chriscapital Investment (supra). We have already held that the decision rendered in the case of Chriscapital Investment (supra) is obiter dicta and that the ratio decidendi laid down by the Hon'ble Bombay High Court in the case of Pentair (supra) which is favourable to the Assessee has to be followed. Therefore, the decisions cited by the learned DR before us cannot be the basis to hold that high turnover is not relevant criteria for deciding on comparability of companies in determination of ALP under the Transfer Pricing regulations under the Act. For the reasons given above, we uphold the order of the CIT(A) on the issue of application of turnover filter and his action in excluding companies by following the ratio laid down in the case of Genisys Integrating (supra).

14. In view of the aforesaid decision, we hold that companies listed in Sl.No.(a) to (g) of Grd.No.8.7 raised by the Assessee whose turnover in the

current year is more than Rs.200 Crores should be excluded from the list of comparable companies.

15. As far as exclusion of R.S.Software (India) Ltd., is concerned, the turnover of this company in the current year is less than Rs.200 Crores but in the earlier two years its turnover was more than Rs.200 crores and was liable to be excluded in those earlier two years. The question raised in the aforesaid grounds is as to:

whether this company should also be excluded on the application of turnover filter by reason of its turnover in the earlier two years being more than Rs.200 crores in the light of Rule 10CA of the rules which were applicable from AY 2014-15 onwards

or

whether in computing the weighted average profit margin of this company, the earlier two years profit margins have to be ignored because they fail the test of comparability in those two earlier years by reason of the application of the Rs.200 Crore turnover filter.

16. To answer the above question, we need to look at the amendment to the rules that allow for introduction of a "range concept" for determination of ALP and "use of multiple year data" for undertaking comparability analysis in **transfer pricing** cases. The provisions of the Income-tax Act were amended through the Finance (No.2) Act, 2014 to facilitate alignment of Indian transfer regime with international best practices. The manner of computation of ALP is laid down under the Income-tax Rules. The Government has notified the amended Rules for determining ALP vide S.O. No. 2860 (E) dated 19/10/2015. The amended regime will be applicable for

computation of ALP of international transactions and specified domestic transactions undertaken on or after 1/04/2014 i.e. on and after PY 2014-15. The amended rules allow for introduction of a "range concept" for determination of ALP and "use of multiple year data" for undertaking comparability analysis in **transfer pricing** cases. The use of range concept being a statistical tool enhances the reliability of analysis undertaken for computation of ALP. The range concept will be applicable in certain cases for determining the price and will begin with the 35th percentile and end with the 65th percentile of the comparable prices. Transaction price shown by the taxpayers falling within the range will be accepted and no adjustment will be made. The use of multiple year data allows for yearly variations to be averaged out and would therefore add value to transfer pricing analysis. The Amended Income tax Rules, 1962 ('Rules') via Notification 83 of 2015 which is the 16th amendment to the originally drafted Indian Tax Rules, 1962, are applicable for transactions undertaken on or after 1 April 2014 (i.e. from FY 2014-15 and onwards). These amended provisions are applicable only when the determination of 'ALP' is done under the MAM being resale price method ('RPM'), cost plus method ('CPM') or transactional net margin method ('TNMM'). The relevant provisions of Rule 10CA of the Rules, in so far as it relates to choice of comparable companies, read as follows:

> **"Computation of arm's length price in certain cases.**
>
> **10CA.** *(1) Where in respect of an international transaction or a specified domestic transaction, the application of the most appropriate method referred to in sub-section (1) of section 92C results in determination of more than one price, then the arm's length price in respect of such international transaction or specified*

domestic transaction shall be computed in accordance with the provisions of this rule.

(2) A dataset shall be constructed by placing the prices referred to in sub-rule (1) in an ascending order and the arm's length price shall be determined on the basis of the dataset so constructed:

Provided *that in a case referred to in clause (i) of sub-rule (5) of rule 10B, where the comparable uncontrolled transaction has been identified on the basis of data relating to the current year and the enterprise undertaking the said uncontrolled transaction, [not being the enterprise undertaking the international transaction or the specified domestic transaction referred to in sub-rule (1)], has in either or both of the two financial years immediately preceding the current year undertaken the same or similar comparable uncontrolled transaction then,—*

(i) *the most appropriate method used to determine the price of the comparable uncontrolled transaction or transactions undertaken in the aforesaid period and the price in respect of such uncontrolled transactions shall be determined; and*

(ii) *the weighted average of the prices, computed in accordance with the manner provided in sub-rule (3), of the comparable uncontrolled transactions undertaken in the current year and in the aforesaid period preceding it shall be included in the dataset instead of the price referred to in sub-rule (1)*:

Provided further *that in a case referred to in clause (ii) of sub-rule (5) of rule 10B, where the comparable uncontrolled transaction has been identified on the basis of the data relating to the financial year immediately preceding the current year and the enterprise undertaking the said uncontrolled transaction, [not being the enterprise undertaking the international transaction or the specified domestic*

transaction referred to in sub-rule (1)], has in the financial year immediately preceding the said financial year undertaken the same or similar comparable uncontrolled transaction then,—

(i) *the price in respect of such uncontrolled transaction shall be determined by applying the most appropriate method in a similar manner as it was applied to determine the price of the comparable uncontrolled transaction undertaken in the financial year immediately preceding the current year; and*

(ii) *the weighted average of the prices, computed in accordance with the manner provided in sub-rule (3), of the comparable uncontrolled transactions undertaken in the aforesaid period of two years shall be included in the dataset instead of the price referred to in sub-rule (1) :*

Provided also *that where the use of data relating to the current year in terms of the proviso to sub-rule (5) of rule 10B establishes that,—*

(i) *the enterprise has not undertaken same or similar uncontrolled transaction during the current year; or*

(ii) *the uncontrolled transaction undertaken by an enterprise in the current year is not a comparable uncontrolled transaction,*

then, irrespective of the fact that such an enterprise had undertaken comparable uncontrolled transaction in the financial year immediately

preceding the current year or the financial year immediately preceding such financial year, the price of comparable uncontrolled transaction or the weighted average of the prices of the uncontrolled transactions, as the case may be, undertaken by such enterprise shall not be included in the dataset.

(3) Where an enterprise has undertaken comparable uncontrolled transactions in more than one financial year, then for the purposes of sub-rule (2) the weighted average of the prices of such transactions shall be computed in the following manner, namely:—

(i) *where the prices have been determined using the method referred to in clause (b) of sub-rule (1) of rule 10B, the weighted average of the prices shall be computed with weights being assigned to the quantum of sales which has been considered for arriving at the respective prices;*

(ii) *where the prices have been determined using the method referred to in clause (c) of sub-rule (1) of rule 10B, the weighted average of the prices shall be computed with weights being assigned to the quantum of costs which has been considered for arriving at the respective prices;*

(iii) *where the prices have been determined using the method referred to in clause (e) of sub-rule (1) of rule 10B, the weighted average of the prices shall be computed with weights being assigned to the quantum of costs incurred or sales effected or assets employed or to be employed, or as the case may be, any other base which has been considered for arriving at the respective prices*

……..

17. Let us apply the above rules to the comparable company R.S.Software (India) Ltd. As per Rule 10CA(2), the dataset of comparable companies

chosen has to be arranged in ascending order. As per the 1st proviso to Rule 10CA(2), R.S.Software (India) Ltd., was chosen as a comparable company based on the data relating to the current year and in the earlier two financial years immediately preceding the current financial year. In all the financial years the said company has undertaken similar comparable uncontrolled transaction. Clause (i) to 1st proviso to Sec.10CA(2) mandates that the same MAM has to be used to arrive at the price of the comparable uncontrolled transaction undertaken by R.S.Software (India) Ltd., in the financial years 2013-14 and 2014-15. As per clause (ii) of 1st proviso to Sec.10CA(2), weighted average of the prices of the 3 financial years have to be taken in accordance with Rule 10CA(3) and the weighted average so taken shall be included data set instead of the price arrived at by using current year data alone. In the present case, if one sees the chart of comparables of TPO given in paragraph-4 of this order, the profit margins of the Company R.S.Software (India) Ltd., for the three financial years were 2013-14 to 2015-16 were 24.14%, 32.75% and -2.09% respectively and the weighted average margin of 24.83% has been considered by the TPO.

18. The second proviso to Sec.10CA(2) of the Rules provides for a situation where R.S.Software (India) Ltd., has undertaken comparable uncontrolled transaction only in Financial year 2014-15 & 2015-16, then the weighted average of the two financial year 2014-15 and 2015-16 has to be computed in the manner laid down in Rule 10CA(3) of the Rules and the margin so arrived at has to be included in the dataset.

19. The third proviso to Sec.10CA(2) of the rules provides that if in the current year i.e., financial year 2015-16 if R.S.Software (India) Ltd., has not

undertaken any uncontrolled comparable transaction then that company can never be considered for inclusion in the dataset.

20. The submission of the learned Counsel for the Assessee was that as per the proviso to Rule 10CA(2) of the Rules, R.S.Software (India) Ltd., cannot be regarded as comparable company for Financial Year 2013-14 and 2014-15 because in those years, the turnover of this company was more than Rs.200 crores. Therefore as per the first and second proviso to Rule 10CA(2) of the Rules, the profit margin of this company for Financial year 2013-14 & 2014-15 has to be ignored and the profit margin of the financial year 2015-16 alone should be taken. If one looks at Rule 10CA(2) in isolation, we have to reject this argument because the 1st and 2nd proviso to Rule 10CA(2) of the Rules refers to only R.S.Software (India) Ltd., (i.e., "*where the comparable uncontrolled transaction has been identified on the basis of data relating to the current year and the enterprise undertaking the said uncontrolled transaction has in either or both of the two financial years immediately preceding the current year undertaken the same or similar comparable uncontrolled transaction")* undertaking uncontrolled transaction during the relevant previous year and if this condition is satisfied then the profit margin of R.S.Software for the 2 financial years immediately prior to the current financial year has to be taken. A plain reading of the 1st proviso would show that the question of comparability is not to be seen while applying the 1st and 2nd proviso to Rule 10CA(2) of the Rules. The provisions of Rule 10CA(2) have to be read harmoniously with the other provisions of Rule 10B.

Determination of arm's length price under section 92C .

10B . (1) For the purposes of sub-section (2) of section 92C, the arm's length price in relation to an international transaction **[***or a specified domestic transaction***]** shall be determined by any of the following methods, being the most appropriate method, in the following manner, namely :—

(a) to (d)…..

(e) transactional net margin method, by which,—

(*i*) the net profit margin realised by the enterprise from an international transaction **[***or a specified domestic transaction***]** entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;

(*ii*) the net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;

(*iii*) the net profit margin referred to in sub-clause (*ii*) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction **[***or the specified domestic transaction***]** and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;

(*iv*) the net profit margin realised by the enterprise and referred to in sub-clause (*i*) is established to be the same as the net profit margin referred to in sub-clause (*iii*);

(*v*) the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction **[***or the specified domestic transaction***]**;

……..

(2) For the purposes of sub-rule (1), the comparability of an international transaction **[***or a specified domestic transaction***]** with an

uncontrolled transaction shall be judged with reference to the following, namely:—

(*a*) the specific characteristics of the property transferred or services provided in either transaction;

(*b*) the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;

(*c*) the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;

(*d*) conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

(3) An uncontrolled transaction shall be comparable to an international transaction **[***or a specified domestic transaction***]** if—

(*i*) none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market; or

(*ii*) reasonably accurate adjustments can be made to eliminate the material effects of such differences.

(4) The data to be used in analysing the comparability of an uncontrolled transaction with an international transaction **[***or a specified domestic transaction***]** shall be the data relating to the financial year **[***(hereafter in this rule and in rule 10CA referred to as the 'current year')***]** in which the international transaction **[***or the specified domestic transaction***]** has been entered into :

> **Provided** that data relating to a period not being more than two years prior to **[***the current year***]** may also be considered if such data reveals facts which could have an influence on the determination of transfer prices in relation to the transactions being compared:

A reading of Rule 10B(3) shows that comparison of an uncontrolled transaction to an international transaction can be done only if differences, if any, between the transactions that are compared or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market or reasonably accurate adjustments can be made to eliminate the material effects of such differences. A reading of Proviso to Rule 10B(4) would show that use of data relating to a period of two years prior to the current year may also be considered but with a rider that "if such data reveals facts which could have an influence on the determination of transfer prices in relation to the transactions being compared". If by application of any filter an enterprise undertaking uncontrolled transaction similar to an international transaction is regarded as not being comparable in the earlier two years immediately preceding the current year and thereby attracting the provisions of Rule 10B(2) or 10B(3) then the data for those years will not have any influence on the determination of transfer prices in relation to the transactions being compared for the current year and hence have to be ignored. On a harmonious reading of the provisions of Rule 10CA, 10B(3) (4) of the Rules, we agree with the stand taken by the learned counsel for the Assessee. Therefore, if at all R.S.Software Ltd., is to be regarded as a comparable company, then the margins for AY 2014-15 and 2015-16 of the company have to be ignored because in those years they are to be regarded as not comparable. We hold accordingly.

21. As far as exclusion of this company R.S.Software (India) Ltd., on the ground that the related party transaction is more than 15% is concerned, we find that the admitted position with regard to related party transaction in this case of R.S.Software (India) Ltd., is 17.52%. The DRP in its order proceeded on the basis that the threshold limit for application of the Related Party Transaction filter (RPT filter) would be 25% of the total transaction. The Hon'ble Karnataka High Court in its Judgment 28-06-2018 in I.T.A.No.684/2017 & I.T.A..No.685/2017 Pr. Commissioner of Income Tax-7 & Anr. Vs. M/s. Yodlee Infotech Pvt Ltd., had to consider among other questions of law the following questions of law with regard to application of RPT filter, viz., Whether on the facts and in the circumstances of the case, and in law, the Tribunal was justified by not acknowledging its own orders where the Tribunal has held in stretching RPT% from 15-20% in case of Katera Software India Pvt Ltd? and Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that RPT filters should be 15% and not 25%, taken by the TPO?. The Hon'ble Court held as follows:

> "3. The learned Tribunal, after discussing the rival contentions of both the Appellants-Revenue and the Respondent-assessee, has given the following findings against Revenue with regard to various issues raised before it with regard to 'Transfer Pricing' and 'Transfer Pricing Adjustments' made by the concerned authorities below. We consider it appropriate to quote from the order of Tribunal rejecting the Application seeking a review before Tribunal as hereunder:-
>
> > "7. We have heard the learned Departmental Representative as well as learned Authorised Representative and considered the relevant material on record. At the outset, we note that the TPO has applied the filter of 25% RPT whereas the assessee has contended that the filter of revenue from RPT should be

applied at 15% instead of 25% applied by the TPO. The learned Departmental Representative has submitted that there is no standard rule for applying the filter of 15% regarding the RPT. It is pertinent to note that the ALP as per the provisions of the TP has to be determined by considering uncontrolled comparable prices and therefore only unrelated prices have to be taken into account to bench marked international transactions. However, 0% RPT of the comparable price is an impossible situation and therefore a reasonable tolerance range from revenue from RPT can be considered for selecting uncontrolled comparables. There is no dispute that there cannot be a single criteria/parameter to be applied as a general rule in all the cases. The tolerance range varies from case to case and depending upon the availability of comparables for a particular case. Thus if the comparables of an international transactions are easily available in sufficient number then this tolerance range of RPT should be restricted to minimum. Though there is no specified range in the provisions of Act or Rules, however, in due course of discussion and adjudication of this issue in a series of decisions of this Tribunal, tolerance range of 5% to 25% of total revenue from RPT has been considered as reasonable depending upon the facts and circumstances of each case. In the case of the assessee before us, the TPO/A.O. selected 17 comparables. Therefore, the availability of the comparables of the international transactions of the assessee is not a difficult task. Thus, when a good number of comparables are available then the RPT cannot be allowed to the extreme limit of 25% of revenue. Accordingly, in order to determine the ALP considering by considering the uncontrolled comparable transactions, it should be kept in mind that the uncontrolled transactions should be least influenced by the controlled and related prices. This Tribunal in the series of decisions has taken a view that when good number of comparables are available, then the threshold limit of RPT shall not be more than 15% of total revenue. In view of the facts and circumstances of the case when good number of comparables available, then we are of the considered opinion that the RPT filter of 15% is proper in the case of the assessee. By applying this filter of 15% RPT, we modify the impugned order of the CIT (Appeals) and therefore only one company

> namely Four Soft Limited will be excluded from the said comparable having more than 15% RPT. Accordingly, we direct the A.O./TPO to exclude the Four Soft Ltd. having 19.89% of RPT."
>
> ……..

4. This Court in ITA No.536/2015 C/w ITA No.537/2015 delivered on 25.06.2018 (Prl. Commissioner of Income Tax & Anr. Vs. M/s. Softbrands India Pvt. Ltd.,) has held that in these type of cases, unless an ex-facie perversity in the findings of the learned Income Tax Appellate Tribunal is established by the appellant, the appeal at the instance of an assessee or the Revenue under Section 260-A of the Act is not maintainable.

……

5. The relevant portion of the said judgment is quoted below for ready reference:

> " Conclusion:
> 55. A substantial quantum of international trade and transactions depends upon the fair and quick judicial dispensation in such cases. Had it been a case of substantial question of interpretation of provisions of Double Taxation Avoidance Treaties (DTAA), interpretation of provisions of the Income Tax Act or Overriding Effect of the Treaties over the Domestic Legislations or the questions like Treaty Shopping, Base Erosion and Profit Shifting (BEPS), Transfer of Shares in Tax Havens (like in the case of Vodafone etc.), if based on relevant facts, such substantial questions of law could be raised before the High Court under Section 260-A of the Act, the Courts could have embarked upon such exercise of framing and answering such substantial question of law. On the other hand, the appeals of the present tenor as to whether the comparables have been rightly picked up or not, Filters for arriving at the correct list of comparables have been rightly applied or not, do not in our considered opinion, give rise to any substantial question of law.

> 56. We are therefore of the considered opinion that the present appeals filed by the Revenue do not give rise to any substantial question of law and the suggested substantial questions of law do not meet the requirements of Section 260-A of the Act and thus the appeals filed by the Revenue are found to be devoid of merit and the same are liable to be dismissed.
>
> 57. We make it clear that the same yardsticks and parameters will have to be applied, even if such appeals are filed by the Assessees, because, there may be cases where the Tribunal giving its own reasons and findings has found certain comparables to be good comparables to arrive at an 'Arm's Length Price' in the case of the assessees with which the assessees may not be satisfied and have filed such appeals before this Court. Therefore we clarify that mere dissatisfaction with the findings of facts arrived at by the learned Tribunal is not at all a sufficient reason to invoke Section 260-A of the Act before this Court.
>
> 58. The appeals filed by the Revenue are therefore dismissed with no order as to costs."

> 6. Having heard the learned counsels for the parties, we are therefore of the opinion that no substantial question of law arises in the present cases also. The appeals filed by the Appellants-Revenue are liable to be dismissed and are dismissed accordingly.

22. We are of the view that the facts of the Assessee's case is similar to the case decided by the Hon'ble High Court and in the light of the aforesaid decision of the Tribunal which has been upheld by the Hon'ble Karnataka High Court, the RPT filter has to be applied adopting the threshold limit of 15%. We hold and direct accordingly.

23. The next ground that requires adjudication is grounds with regard to exclusion from the list of comparable companies, (a) Inteq Software Private Limited and (b) Infobeans Technologies Ltd.

24. As far as exclusion of Inteq Software Private Limited is concerned, the first objection of the learned counsel for the Assessee was that this company is functionally not comparable because it is engaged in the business of computer programming, consultancy and related activities. The objections of the Assessee in this regard are based on contents in the website of this company. The DRP has dealt with this objection in paragraph 2.18.1 of its order, which reads thus:

> *"2.20.1 Having considered the submissions, we note that as per information in the Director's report of the company, the company's principal activity is software development services (MC code 620), which is 100% of its total turnover (Annexure-A to the Boards Report). The independent Audit report states that the Company is a service company primarily rendering software services. As per Revenue Recognition Policy (Note 20(F)), there is mention relating to revenue from software development and there is no information about product. sales. We also note that this company satisfies the various filters adopted by the TPO. The assessee has not disputed or rebutted any of these information stated in the annual report. Instead, the assessee has merely argued that this company is functionally different with reference to certain information in the website. We have already discussed that the information in the website cannot be given credence as they are generally forward looking statements with advertisement and promotional motives. In view of these, we do not find any merit. in the assessee's picas. As we find that this company is engaged in software development services, we hold that it is functionary comparable to the assessee and accordingly, the objection is rejected."*

We find no grounds to take a view different from the view taken by the DRP on this aspect of comparability of this company.

25. The next argument for exclusion of this company is based on inconsistencies in the financial statement of this company. The argument advanced in this regard were that the value of the intangible assets to the total assets is very high and that indicates that the functions of this company could be dissimilar. Regarding the argument that there are some unusual features observed from the financial statements of this company, these features do not affect the comparability. By merely pointing out that there is a substantial increase in value of intangible assets, the Assessee cannot seek to exclude this company from the list of comparable companies, unless the Assessee is able to show that the presence of intangibles is owing to factors which can affect the functional comparability of this company with the Assessee.

26. The next argument is that by applying RPT filter this company cannot be regarded as comparable for FY 2013-14 and therefore while working the margin of this company the margin for FY 2013-14 should not be considered. We have already upheld similar argument while deciding on the exclusion of margins of R.S.Software on the ground of application of turnover filter for FY 2013-14 and 2014-15. Those reasons given will equally apply to this comparable company also and accordingly, we direct that the margins of this company for FY 2013-14 should not be taken for working out the average profit margins of this company which is to be included in the dataset.

27. As far as the plea of the Assessee for exclusion of Infobeans Software Ltd., is concerned, the first plea of the learned counsel for the Assessee is that this company is functionally dissimilar to a SWD service provider and in this regard reference has been made to certain decisions of Tribunal rendered for AY 2015-16. As far as AY 2016-17 is concerned, the DRP has observed that this company was in the business of rendering SWD services in para 2.16.3 to 2.16.7 of its order, which reads thus:

> *"2.16.3. It was also pleaded that some of the software activities carried out by this company are not software services as defined in the safe harbor rules. In this regard, it is relevant to note that as per information submitted by this company in response to 133(6), this company is engaged in customized software development services and has not earned revenue from any service activity other than customized software development services. The relevant extract of the reply submitted is as under: -*
>
> > *That our company is engaged the Customized Software Development Services and the expertise/clarifications of the employees belongs to the same field of software development.*
> >
> > *That the company has no: earned from any services other than from the customized Software Development Services,*
> >
> > *4 (a) (1) Since no software product and that no "off the shelf" software product was manufactured by the company, thus this point is not applicable.*
> >
> > *4 (a) (2)] Likewise no sale of softv4are product was made during the assessment year 2016-17, details or revenue generated from Software services is mentioned in the Audited Profit & Loss A/c.*
> >
> > *4 (a) (3)] That the company owned intangible assets (Software) which is also mentioned in Note no. 10 of the Audited Balance Sheet. As regard "whether the same represent software licenses acquired for its own use or if it is*

an inbuilt software product which generate revenue for company", it is submitted that no such software is owned by the company. The software represents mainly Utility Software for the purpose of its efficient operation of the business and coding software's for providing software services.

our company is not engaged in technology innovation activity: thus this point is not applicable.

2.16.4 Therefore this plea has no merits and rejected.

2.16.5 With regard to the objections related to information collected under Section 133(6) and the claim of high-end service provider, we note that there is no inherent contradiction as claimed by the assessee. From the information collected u/s.13:3(6), it is confirrned by the company that it is engaged in provision of customised software development services and rot in any activity relating to technological innovation. The functional aspect of the comparable company cannot be contradicted when the company itself confirmed its business activity. Accordingly, we reject the assessee's pleas. _

2.16.6 The intangibles referred in the Asset Schedule represent the computer software, and as such does not refer to any IPR or licence owned by the said company. For any sofware company, it is essential to have rights of software for coding purposes. Further these intangibles are meagre 6.89% of total fixed assets. Therefore, such intangibles cannot be equated with the intangibles acquired created by the assessee to provide specific enduring benefit. Also, the assessee has failed to establish that such differences have material effect on the margin of the above company, in terms of clause (i) of sub-rule of Rule 10B, which provides that an uncontrolled transaction shall be comparable to an international transaction if none of the differences, if any, between enterprises entering into business transactions or likely to materially affect the profit arising from such transactions in the open market. Hence, these pleas arc rejected.

2.16.7 It was contended that sufficient business information is not available in the public domain, and hence, it has to be excluded. We

note that there is clear information in the annual report to show that this company is engaged in software development activity. Further. the information obtained u/s 133(6) clarify that this company is engaged in software development activity. Hence, this plea is rejected."

28. The above conclusions of the DRP have not been countered by the Assessee and by merely relying on findings in earlier AY that this company was held to be not a comparable company, the Assessee cannot seek exclusion of this company from the list of comparable companies. The only direction that the Assessee can get is that the margins for AY 2015-16 in which year this company was regarded as not comparable have to be ignored in arriving at the average of three years profit margin of this company. We direct accordingly.

29. No other grounds except the above were argued before us, though in the written note plea to include Akshay Software Technoloiges Ltd., and E-Zest Solutions Ltd., has been made. Therefore the prayer for inclusion of these two companies are not being decided. The TPO/AO is directed to compute the ALP of the international transaction of rendering of SWD services by the Assessee to AE in the light of the directions given above, after affording Assessee opportunity of being heard.

30. In Grd.No.8.2 the Assessee has raised an issue that the international transaction in question would be at Arm's length when benchmarked with its transaction with unrelated parties on the basis of the internal TNMM. The submissions in this regard was that the Assessee undertook transactions with non AE entities also and those transactions were similar in nature to the one entered into with the AE. The price charged in those transactions in the non

AE was on a profit margin of 15.26% whereas the price charged to the AE was at a profit margin of 17.35% and therefore by applying the internal TNMM the transaction with the AE has to be regarded as at Arm's Length.

31. We have considered the above submission and we find that this issue has been raised by the Assessee for the first time before the Tribunal. The Revenue authorities did not have any occasion to examine this issue and therefore we deem it fit and proper to remand this issue to the AO/TPO for consideration afresh and in the light of the relevant applicable statutory provisions.

32. The next issue to be dealt with in this appeal is Ground No.9 of grounds of appeal with regard to determination of ALP by construing the delayed realization of receivable by the Assessee from its AE as a separate international transaction and determining ALP of such delayed receivables. The facts in this regard are that in the order passed under Section 92CA of the Act determined a TP adjustment of Rs.50,87,241/- in respect of delayed receivables on a notional manner. The TPO has observed in this regard in his order that the Assessee was asked to furnish details of trade receivable and details of realization and in the absence of such details, he has no other option but to determine the interest attributable to delayed realization of trade receivables by applying 6 months LIBOR plus 400 basis points with a mark-up of 100 basis points (which works out to 4.485%) on the average of opening and closing receivable. The DRP confirmed the action of the TPO. The computation done by the TPO in this regard was as follows:

"24. <u>Computation of interest on delayed receivables</u>

24.1 As discussed in the preceding paragraphs, interest on the delayed trade receivables is proposed to be computed on invoice basis. To calculate the delay, the Assessee (vide the show cause issued on 30.5.2019) was asked to furnish invoice wise details of all the trade receivables from AEs during the year. The following details were asked in a particular format: Amount raised in invoice, date of invoice, date of receipt, delay in no. of days.

Interest is calculated, using LIBOR- 6 months + 400 basis points applicable for the FY 2015-16 and which works out to 4.485%. The detailed computation is as follows:

Amount in Rs.	*31.03.2016*	*31.03.2015*
ReceivablesfromAEs(A)	*13,86,01,600*	*10,85,69,642*
Payable due toAEs(B)	*0*	*0*
Net receivable (C=A-B)	*13,86,01,600*	*10,85,69,642*
Average Net receivable		*12,35,85,621*
Interest Rate		*4.485%*
Period of delay (days)		*335*
Interest Amount		*50,87,241*

**Period of delay is 365 – allowed period of 30 days.*

Thus, arm's length interest amount to be charged works out to be Rs.50,87,241/-. The same is treated as adjustment u/s 92CA for interst on delayed receivables."

33. The DRP confirmed the action of the DRP. Before the Tribunal the learned counsel for the Assessee submitted that the amounts outstanding

from the AE will be settled with the AE on an ongoing basis in the normal course of business, having regard to commercial and economic factors. The arm's length price determination for the said receivables is subsumed within the arm's length price determination of the principal transaction itself. The outstanding receivables are in respect of the provision of software development services by the Assessee and hence arise out of the primary transaction of rendering SWD services. Since the receivables are integral to the main transaction, the same ought to be aggregated with the said transaction and adjustment ought to be computed accordingly. Reliance in this regard was placed on the decision of this Hon'ble Tribunal in the case of *Avnet India (P.) Ltd. v. DCIT (reported in [2016] 65 taxmann.com 187 [Bangalore - Trib.)]* which was upheld by the Hon'ble High Court of Karnataka in *ITA No. 358/2016*. It was further contended that that the Delhi Bench of ITAT in the case of *Kusum Healthcare Pvt. Ltd. v. ACIT* (Order dated *31.03.2015* passed by the Delhi Bench of the Hon'ble Tribunal in *ITA No. 6814/Del/2014*) held that if the working capital investment of the assessee and the comparables rather are considered than looking at the receivable independently is not necessary as the working capital adjustment takes into account the impact of outstanding receivables on the profitability. It was pointed out that this decision came to be upheld by the Hon'ble Delhi Court in *PCIT v. Kusum Healthcare Pvt. Ltd.* (Order dated *25.04.2017* passed in *ITA No. 765/2016*) (refer paras 10 and 11):-

> "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."

34. It was argued that the above principles have been followed consistently by the various Benches of the Tribunal. In view of the above, it was submitted that the delayed receivables cannot be treated as an independent international transaction.

35. Without prejudice to the above submissions, it was contended that even assuming that delayed realization of trade receivables is an international transaction, it was submitted that no interest on outstanding receivables can be computed in the case of a debt free company such as the Assessee. In this regard our attention was drawn to the relevant extract of the Balance Sheet as on 31.3.2015 and 31.3.2016 to demonstrate that the Assessee was a debt free company. There was no long term borrowing or short term borrowing or trade payables and it was argued based on judicial pronouncements that interest on AE receivables cannot be computed in the case of debt free

company. It was further submitted that the Assessee has not charged interest on non-AE receivables and hence this was a comparable uncontrolled transaction that could be benchmarked against the AE receivables and in this regard reference was made to certain judicial pronouncements. It was also submitted that the delay in realization of the trade receivables in this case is not inordinate so as to warrant any benefit provided to the AE warranting determination of ALP. Our attention was drawn to the fact that the average realization period of the trade receivables is 96 days. It was contended that since the period of credit is not unusually high, no addition is warranted. The ld. DR relied on the order of the DRP.

36. We have carefully considered the rival submissions. On the question whether delayed realization of trade receivables from the AE constitutes an international transaction or not, there are conflicting decisions of various benches of the Tribunal, which we shall point out. Sec.92B of the Act defining what is an international transaction was amended by Finance Act, 2012, way of insertion of an Explanation to sec.92B with retrospective effect from 1-4-2002 and the same reads thus:-

> "Explanation- For the removed of doubts, it is hereby clarified then-(i) the expression "international transaction" shall include—
>
> (a) …….
>
> (b) ……..
>
> (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 of receivable or any other debt arising during the course of business: ……"

37. The amendment is to the effect that “international transaction” would specifically include within its ambit. 'deferred payment or receivable or any other debt arising during the course of business’ and hence non-charging or under-charging of interest on the excess period of credit allowed to the AE for the realization of invoices would amount to an international transaction. It was so held by the ITAT Delhi Bench in the case of *Bechtel India Pvt Ltd (in ITA No.6530/De1/2016 dated 16 May 2017)*. It is important to note that the Bench while arriving at the said conclusion distinguished its earlier order in the case of *Kusum Healthcare Pvt. Ltd. (supra)* and rejected the contention that interest gets subsumed in the working capital adjustment. The Hon`ble Bombay High court in the case of CIT vs. Patni Computer Systems Ltd, (2013) 215 Taxman 108 (Bom) dealt, inter alia, with the following question of law:-

> "(c) Whether on the facts and circumstances of the case and in law, the Tribunal did not err in holding that the loss suffered by the assessee by allowing excess period of credit to the associated enterprises without charging an interest during such credit period would not amount to international transaction whereas section 92B(1) of the Income-tax Act, 1961 refers to any Other transaction having a bearing on the profits, income, losses or assets of such enterprises?"

38. While answering the above question, the Hon'ble High Court noticed that an amendment to section 92B has been carried out by the Finance Act, 2012 with retrospective effect from 1.4.2002. Setting aside the view taken by the Tribunal, the Hon'ble High Court restored this issue to the file of the Tribunal for fresh decision in the light of the legislative amendment. In the case of *BT e Serv (TS-849-ITAT-2017(DEL)-TP)* the ITAT Delhi Bench held that 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. The ITAT concluded that if outstanding receivables are within the terms of agreement, then it may be argued that interest on such outstanding is already covered in the sale price of the goods. However, 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. The ITAT confirmed 30 days as the normal credit period adopted by the TPO.

39. The foregoing discussion discloses that non-charging or under- charging of interest on the excess period of credit allowed to the AE, for the realization of invoices amounts to an international transaction and the ALP of such an international transaction is required to be determined. In view of the above observations. the reliance placed by the ld. counsel for the assessee on earlier decisions cannot be accepted. Similarly, Considering the above discussion, it is held that deferred trade receivable constitutes international transaction.

40. Having concluded that deferred trade receivables constitute international transaction, we come to the computation of the ALP of the international transaction of 'debt arising during the course of business.' This has two ingredients, viz., the amount on which interest should be charged and the arm's length rate at which the interest should be charged. On this aspect we

can take useful guidance from the decision of the ITAT Delhi Bench in the case of Techbooks International (P.) Ltd. v. Deputy Commissioner of Income-tax, Circle-3, Noida [2015] 63 taxmann.com 114 (Delhi - Trib.), wherein the Tribunal laid down guidelines on the manner of determination of ALP, as follows:

> "13.11 Now, we come to the computation of the ALP of the international transaction of 'debt arising during the course of business.' This has two ingredients, viz., the amount on which interest should be charged and the arm's length rate at which the interest should be charged.
>
> 13.12 In so far as the first aspect is concerned, we find that the TPO has taken normal credit period of 60 days and accordingly made addition on account of transfer pricing adjustment for the period in excess of 60 days. In our considered opinion, transfer pricing adjustment on account of interest for the entire period of delay beyond 60 days cannot be treated as a separate international transaction of trading debt arising during the course of business. It is noticed that the assessee entered into an agreement with its AE for realization of invoices within a period of 150 days. This implies that the interest amount on non-realization of invoices up to 150 days was factored in the price charged for the services rendered. Annexure-1 to the TPO's order gives details of the instances of late realization or non-realization of advances up to the year ending. First three and a half pages of this Annexure indicate number of days for which there was delayed realization. Such delay ranges from 175 days to 217 days. The remaining pages disclose no realization of invoices up to 31st March, 2010. When we consider the dates of invoices in the remaining pages, it is manifested that in certain cases these invoices have been raised on 31st August, 30th or September or 31st October, 2009. In all such cases, the period of 150 days already stood expired as on 31st March, 2010 and the assessee ought to have charged interest on the delay in realizing such invoices along with the first three and a half pages in which there is an absolute and identified delay in realization of invoices beyond the stipulated period. When the interest for realization of trade advances up to 150 days is part and

parcel of the price charged from the AE, then the delay up to this extent cannot give rise to a separate international transaction of interest uncharged. Rather interest for the period in excess of normally realizable period in an uncontrolled situation upto 150 days needs to be considered in the determining the ALP of the international transaction of the 'Provision of IT Enabled data conversion services'. This can be done by increasing the revenue charged by the comparable companies with the amount of interest for the period between that allowed by them in realization of invoices and 150 days as allowed by the assessee, so as to bring such comparables at par with the assessee's international transaction of provision of the ITES. To illustrate, if the comparables have allowed credit period of, say, 60 days and the assessee has realized its invoices in 180 days, then interest for 90 days (150 days minus 60 days) should be added to the price charged by the comparables and the amount of their resultant adjusted operating profit be computed. Rule 10B permits making such an adjustment. Sub-rule (2) to rule 10B stipulates that for the purposes of sub-rule (1), the comparability of an international transaction with an uncontrolled transaction shall be judged, inter alia, with reference to the : '(c) the contractual terms (whether or not such terms are formal or in writing) of the transactions …' . Then sub-rule (3) mandates that an uncontrolled transaction shall be comparable to an international transaction if 'reasonably accurate adjustments can be made to eliminate the material effects of such differences'. Applying the prescription of rule 10, it becomes vivid that difference on account of the 'contractual terms of the transactions', which also include the credit period allowed, needs to be adjusted in the profit of comparables. As the TPO has taken the entire delay beyond that normally allowed as a separate international transaction, which position is not correct, we hold that the effect of delay on interest up to 150 days over and above the normal period of realization in an uncontrolled situation, should be considered in the determination of the ALP of the international transaction of 'Provision of IT Enabled data conversion services' and the period of delay above 150 days, namely, 30 days in our above illustration (180 days minus 150 days) should be considered as a separate international transaction in terms of clause (c) of Explanation to section 92B.

> 13.13 In so far as the question of rate of interest is concerned, we find that this issue is no more res integra in view of the judgment of the Hon'ble jurisdictional High Court in the case of Cotton Naturals (I) (P.) Ltd. (supra), in which it has been held that it is the currency in which the loan is to be repaid which determines the rate of interest and hence the prime lending rate should not be considered for determining the interest rate. Under such circumstances, we set aside the impugned order and remit the matter to the file of TPO/AO for a fresh determination of addition on account of transfer pricing adjustment towards interest not realized from its AE on the debts arising during the course of business in line with our above observations."

41. We are of the view that the issue with regard to determination of ALP in respect of the international transaction of giving extended credit period for receivables should be directed to be examined afresh by the AO/TPO on the guidelines laid down in the decision referred to in the earlier paragraph, after affording Assessee opportunity of being heard. As held in the aforesaid decision the prime lending rate should not be considered and this reasoning will apply to adopting short term deposit interest rate offered by State Bank of India (SBI) also. The rate of interest would be on the basis of the currency in which the loan is to be repaid. We hold and direct accordingly. All issues on determination of ALP of the transaction are kept open.

42. In the result, the appeal by the Assessee is partly allowed.

Pronounced in the open court on the date mentioned on the caption page.

(CHANDRA POOJARI)
ACCOUNTANT MEMBER

(N. V. VASUDEVAN)
VICE PRESIDENT

Bangalore, Dated : 25.10.2021.
/NS/*/vms

Copy to:
1. Appellant 2. Respondent 3. CIT 4. CIT(A)
5. DR, ITAT, Bangalore.

By order

Assistant Registrar
ITAT, Bangalore.