

**IN THE INCOME TAX APPELLATE TRIBUNAL  
'C' BENCH : BANGALORE**

**BEFORE SHRI GEORGE GEORGE K, JUDICIAL MEMBER AND  
MS. PADMAVATHY S, ACCOUNTANT MEMBER**

IT(TP)A No.246/Bang/2021
Assessment year : 2016-17

Bharat Vijaykumar Jain (HUF), No.701, 11 <sup>th</sup> Main Road, 4 <sup>th</sup> Block, Jayanagar, Bengaluru-560 011. PAN – AAIHB 7841 N	Vs.	The Dy. Commissioner of Income-tax, Circle-2(2), Bengaluru.
APPELLANT		RESPONDENT

Assessee by	:	Shri Narendra Kumar Jain, Advocate
Revenue by	:	Shri Muzaffar Hussain, CIT(DR)

Date of hearing	:	10.02.2022
Date of Pronouncement	:	14.02.2022

**ORDER**

*Per Padmavathy S, Accountant Member*

This appeal by the assessee is directed against the order of the DCIT, Central Circle-2(2), Bengaluru dated 23/4/2021 passed u/s. 143(3) r.w.s.144C(13) of the Income-tax Act 1961 (the Act) for the assessment year 2016-17.

2. The assessee raised several grounds before us.
  - i. Ground No.1 is general.
  - ii. Ground Nos. 2 and 3 are legal grounds relating to Transfer Pricing.
  - iii. Ground Nos. 4 to 7 related to TP Adjustments on merits.
  - iv. Ground No.8 is interest u/s 234B of the Act.
  
3. The brief facts of the case are that the assessee is an HUF engaged in jewellery business. For the asst. year 2016-17, the assessee filed the return of income u/s 139(1) on 30/9/2016 declaring a total income of Rs.57,89,890/-. The asst. was selected for scrutiny. The AO issued notice u/s 143(2) of the Act. During the course of asst. proceedings, the matter was referred to the TPO to determine the arms length price (ALP) on the specified domestic transactions undertaken by the assessee with its associated enterprises. The TPO by his order dated 16/10/2019 determined the adjustment u/s 92CA for an amount of Rs.66,54,892/-. Aggrieved by the adjustments made, assessee filed adjustments before the Dispute Resolution Panel (DRP). The DRP, vide its direction dated 29/3/2021 disposed of the objections of the assessee. Pursuant to the DRP's directions the final assessment order was passed on 23/4/2021.

4. Aggrieved by the final order passed by the AO, the assessee has filed an appeal before us. Though the assessee has raised several grounds in the appeal, the Ld.AR during the course of hearing requested for adjudication of only ground No.6 and prayed for leaving the other grounds open. Hence for the purpose of this appeal we will be considering only the below ground for adjudication

*6. The lower authorities have erred in:*

- (i) Not granting adjustment functional and transactional differences between the assessee and the comparable companies.*
- (ii) Not granting adjustment for working capital and risk differential; and*

5. In the TP analysis performed by the assessee, it had followed CUP method for computing the arms length price. The TPO has rejected the assessee's TP analysis and proceeded to compute ALP under the TNMM. Hence the assessee requested to the TPO that the working capital adjustment should be given effect as it is limited risk bearer. However, while computing the ALP, the TPO has not made any adjustment for transactional or enterprise wide differences and also denied the working capital adjustment claim by the assessee.

6. The AO passed a draft assessment order against which the assessee preferred an appeal before the DRP. The assessee made various submissions to DRP to substantiate its claimed that working capital adjustment should be allowed while computing the arms length price under TNMM method relying on the OECD Guidelines 2017 and various judicial pronouncements. However, the DRP agreed with the view taken by the TPO held that –

*“Having considered the submissions, we note that Rule 10B provides for making reasonably accurate adjustment to the uncontrolled comparable transaction to eliminate the material effects of differences on the price, cost or profits. The assessee has argued for working capital adjustment contending that there exist differences in the payable and receivable position between the assessee and the comparables. However, it was not demonstrated with any data or information as to the impact of such difference on the price, cost or profits and as to whether such difference materially affects the price, cost or profits. The ‘accounts payable and ‘receivable’ shown in the balance sheet only reflects the position as at the end of the financial year and as such it would not enable to measure the impact of working capital on the costs, price or profits. The working capital requirements and impact depends on various factors such as business cycle, the nature of business activity with its correlation on the general economic trends, the fund and capital position of the company its marketing strategies, its*

*market share etc. all of which cannot be captures in the year receivable or payable position. Besides the 'payable' and 'receivable' position stated in the balance sheet may not exactly reflect as to whether it arises from transaction relating to revenue account or capital account as there is no uniformity in the accounting or reporting requirements and an intermixing is generally possible. The cost ascribable to the working capital would be different to different enterprises depending on the cost of fund to the enterprise, the cost of money in the economy it operates etc. In view of these, a reasonable accurate adjustment is not possible as the differences in working capital requirements itself is based on various assumptions. Besides we also note that the assessee had failed to demonstrate such material differences so as to warrant an adjustment. In these circumstances, we are inclined to uphold the TPO's reasoning and reject the assessee's claim for working capital adjustment"*

7. The AO in his final order gave effect to the direction of the DRP and made the final TP adjustment.
8. Aggrieved by the order of the AO, the assessee filed this appeal before us.

9. Before us the Ld.AR re-iterated the submissions made before the AO and DRP. The Ld.AR also submitted that the coordinate bench in the case of Toyota Kirloskar Motors Pvt. Ltd., (ITA No.2016/Bang/2018) vide order dated 18/8/2021 has held that the working capital adjustment should be granted.

10. The Ld.DR submitted that he places reliance on the view taken by the lower authorities.

11. We heard both the parties and perused the material on record.

12. We notice that the coordinate bench of the Tribunal has been consistently adjudicating that the working capital adjustment is permissible. In the following judicial pronouncements the Tribunal has held that working capital adjustment has been provided for the purpose of better comparability.

- 1) Swiss Re Global Business Solutions India (P) Ltd., Vs. DCIT [2020] 116 taxmann.com 716 (Bangalore – Trib.)
- 2) Maxim India Integrated Circuit Design Pvt. Ltd. Vs. DCIT [IT(TP)A No.1573/Bang/2017 dated 2/11/2020.
- 3) Nagravision India Pvt. Ltd., Vs. ACIT (TP 1536/Bang/2017 dated 3/7/2020

13. In the case of Nagravision India Pvt. Ltd., (Supra), the Tribunal held that the working capital adjustment should be allowed. For holding so, the Tribunal has followed the decision rendered by another Bench in the case of Huawei Technologies (India) Pvt. Ltd., Vs. DCIT (2019) (101 taxmann.com 313). The decision rendered in the case of Huawei Technologies (India) Pvt Ltd (supra) are extracted below:-

*“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)\*\*

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(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(l)(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, endeavor 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."*

14. We respectfully follow the judicial pronouncement above and hold that the AO is not justified in denying the working capital adjustment to the assessee. We accordingly direct the AO to allow the working capital adjustment.

15. The assessee did not argue the rest of the grounds before us, and hence we, for the purpose of this order, leave the other grounds open.

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

Order pronounced in court on 14<sup>th</sup> February, 2022

Sd/-

Sd/-

**(GEORGE GEORGE K)**

**( PADMAVATHY S)**

Judicial Member

Accountant Member

Bangalore,

Dated, 14<sup>th</sup> February, 2022

/ vms /

Copy to:

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2. The Respondent
3. The CIT
4. The CIT(A)
5. The DR, ITAT, Bangalore.
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By order

Asst. Registrar, ITAT, Bangalore.

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