

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

**BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT AND  
SHRI B. R. BASKARAN, ACCOUNTANT MEMBER**

<b>IT(TP)A No.394/Bang/2019</b>
<b>Assessment Year : 2011-12</b>

M/s. Moog India Technology Centre Private Limited, No.1, 2 and 3, Hosur Main Road, Electronic City, Bengaluru-560 100. <b>PAN:AAGCM 3566 Q</b>	Vs.	The Income Tax Officer, Ward - 4(1)(4), Bengaluru.
APPELLANT		RESPONDENT

Appellant by	:	Shri. K. R. Vasudevan & Smt.Rashmi, Advocate
Respondent by	:	Shri. Sumer Singh Meena, CIT(DR)(ITAT), Bengaluru

Date of hearing	:	23.11.2021
Date of Pronouncement	:	29.11.2021

**ORDER**

***Per N. V. VASUDEVAN, Vice President:***

This appeal by the Assessee is directed against the Order of Assessment dated 04.12.2015 (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 2011-12.

2. The Assessee is engaged in the business of provision of Software Development Services (SWD services), to its wholly owned holding company. In terms of the provisions of Sec.92-A of the Act, the Assessee and its wholly owned holding company 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 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. The OP/OC of the Assessee was arrived at 14.68% by the Assessee in its TP study. 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/TC. He also selected comparable companies from database. The TPO identified 13 companies as comparable with the Assessee company and worked out the average arithmetic mean of their profit margins as follows:

**Comparables selected by TPO and their arithmetic mean:**

<b>Sl. No.</b>	<b>Name of the Company</b>	<b>Mark-up on Total Costs (WC-unadj) (in %)</b>
1.	Acropetal Technologies Ltd. (seg)	31.98
2.	e-Zest Solutions Ltd.	21.03
3.	E-Infochips Ltd.	56.44
4.	Evoke Technologies Pvt. Ltd.	8.11
5.	ICRA Techno Analytics Ltd.	24.83
6.	Infosys Ltd.	43.39
7.	Larsen & Toubro Infotech Ltd.	19.83
8.	Mindtree Ltd. (seg)	10.66
9.	Persistent Systems & Solutions Ltd.	22.12
10.	Persistent Systems Ltd.	22.84
11.	R S Software (India) Ltd.	16.37
12.	Sasken Communication Technologies Ltd.	24.13
13.	Tata Elxsi Ltd. (seg)	20.91
<b>AVERAGE MARK-UP</b>		<b>24.82</b>

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

Computation of arm's length price by the TPO and the adjustment made:

Arm's Length Mean Mark-up	24.82%
Less: Working Capital Adjustment	1.63%
Adjusted mean mark-up of the comparables	23.19%
Operating Cost	321,360,433
Arm's Length Price – 127.03% of Operating Cost	395,883,917
Price Received	368,537,395
<b>Shortfall being adjustment u/s. 92CA</b>	<b>27,346,522</b>

Thus a sum of Rs.2,73,46,522/- 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 to ALP was added to the total income of the Assessee by the AO. The Assessee filed objections before the DRP and 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. The Tribunal by its order dated 19.10.2017 remanded to the DRP certain issues for fresh consideration. The present appeal has been filed against the order of the AO passed pursuant to the directions given by the DRP after remand by the Tribunal.

7. At the time of hearing, the learned counsel for the Assessee pressed for adjudication of only Gr.No.6 and 11 for adjudication. Gr.No.6 reads as follows:

9. *The Hon'ble DRP / learned AO/ learned TPO has grossly erred in accepting companies that ought to have been rejected as comparables:-*

- *E-Zest Solutions Ltd.*
- *ICRA Techno Analytics Ltd.*
- *Infosys Ltd.*
- *Larsen & Toubro Infotech Ltd.*
- *Persistent Systems Ltd.*
- *Sasken Communication Technologies Ltd.*
- *Tata Elxsi Ltd.*

8. The Learned counsel sought exclusion of the aforesaid 7 comparable companies from the list of comparable companies chosen by the TPO. In this regard he relied on decision of the ITAT Bangalore Bench in the case of M/S.L.G.Soft India Pvt.Ltd., Vs. DCIT IT(TP) A.No.52 & 97/Bang/2016 for AY 2011-12 order dated 5.8.2020. In the aforesaid decision, the 7 comparables referred to in Grd.No.9 were excluded. It is not in dispute that the functional profile of the Assessee and the Assessee in the case cited by the learned counsel for the Assessee are identical. In fact the very same 13 comparables had been chosen in the case of the Assessee in the decision cited by the learned counsel for the Assessee before us.

9. Before we refer to the aforesaid decision, we may look at 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 (i) 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.

10. 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.

11. 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.”

12. In the case of L.G.Soft India Pvt.Ltd. (supra), the Tribunal held on the comparability of the aforesaid companies, as follows:

*“10. With regard to the other 7 comparable companies, whose exclusion is challenged by the revenue in ground No.2 of its appeal, we find that exclusion of these comparables from the list of companies selected by the TPO had come up for consideration before the Bangalore ITAT in the case of Electronic for Imaging (I)*

*Pvt. Ltd. v. DCIT [2017] 85 taxmann.com 124 [Bang. Trib]. ; Symantech Software & Services (I) Pvt. Ltd. v. DCIT, ITA No\_614/Mds./2016; DCIT v. Ikanos Communication Pvt. Ltd. in ITA 137 Bang 2015; Ness Technologies (I) Pvt. Ltd. v. DCIT in ITA tic.536Mum 2016 which are also decisions rendered in relation to AY 22' -12 in the case of a companies providing SWD services such as the assessee in the present appeal. It is also relevant to point out that the very same comparable companies chosen by the TPO in the present appeal had been chosen by the TPO as comparable companies in the case of Electronic for Imaging (I) Pvt. Ltd. (supra). The Tribunal in its order dated 14.7.2017 in the aforesaid case dealt with the comparability of these companies.*

11. *As far as Acropetal Technologies Ltd. is concerned, vide para 8 of the order of Tribunal in Electronics for Imaging (I) Pvt. Ltd. (supra). exclusion of Acropetal was upheld on the ground that this company was into development of computer products. The Tribunal also held that L&T Infotech Ltd. had RPT at 18.66% and since the RPT was beyond the threshold limit of 15%. this company was directed to be excluded from the list of comparable companies. The Tribunal further excluded Tata Elxsi Ltd. from the list of comparables on the ground that this company was engaged in diversified activities and was not a pure SWD services provider such as the assessee. In para 9 of the aforesaid order, the Tribunal held e-Infochips Ltd., was earning revenue both from the software services and software products and though the break-up of revenue from the two segments were available, but the break-up of Operating Cost and Net Operating revenue and segmental details were not available.*

12. *As regards e-Zest Solutions Ltd., in the case of Symantech Software & Services (I) Pvt. Ltd. v. DCIT, ITA No.614/1Vlds2016, this company was held to be engaged in*

*Knowledge Process Outsourcing (KPO) and cannot be regarded as a SWD services company.*

13. *The Tribunal in the case of DCIT v. Ikanos Communication Pvt. Ltd. in ITA 137/Bang/2015 excluded the company. ICRA Techno Analytics Ltd., on the ground that it was engaged in engineering and consulting services, besides licensing and sub-licensing and no segmental information was available to compare the margins of SWD services segment.*

14. *The Mumbai Tribunal in the case of Ness Technologies (I) Pvt. Ltd. v. DCIT in ITA No.696/Mum/2016 held Infosys Ltd. to be not comparable for the reason that this company was engaged in manufacturing of software products and was a giant company assuming various risks. As far as Larsen & Toubro Infotech Ltd., is concerned, vide paragraph-8 page-16 of the order in the case of Electronics for imaging India Pvt. Ltd., (supra) this tribunal excluded this company on the ground of presence of onsite revenue of more than 50% and that the related party transaction was more than 15% (18.66%).*

15. *Respectfully following the aforesaid decisions, we uphold the exclusion of the aforesaid 7 companies from the list of comparable companies and ground No.2 raised by the assessee to this extent is dismissed. We may add that the other grounds raised by the revenue in its appeal are purely supportive of ground No.2 and are general grounds with no specific reference to instances of comparables excluded and hence dismissed.*

16. *Now we shall take up the appeal of the assessee. The assessee in ground No.13 seeks exclusion of 3 companies viz., Persistent Systems & Solutions Ltd., Sasken Communication Technologies Ltd. and Persistent Systems Ltd. Exclusion of these 3*

*companies was considered by the Tribunal in the case of Electronics for Imaging (I) Pvt. Ltd. (supra). In para 8 of the order, this Tribunal held that Persistent Systems & Solutions Ltd. was a company engaged in SWD services and products with no segmental details and excluded it. Similarly, Persistent Systems Ltd. was also excluded on the ground that it was engaged in diverse activities with no segmental break-up. As far as Sasken Communication Technologies Ltd is concerned, this Tribunal in the case of Symantech Software & Services (I) Pvt. Ltd. (supra) has excluded this company on the ground of functional dissimilarity viz., dealing with multimedia products and R&D activities with lc break-up of segmental information.*

*17. Following the aforesaid decisions, we direct exclusion of the aforesaid 3 comparable companies. The TPO is directed to compute the ALP of the international transaction in accordance with the directions given above in this order, after affording Assessee opportunity of being heard.”*

13. Respectfully following the aforesaid decision, we direct exclusion of the 7 comparable companies set out in Grd.No.9 of the Assessee’s appeal.

14. As far as ground No.11 raised by the assessee is concerned, the relevant ground of appeal reads as follows:

*11. The Hon'ble DRP / learned AO/ learned TPO has erred in making the following errors in the computation of working capital adjustment:*

- a. by not considering the fact that the Appellant does not have any working capital risk, therefore, no negative working capital adjustment should be allowed.*
- b. in proposing a restriction to the working capital adjustment without giving any cogent reason.*

*c. in considering the wrong SBI PLR while computing the working capital adjustment.*

15. The issue raised in Grd.No.11 is with regard to the question whether working capital adjustment should be given or not. In this regard, we find that the reasons given by the CIT(A) for not allowing working capital adjustment are not the same reasons as was given in the case of Huawei Technologies India Pvt. Ltd. v. JCIT [2019] 101 taxmann.com 313 (Bang. Trib.). In the aforesaid decision on an identical issue, the Tribunal held that working capital adjustment has to be given. The following are the relevant observations of the Tribunal :-

“10. The next grievance projected by the Assessee in its appeal is with regard to the action of the CIT (A) in not allowing any adjustment towards working capital differences. On this issue we have heard the rival submissions. 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 (b)\*\*      \*\*      \*\*

(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.

11. 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.

12. 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."

13. In Paragraphs 13 to 16 of the aforesaid OECD guidelines, need for working capital adjustment has been explained as follows:

"13. In a competitive environment, money has a time value. If a company provided, say, 60 days trade terms for payment of accounts, the price of the goods should equate to the price for immediate payment plus 60 days of interest on the immediate payment price. By carrying high accounts receivable a company is allowing its customers a relatively long period to pay their accounts. It would need to borrow money to fund the credit terms and/or suffer a reduction in the amount of cash surplus which it would otherwise have available to invest. In a competitive environment, the price should therefore include an element to reflect these payment terms and compensate for the timing effect.

14. The opposite applies to higher levels of accounts payable. By carrying high accounts payable, a company is benefitting from a relatively long period to pay its suppliers. It would need to borrow less money to fund its purchases and/or benefit from an increase in the amount of cash surplus available to invest. In a competitive environment, the cost of goods sold should include an element to reflect these payment terms and compensate for the timing effect.

15. A company with high levels of inventory would similarly need to either borrow to fund the purchase, or reduce the amount

of cash surplus which it is able to invest. Note that the interest rate July 2010 Page 6 might be affected by the funding structure (e.g. where the purchase of inventory is partly funded by equity) or by the risk associated with holding specific types of inventory)

16. Making a working capital adjustment is an attempt to adjust for the differences in time value of money between the tested party and potential comparables, with an assumption that the difference should be reflected in profits. The underlying reasoning is that:

- ◆ A company will need funding to cover the time gap between the time it invests money (i.e. pays money to supplier) and the time it collects the investment (i.e. collects money from customers)
- ◆ This time gap is calculated as: the period needed to sell inventories to customers + (plus) the period needed to collect money from customers - (less) the period granted to pay debts to suppliers."

14. Examples of how to work out adjustment on account of working capital adjustment is also given in the said guidelines. The guideline also expresses the difficulty in making working capital adjustment by concluding that the following factors have to be kept in mind (i) The point in time at which the Receivables, Inventory and Payables should be compared between the tested party and the comparables, whether it should be the figures of receivables, inventory and payable at the year end or beginning of the year or average of these figures, (ii) the selection of the appropriate interest rate (or rates) to use. The rate (or rates) should generally be determined by reference to the rate(s) of interest applicable to a commercial enterprise operating in the same market as the tested party. The guidelines conclude by observing that the purpose of working capital adjustments is to improve the reliability of the comparables.

15. In the present case the TPO allowed working capital adjustment accepting the calculation given by the Assessee. The CIT (A) in exercise of his powers of enhancement held that no adjustment should be made to the profit margins on account of working capital

differences between the tested party and the comparable companies for the following reasons:

- (i) The daily working capital levels of the tested party and the comparables was the only reliable basis of determining adjustment to be made on account of working capital because that would be on the basis of working capital deployed throughout the year.
- (ii) Segmental working capital is not disclosed in the annual reports of companies engaged in different segments and therefore proper comparison cannot be made.
- (iii) Disclose in the balance sheet does not contain break up of trade and non-trade debtors and creditors and therefore working capital adjustment done without such break up would result in computation being skewed.
- (iv) Cost of capital would be different for different companies and therefore working capital adjustment made disregarding this different based on broad approximations, estimations and assumptions may not lead to reliable results.

16. The CIT (A) also placed reliance on a decision of Chennai ITAT in the case of Mobis India Ltd. v. Dy. CIT [2013] 38 taxmann.com 231/[2014] 61 SOT 40. That decision was based on the factual aspect that the Assessee was not able to demonstrate how working capital adjustment was arrived at by the Assessee. Therefore nothing turns on the decision relied upon by the CIT (A) in the impugned order. In the matter of determination of Arm's Length Price, it cannot be said that the burden is on the Assessee or the Department to show what is the Arm's Length Price. The data available with the Assessee and the Department would be the starting point and depending on the facts and circumstances of a case further details can be called for. As far as the Assessee is concerned, the facts and figures with regard to his business has to be furnished. Regarding comparable companies, one has to

fall back upon only on the information available in the public domain. If that information is insufficient, it is beyond the power of the Assessee to produce the correct information about the comparable companies. The Revenue has on the other hand powers to compel production of the required details from the comparable companies. If that power is not exercised to find out the truth then it is no defence to say that the Assessee has not furnished the required details and on that score deny adjustment on account of working capital differences. Regarding applying the daily balances of inventory, receivables and payables for computing working capital adjustment, the Delhi Bench of ITAT in the case of ITO v. E Value Serve.com [2016] 75 taxmann.com 195 (Delhi - Trib.). has held that insisting on daily balances of working capital requirements to compute working capital adjustment is not proper as it will be impossible to carry out such exercise and that working capital adjustment has to be based on the opening and closing working capital deployed. The Bench has also observed that that in Transfer Pricing Analysis there is always an element of estimation because it is not an exact science. One has to see that reasonable adjustment is being made so as to bring both comparable and test party on same footing. Therefore there is little merit in CIT (A)'s objection on working adjustment based on unavailable daily working capital requirements data. There is also no merit in the objection of the CIT (A) regarding absence of segmental details available of working capital requirements of comparable companies chosen and absence of details of trade and non-trade debtors of comparable companies as these details are beyond the power of the Assessee to obtain, unless these details are available in public domain. Regarding absence of cost of working capital funds, the OECD guidelines clearly advocates adopting rate(s) of interest

applicable to a commercial enterprise operating in the same market as the tested party. Therefore this objection of the CIT (A) is also not sustainable.

17. In the light of the above discussion we are of the view that the CIT (A) was not justified in denying adjustment on account of working capital adjustment. Since, the CIT (A) has not found any error in the TPO's working of working capital adjustment, the working capital adjustment as worked out by the TPO has to be allowed. We may also add that the complete working capital adjustment working has been given by the Assessee and a copy of the same is at pages 173 & 192 of the Assessee's paper book. No defect whatsoever has been pointed out in these working by the CIT (A). We may also further add that in terms of Rule 10B(1)(e) (iii) of the Rules, the net profit margin arising in comparable uncontrolled transactions should 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. It is not the case of the CIT (A) that differences in working capital requirements of the international transaction and the uncontrolled comparable transactions is not a difference which will materially affect the amount of net profit margin in the open market. If for reasons given by CIT (A) working capital adjustment cannot be allowed to the profit margins, then the comparable uncontrolled transactions chosen for the purpose of comparison will have to be treated as not comparable in terms of Rule 10B(3) of the Rules, which provides as follows:

"(3) An uncontrolled transaction shall be comparable to an international 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 to 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."

18. In such a scenario there would remain no comparable uncontrolled transactions for the purpose of comparison. The transfer pricing exercise would therefore fail. Therefore in keeping with the OECD guidelines, endeavour should be made to bring in comparable companies for the purpose of broad comparison. Therefore the working capital adjustment as claimed by the Assessee should be allowed. We hold and direct accordingly."

19. The aforesaid decision clearly lays down the proposition that working capital adjustment is to be given effect to while determining ALP while adopting TNMM method. Respectfully following the said decision, we allow Ground No.11 of the Assessee.

20. No other grounds were pressed for adjudication. We direct the TPO to compute the ALP of the international transaction in accordance with the directions given in this order after affording the Assessee opportunity of being heard.

21. In the result, appeal of the Assessee is partly allowed.

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

Sd/-

**(B. R. BASKARAN)**  
**ACCOUNTANT MEMBER**

Sd/-

**(N. V. VASUDEVAN)**  
**VICE PRESIDENT**

Bangalore,  
Dated : 29.11.2021.  
/NS/\*

Copy to:

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

By order

Assistant Registrar  
ITAT, Bangalore.