

**IN THE INCOME TAX APPELLATE TRIBUNAL
BANGALORE BENCHES “C”, BANGALORE**

Before Shri George George K, JM & Ms.Padmavathy S, AM

IT(TP)A No.103/Bang/2019 : Asst.Year 2014-2015
IT(TP)A No.790/Bang/2019 : Asst.Year 2014-2015

M/s.Brady Company India Private Limited, No.26, Survey No.41 Konappana Agrahara Village Begur, Hobli, Electronci City, Phase-II, Bengaluru – 560 100. PAN : AACCB8163A	v.	The Income Tax Officer Ward 1(1)(4) Bengaluru.
(Appellant)		(Respondent)

Appellant by : Sri.K.R.Vasudevan, Advocate
Respondent by : Sri.Pradeep Kumar, CIT-DR

Date of Hearing : 07.03.2022	Date of Pronouncement : 22.03.2022
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ORDER

Per George George K, JM :

These appeals are at the instance of the assessee. The relevant assessment year is 2014-2015.

2. The reason for filing two appeals for assessment year 2014-2015 is that pursuant to the Dispute Resolution Panel's (DRP) directions (directions dated 28.09.2008), the A.O. passed final assessment order u/s 143(3) r.w.s. 144C of the I.T.Act dated 15.11.2018. In the said assessment order, the aggregate Transfer Pricing adjustment was determined at Rs.14,43,51,081. An appeal has been filed before the Tribunal against the order u/s 143(3) r.w.s. 144C of the I.T.Act (appeal No.IT(TP)A No.103/Bang/2019). Subsequently, on application by the assessee, the DRP passed rectification order dated

10.01.2019 under Rule 13 of the DRP' Rules, restricting TP adjustment in the manufacturing segment to Rs.10,13,12,220, thereby reducing the aggregate TP adjustment to Rs.11,96,99,769. The A.O. passed rectification order u/s 154 of the I.T.Act giving effect to the revised directions of the DRP. An appeal has been filed before the Tribunal against the order u/s 154 of the I.T.Act also.

3. The learned AR during the course of hearing submitted that IT(TP)A No.790/Bang/2019 (arising out of 154 order) may be dismissed as infructuous. In view of the submissions of the learned AR, IT(TP)A No.790/Bang/2019 is dismissed as infructuous. Though the assessee has raised 40 grounds in its memorandum of appeal in IT(TP)A No.103/Bang/2019, the learned AR confined his submissions to the following issues:-

- (i) Manufacturing segment (Grounds 4 to 13)
- (ii) Management fees (Ground 14 to 22) [This adjustment was not proposed by the TPO but was unilaterally added by the DRP)
- (iii) ITES segment (Grounds 23 to 34)
- (iv) Management fee (Grounds 35 to 37) [This addition was unilaterally added by the DRP as a protective addition]

We shall adjudicate the above issues as under:-

(i) Manufacturing segment (Grounds 4 to 13) (Transfer Pricing Adjustment)

4. Brief facts of the case are as follows:

The assessee is a subsidiary of the Brady Group, based in USA. The assessee operates in three distinct segments, namely, (i) Manufacturing segment; (ii) Trading segment; and (iii) Services segment.

4.1 In the manufacturing segment, it is engaged in the production of identification solutions including high performance identification tapes, die-cut products etc. The segmental details of the manufacturing and other segment as per the TP documentations, have been extracted at para 3.1 of the TP order. The TPO has recomputed the segment details for the three segments, which is at para 3.2 of the TP order. The essential difference between the segmental details as computed by the assessee (para 3.1 of the TP order) and as recomputed by the TPO (para 3.2 of the TP order) are as under:-

- (i) The assessee has made adjustment for capacity utilization (capacity taken as 60%), whereas the TPO has disregarded the adjusted capacity utilization and considered the full amounts.
- (ii) The assessee had taken adjustment for Forex fluctuation (1,91,82,480) whereas the TPO has not considered the adjustment.
- (iii) The TPO has added an amount of Rs.97,19,858 towards exchange loss, which means he had considered this amount as not part of operating expenses.

(iv) The TPO has added an amount of Rs.1,73,89,263 towards impairment loss, which means he had considered this amount as not part of operating expenses.

(v) The TPO has taken the segmental apportionment as 56.35%, 8.29%, and 35.36%.

4.2 The assessee in manufacturing segment, had taken a set of 29 comparables with weighted margin of 4.96 (para 6.2 of TP order). The TPO rejected the comparables set taken by the assessee for the reason that the assessee had considered multiple year data. The TPO conducted a fresh TP analysis and selected a set of 26 comparable companies, which contained 16 comparables selected by the assessee and 10 fresh comparable companies. The final set of 26 comparables selected by the TPO is at para 6.4 of the TP order. The TPO computed the TP adjustment for the manufacturing segment as under (para 7.15 of the TP order):

Particulars	Amount (in INR)
Arm's length mean margin on cost	6.33%
Arm's length price is 93.67% of OR	38,83,92,886
Price paid	48,29,05,474
Shofffall being adjustment u/s 92CA	9,45,12,588

4.3 Aggrieved by the above TP adjustment in the manufacturing segment, the assessee filed objections before the DRP. The DRP rejected the objections of the assessee and

confirmed the TPO's order. Pursuant to the DRP's directions, the final assessment order was passed.

4.4 Aggrieved by the final assessment order, the assessee has raised this issue before the Tribunal. The assessee has filed a paper book enclosing therein the TP study, the financials etc. The learned AR has filed a brief written submission. The contentions raised are summarized as follows:-

(i) The learned AR submitted that the TPO has disregarded the AE and non-AE segment details given by the assessee and clubbed both the segments into one revised the segment and made additions. The assessee has also argued that the TP adjustment should be restricted only to the international transactions. The learned AR submitted that the TPO has erred in computing the transfer pricing adjustment for the total manufacturing segment costs. The learned AR submitted that the transaction with non-AE cannot be subject matter of determination of ALP because section 92 of the I.T.Act clearly speaks of determination of ALP only in respect of transactions with AE. The assessee relied on the order of the Bangalore Bench of the Tribunal in the case of IKA India Private Limited reported in 101 taxmann.com 276.

(ii) The assessee's another grievance is non-granting of the adjustment with regard to underutilization of the capacity. The learned AR has submitted that it had idle

capacity to the extent of 40% during the year. The assessee has submitted that the capacity was underutilized due to slumping the market and subsequent closure of Nokia business. The TPO has not allowed capacity utilization adjustment on the ground that adjustment has to be computed on the tested party and not on the comparables. The assessee relied on the order of ITAT in the case of IKA India Private Limited (supra) and submitted additional evidence providing computation of capacity utilization adjustment as outlined in the Tribunal decisions.

(iii) The learned AR submitted that due to adverse foreign exchange fluctuations, import cost of raw materials from Bradley group companies and third parties have increased considerably. The assessee has submitted that increase in import cost could not be passed on to the end customer due to competitive environment in the industry. The assessee has therefore claimed economic adjustment towards Forex fluctuations. The assessee has relied on the order of the ITAT in the case of Honda Trading Corporation India Private Limited in ITA No.5297/Del/2011 (order dated 08th March, 2013).

(iv) On the issue of adjustment for impairment of loss, the learned AR submitted that the Brady Group sold the DC and HPI products manufacturing business to third party. Due to such disposal, the assessee had impaired

certain assets used in manufacturing these products. The loss recognised in the books of account as a result of such impairment is treated as extraordinary item by the assessee and reduced from the operating cost. The DRP has held that the sale of the business is subsequent to the financial year. The DRP has further observed that the shutdown of operation is due to non-compete clause entered by the AE with LTI Products under share purchase agreement and assessee is entitled to certain compensation under the agreement. Therefore, the claim was rejected by the DRP.

4.5 The learned Departmental Representative has filed a brief submission supporting the orders of the TPO and the DRP.

4.6 We have heard rival submissions and perused the material on record. On the issue of segmental financials and TP adjustment to be restricted to AE transactions, we find that the TPO has rejected the segmental profit and loss account given by the assessee and reworked the segmental profit and loss account. The TPO has not given any reason for rejecting the segmental profit and loss account given by the assessee. Further, we find that the TPO has redrawn the segmental profit and loss account on pages 6 to 8 of the order u/s 92CA. However, no basis of allocation has been given in the order. The assessee has rightly contended that section 92 of the Act can be applied only in respect of international transactions, i.e., transactions with AE. In view of the above

transfer pricing provisions and various judicial precedents, we hold that the transfer pricing adjustment should be restricted only to the AE related transactions of the assessee. We are of the view that in the given facts and circumstances of the case, it would be just and appropriate to set aside the impugned order on this issue and remand the issue to the TO / TPO to verify the segmental profit and loss account given by the assessee. The assessee shall provide all the details including details of allocation in case in support of segmental drawn by it. The AO / TPO shall give proper opportunity of hearing to the assessee.

4.6.1 On the issue of capacity adjustment, we find that the settled law is that adjustment on account of capacity utilization has to be granted. In this regard, the Bangalore Bench of the Tribunal in the case of IKA India Private Limited (supra) has held as follows [Bangalore Bench followed its earlier order in IKA India Private Limited's case for assessment year 2012-2013 in IT(TP)A No.2192/Bang/2017 (order dated 17.09.2018)]. The relevant finding of the Tribunal in case of IKA India Private Limited for assessment year 2012-2013 reads as follows:-

"22. We have heard the submissions of the assessee and the ld. DR on the issue raised by the assessee in ground No.7. We shall first see the statutory provisions relevant to the issue. Rule 10B(1)(e) of the Rules states that adjustments should be made to account for:

"...the differences, if any, between the international 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"

23. Rule 10B(2) of the Rules provides comparability of an international transaction with an uncontrolled transaction needs to be judged with reference to certain specified factors. One such factor is 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.

24. Rule 10B(3) of the Rules provide that:

"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 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."

25. As per Section 92C of the Act, ALP is required to be computed using any of the given six methods and in the manner as is prescribed in Rule 10B of the Rules. Rule 10B in turn states that the most appropriate method would be one which inter alia provides the most reliable measure of ALP, and one of the important factors to be taken into account herein is the ability to make reliable and accurate adjustments.

26. The OECD Guidelines on this aspect is as follows:-

Para 1.35 of the OECD Guidelines states as follows:

"Where there are differences between the situations being compared that could materially affect the comparison, comparability adjustments must be made, where possible, to improve the reliability of the comparison. Therefore, in no event can unadjusted industry average returns themselves establish arm's length conditions"

Para 1.36 of the OECD Guidelines states as follows:

".... material differences between the compared transactions or enterprises should be taken into account. In order to establish the degree of actual comparability and then to make appropriate adjustments to establish arm's length conditions (or a range thereof), it is necessary to compare attributes of the transactions or enterprises that would affect conditions in arm's length dealings. Attributes that may be important include the characteristics of the property or services transferred, the functions performed by the parties (taking into account assets used and risks assumed), the

contractual terms, the economic circumstances of the parties, and the business strategies pursued by the parties."

Further, Para 2.74 of the OECD Guidelines while laying down the comparability criteria to be adopted while applying the transaction net margin method states as follows:

"..... Thus where the differences in the characteristics of the enterprises being compared have a material effect on the net margins being used, it would not be appropriate to apply the transactional net margin method without making adjustments for such differences. The extent and reliability of those adjustments will affect the relative reliability of the analysis under the transactional net margin method' (Emphasis supplied)

27. US transfer pricing Regulations on this aspect is as follows:- In addition, the US transfer pricing regulations, u/s 482 of the Internal Revenue Code (hereinafter referred to as 'the US regulations') also support the above. Regulation 1.482-1(d)(2) of the US regulation states as follows:

"In order to be considered comparable to a controlled transaction, an uncontrolled transaction need not be identical to the controlled transaction, but must be sufficiently similar that it provides a reliable measure of an arm's length result. If there are material differences between the controlled and uncontrolled transactions, adjustments must be made if the effect of such differences on prices or profits can be ascertained with sufficient accuracy to improve the reliability of the results. For purposes of this section, a material difference is one that would materially affect the measure of an arm's length result under the method being applied."

28. The Indian transfer pricing regulations, OECD Guidelines and the US transfer pricing regulations call for an adjustment to be made in case of material differences in the transactions or the enterprises being compared so as to arrive at a more reliable arm's length price/ margin. While the Indian transfer pricing regulations refer to the adjustments on uncontrolled transactions, however the same has to be read with Rule10B(3) of the Rules which clearly emphasizes the necessity and compulsion of undertaking adjustments. Hence in case appropriate adjustments cannot be made to the uncontrolled transaction, due to lack of data, then in order to read the provisions of transfer pricing regulations in harmony, the adjustments should be made on the tested party. In the following decisions it has been held that adjustment to the profit margins have to be made on account of underutilization of capacity:

(i) In the case of M/s. Mando India Steering Systems Private Limited vs Assistant Commissioner of Income Tax, [I.T.A. No. 2092/Mds 12012], the Tribunal upheld the contention of the taxpayer for making a suitable adjustment on account of idle capacity for the purpose of margin computation. The relevant extract is reproduced as below:

"10. We are of the considered view that underutilization of production capacity in the initial years is a vital factor which has been ignored by the authorities below while determining the ALP cost. The TPO should have made allowance for the higher overhead expenditure during the initial period of production."

(ii) In the ruling of DCIT Vs Panasonic AVC Networks India Co Ltd (I.T.A. No.: 4620/De1/2011), it was held that:-

"5. Capacity underutilization by enterprises is certainly an important factor affecting net profit margin in the open market because lower capacity utilization results in higher per unit costs, which, in turn, results in lower profits. Of course, the fundamental issue, so far as acceptability of such adjustments is concerted, is reasonable accuracy embedded in the mechanism for such adjustments, and as long as such an adjustment mechanism can be found, no objection can be taken to the adjustment."

(iii) In the case of Biesse Manufacturing Company Limited (IT(TP) A Nos. 97 & 493/Bang/2015) for AY 2010-11, the Tribunal held as follows:

"10.4.1. We have heard the rival contentions and perused and carefully considered the submissions made and material on record; including the judicial pronouncements cited. The issue for consideration is whether adjustment for under-utilisation of capacity is allowable in the case on hand and if so, the manner of computation thereof and the quantum of adjustment.....
.....

10.4.5 In the above cited case of the Mumbai Tribunal i.e. Petro Araldite P. Ltd. (supra), the Tribunal has upheld the principle that adjustment for capacity underutilisation can be granted
Following the decision of the ITAT, Mumbai in the case of Petro Araldite P. Ltd. (supra), we hold that any adjustment for capacity underutilisation can be granted....."

(iv) In the recent case of GE Intelligent Platform Private Limited (IT(TP)A No. 148/Bang/2015 and 164/Bang/2015) for AY 2010-11 was held as follows:

"8 now the law is quite settled to the extent that once there is unutilized capacity or men power, such underutilization impacts margin and therefore, the adjustment should be made while computing the ALP If the underutilization is more than average underutilization of the industry then necessary adjustment is required to be made to the margin of computing ALP....."

29. Moreover, the above argument of the assessee for grant of capacity utilization adjustment is also supported by the following decision of Bangalore ITAT in the case of Genisys Integrating Systems (India) Pvt. Ltd (ITA No.1231/Bang/2010). Relevant extract of the decision is under:-

"15.2 We agree with this contention of the counsel for the assessee. All the comparables have to be compared on similar standards and the assessee cannot be put in a disadvantageous position, when in the case of other companies adjustments for under utilization of manpower is given. The assessee should also be given adjustment for under utilization of its infrastructure. The AO shall consider this fact also while determining the ALP and make the TP adjustments. With these directions, the appeal of the assessee is disposed of."

30. The reliability and accuracy of adjustments would largely depend on availability of reliable and accurate data. For certain types of adjustments, relevant data for comparables may either not be available in public domain or may not be reliably determinable based on information available in public domain, whereas, it may be possible to make equally reliable and accurate adjustments on the tested party (whose data would generally be easily accessible).

31. In such a scenario, one has to resort to the provisions of Rule 10B(3)(ii) which provides for making "reasonably accurate adjustments" for eliminating any material differences between the two transactions being compared. The purpose or intent of the comparability analysis is to examine as to whether or not, the values stated for the international transactions are at ALP i.e., whether the price charges is comparable to the price charges under an uncontrolled transaction of similar nature. The regulations don't restrict or provide that the adjustments cannot be made on the results of the tested party. Therefore, keeping in mind the aforesaid objective, the net profit margin of the tested party drawn from its financial accounts can be suitably adjusted to facilitate its comparison with other uncontrolled entities/transactions as per subclause (i) of rule 10B(1)(e) of the Rules itself. The absence of specific provision in Rule 10B(1)(e)(iii) of the Rules does not impede the adjustment of the profit margin of tested party. The above view has also been upheld in the following decisions:-

- Capegemini India Pvt. Ltd. (ITA No.7861/Mum/2011)
- Demang Cranes & Components (India) Pvt Ltd. [49 SOT 610 (Pune)]

32. As far as data of comparable companies on capacity utilization being not available in public domain is concerned, it is practically not possible to obtain data on capacity utilization of comparable companies and consequently compute adjustment on the comparable companies, the operating cost of the tested party is adjusted for capacity utilization adjustment.

33. *The assessee has under-utilized capacity during the subject AY and is accordingly factually and legally eligible to an adjustment for the same. Therefore, such a benefit cannot be denied to the assessee only for the reason that the data about comparable companies is not available. Requiring the assessee to produce such a data which is not available in public domain would tantamount to requiring the Appellant to perform an impossible task. The only way to get the data in the current case, would be where the TPO collates the same from the comparable companies by exercising his powers under section 133(6) of the Act. The relevant extracts of the section are as under:-*

"(6) require any person, including a banking company or any officer thereof, to furnish information in relation to such points or matters, or to furnish statements of accounts and affairs verified in the manner specified by the Assessing Officer, the Deputy Commissioner (Appeals), the Joint Commissioner or the Commissioner (Appeals), giving information in relation to such points or matters as, in the opinion of the Assessing Officer, the Deputy Commissioner (Appeals), the Joint Commissioner or the Commissioner (Appeals), will be useful for, or relevant to, any enquiry or proceeding under this Act :"

34. *In this regard, we find that the Mumbai ITAT in case of M/s Kiara Jewellery P.Ltd. (I.T.A.No.8109/Mum/2011), has directed the AO/ TPO to obtain the exact details of capacity utilization of comparable companies, if not available in public domain. The relevant extract of the aforesaid decision is as under:-*

"11. Keeping in view the decision of the Tribunal in the case of Petro Araldite (P) Ltd (supra) laying down the guidelines on the issue of capacity utilization, we consider it appropriate to restore this issue relating to adjustment on account of capacity utilization in the case of assessee company to the file of AO/TPO for deciding the same afresh keeping in view the said guidelines. If the exact details of capacity utilization of the comparable companies are not available in the public domain, the AO/TPO is directed to obtain the same directly from the concerned parties and to decide this issue afresh after giving assessee an opportunity of being heard." (Emphasis Supplied)

35 *Accordingly, we direct the TPO to exercise powers under section 133(6) of the Act to call for information on capacity utilization of the comparable companies such as —*

- *Installed Capacity,*
- *Actual Production in Units,*
- *Break-up of Fixed Cost and Variable Cost;*
- *Segmental/ product wise information, if any.*

36. *Post obtaining the information, he is requested to provide the assessee an opportunity by sharing the details so obtained, and accordingly, grant*

the adjustment for capacity under-utilized. Ground No.7 is decided accordingly.”

4.6.2 The assessee has also produced as additional evidence, computation of capital utilization adjustment as stated in the above judicial pronouncements. The additional evidence now produced go to the root of the issue of determination of ALP on the manufacturing segment. For a proper adjudication of the issue and for substantial cause, the same is admitted and taken on record. Accordingly, we set aside the issue to the file of the AO / TPO, directing to follow the directions given in the case of IKA India Private Limited (supra).

4.6.3 On the issue of foreign exchange fluctuations adjustment, we observe that the TPO and the DRP have not properly analysed the submissions of the assessee. There is no analysis whether there was any adverse foreign exchange fluctuations during the relevant assessment year, which is abnormal in nature and what is its effect on the operating margin of the assessee and the comparables. These aspects needs to be analysed. In the given facts and circumstances of the case, we are of the view that it would be just and appropriate to set aside the impugned order on this issue and remand the issue to the TPO.

4.6.4 On the issue of impairment of loss, we observe from note 25 in the financial statement, that the agreement to sell is entered into on February 24, 2014 and effective date of sale is August 1, 2014. However, the assessee has recognised

impairment loss during the current assessment year. The TPO and the DRP have not properly analysed the issue and thus it would be appropriate to set aside the impugned order on this issue and remand the issue to the TPO.

4.6.5 On the issue of comparable selection, we find that the DRP has not properly analysed the submissions of the assessee. The DRP has also observed that the annual report of the comparables was not filed by the assessee. The DRP has made general observation that TNMM requires broadly similar comparables and exactly similar companies are not required. This is not proper reason and TPO / DRP are duty bound to specifically analyse the comparables submitted by the assessee and the assessee's objection to the comparable selected by the TPO. The assessee is also duty bound to file the annual reports and make specific submissions with respect to the comparables. Therefore, the entire TP adjustment made by the TPO in management segment is set aside. The TPO shall undertake a fresh TP analysis and make necessary TP adjustment in accordance with law, after affording reasonable opportunity of hearing to the assessee. It is ordered accordingly.

4.6.6 In the result, ground 4 to 13 is allowed for statistical purposes.

Management Fees (Grounds 14 to 22) (TP Adjustment)

5. Brief facts in relation to the above issue are as follows:

The assessee had applied TNMM method as the Most Appropriate Method for justifying the ALP of the transaction of

management fees paid. In the TP documentation, the assessee had performed searches using external databases, the results of which are provided below:-

Associated Enterprises	Tested party	Rate	Arm's length price / margin
Brady Corporation Asia Pacific Pte Ltd. (Brady Singapore)	Brady Singapore	5%	8.54%
Brady Worldwide Inc (BWW)	BWW	At cost	9.06%

5.1 The TPO had apparently accepted the ALP of the management fee transaction, as no adjustment was proposed by him in the TP order. However, the DRP *suo moto* decided that the ALP of this transaction as Nil and directed the AO / TPO to add the entire amount as adjustment.

5.2 Aggrieved, the assessee has raised this issue before the ITAT. It was submitted that the DRP was wrong, both on facts and on legal principles. The submissions of the learned AR in brief are summarized as follows:-

(i) *No opportunity provided to assessee by DRP.*

The assessee submits that the TPO had issued a show cause notice in connection with management fees, to which the assessee had responded with its detailed submission and supporting evidences. The TPO did not propose any adjustment (SCN at page 702 of PB).

During the course of the DRP hearing, the Panel members had not discussed this issue with the assessee nor requested us to furnish any information / documents. Subsequently the DRP had suo moto determined the ALP of this transaction as Nil in the DRP directions. By doing so, the Panel has passed the directions without giving an opportunity to the assessee as mandated u/s 144C(11).

(ii) *No Benchmarking analysis was done by DRP.*

While proposing the TP adjustment, the DRP had not adopted any of the TP methods prescribed under regulations or provided any

comparable transactions, thereby not adhering to the process prescribed under Rule 10B of the TP regulations.

(iii) TNMM accepted as ALP and hence no separate addition for management fees.

Without prejudice to the above, the assessee wishes to submit that the DRP, having accepted TNMM for all the international transactions should not have subjected one transaction (management charges) to a separate treatment.

(iv) Double adjustment.

Further, the assessee wishes to highlight that the TPO had already considered management charges as part of cost base while computing adjustment for manufacturing segment under TNMM. The same was also separately disallowed by the DRP. The same amounts to duplicate adjustment for the same international transaction leading to double adjustment.

(v) Since the DRP has made the disallowance arbitrarily, without calling for any details and without affording opportunity of hearing, the assessee has submitted additional evidence regarding the management fee, with a request to admit the same and consider the details submitted.

5.3 The learned Departmental Representative supported the orders of the DRP.

5.4 We have heard rival submissions and perused the material on record. This adjustment was not proposed by the TPO but was unilaterally added by the DRP. During the course of hearing before the DRP, the assessee was not requested to furnish any information / documents. The DRP suo moto determined the ALP of this transaction as NIL in the DRP's directions. We find that the DRP has not adhered to the process prescribed under Rule 10B of the T.P.Regulations and no benchmarking analysis has been done by the DRP. The management charges was part of the cost base while computing the adjustment for manufacturing segment under the TNMM. The question whether the transaction of payment

of management fees can be aggregated with the international transaction under the manufacturing segment also requires a fresh look in the light of the submissions made by the learned AR (since management fees is directly linked with the operation of the assessee). This aspect has not been analysed in a proper perspective. In these given facts and circumstances of the case, we deem it fit and proper that the issue of determination of ALP of the management fees be remanded to the AO / TPO for fresh determination. The AO / TPO shall afford the assessee reasonable opportunity of being heard before a decision is taken in this matter. It is ordered accordingly.

5.5 In the result, grounds 14 to 22 are allowed for statistical purposes.

ITES Segment (Grounds 23 to 34) (TP adjustment)

6. Brief facts in relation to ITES segment are as follows:

It is stated that the assessee has maintained full segmental details of the three segments, namely, manufacturing segment, trading segment and service segment. The segmental details of ITES segment is at para 3.1 of the TP order. However, the TPO disregarded the segmental details and revised the same as given in para 3.2 of the TP order. The assessee selected a set of 11 comparable companies, as given in para 11 of the TP order. However, the TPO rejected the TP documentation of the assessee and conducted his own TP analysis by adopting his own filters. The TPO selected a set of six comparables. The set of

comparables selected by the TPO (at page 27 of the TP order) and computation of ALP are as follows:

Comparable companies selected by the TPO (page 27 of the TP order)

Sl. No.	Company Name	OP/OC
1.	Infosys BPO Limited	27.43%
2.	Microgenetic Systems Limited	18.06%
3.	Microland Limited	20.07%
4.	BNR Udyog Limited	24.08%
5.	Crossdomain Solutions Pvt.Ltd.	21.07%
	Arithmetic Mean	22.34%

Computation of ALP by TPO (page 43 of TP order)

Particulars	Amount (Rs.)
Arm's Length Mean Margin on cost	22.34%
Operating cost (B)	27,76,87,074
Arm's Length Price (122.34% of (B))	27,85,52,366
Price received	25,85,93,776
Shortfall being adjustment u/s 92CA	1,99,58,590

6.1 The limited submission of the learned AR before the ITAT are as follows:-

- (i) The exclusion of comparable companies (Ground 23)
 - * Infosys BPO Limited
 - * Microland Limited
- (ii) Inclusion of three comparable companies (Ground 24)
 - * Informed Technologies,
 - * Crystal Voxx
 - * Jindal Intellicom Limited.
- (iii) Grant of working capital adjustment (Ground 26)

We shall adjudicate the above issues raised as under:-

Exclusion of comparable companies (ground 23) – (i) M/s.Infosys BPO Limited & (ii) Microland Limited.

(i) M/s.Infosys BPO Limited

6.2 This company Infosys BPO Limited was selected as a comparable company by the TPO. The assessee objected to its inclusion both before the TPO as well as the DRP, but both the authorities below rejected the assessee's objections to its inclusion.

6.2.1 The assessee objected to the inclusion of this company, on the following grounds:-

- (a) Functionally diversified – Provides high end and end-to-end outsourcing services in the nature of business process management. Engaged in providing cloud based services such as 'E-Discover' as well as services in relation to compliance in Health, Safety and Environment.
- (b) Different business model – consultancy expenses in the nature of sub-contracting charges.
- (c) Presence of intangible assets and intellectual properties.
- (d) Significant brand value and performs brand building functions.
- (e) Higher scale of operations.

6.2.2 We have heard rival submissions and perused the material on record. The Bangalore Bench of the Tribunal in

the case of M/s.Ocwen Financial Solutions Private Limited (supra), had excluded M/s.Infosys BPO Limited from the list of comparable company. The relevant finding of the Bangalore Bench of the Tribunal, reads as follows:-

“7.4.1 We have considered the rival contentions / submissions and perused the material on record; including the judicial decisions cited. We find from a perusal of the Annual Report at page 14 thereof, under the head ‘Managements Discussion and Analysis’, it has been stated that this company provides services to both horizontal and vertical focus areas. The Horizontal focus areas are sourcing and procurement (S & P), Customer Services (CS), Finance and Accounting (F & A), Legal Process Outsourcing (LPO), Sales and Fulfillment (S & F), Analytics (AT), Business Platform (BP), Business Transformation Services (BTS), Human Resources Outsourcing (HRO) and Technology Solution Optimization (TSO). The Vertical focus areas of services are Financial Services & Insurance (FSI) Manufacturing (MFG), Energy, Utilities Communication & Services (ECS) and Retail, Consumer Packaged Foods, Logistics & Life Services (RCL). From the above, it is clear that ‘Infosys’ offers a gamut of different and diversified services which cannot be compared with routine back office services provided by the assessee. In fact, it is mentioned at page 14 of the Annual Report that the company ‘Infosys’ provides business process management services which are different from routine back office services. It is also seen that this company enjoys significant brand value and owns intangible assets which clearly establish that Infosys is different from the assessee in the case on hand.

7.4.2 We also further observe that this company, ‘Infosys’ has consistently been rejected as a comparable to companies rendering routine back office services in various judicial pronouncements of the Tribunal; including the two decisions cited by the assessee (supra). In the case of CGI Informaiton Systems and Management Consultants (P) Ltd., (2018) 94 taxmann.com97 (Bangalore – Trib) for Assessment Year 2012-13, cited by the assessee, this company ‘Infosys’ has been excluded from the list of comparables for the reason that it has brand value which had an impact on its pricing and margins. As the facts of the year under consideration are similar, the decision rendered in the earlier year would apply to the year under consideration as well. In this factual view of the matter, we hold that Infosys BPO Ltd., stands on a totally different footing from a company engaged in rendering routine back office ITES; being both functionally different and having brand value and therefore is to be excluded from the final set of comparables. We hold and direct accordingly.”

6.2.3 Since the profile of the assessee-company and the profile of the assessee in the case of M/s.Ocwen Financial

Solutions Pvt. Ltd.(supra) being similar and the assessment year also being the same, i.e. A.Y. 2014-2015, we hold that the finding of the co-ordinate Bench order in the case of M/s.Ocwen Financial Solutions Pvt. Ltd. (supra) will have application to the facts of the instant case. Therefore, we direct the AO/TPO to exclude Infosys BPO Limited from the list of comparables. It is ordered accordingly.

Microland Ltd., ('Microland')

7. This company 'Microland' was selected as a comparable company by the TPO despite the objections to its inclusion in the final list of comparables both before the TPO and DRP.

7.1 The assessee has objected to the inclusion of this company 'Microland' on the following grounds:-

- (a) Erroneous computation of margin – ought to have considered the ITeS segment instead of entity level which includes infrastructure management services. Correct margin is 9.98%.
- (b) Fails service income filter applied by the TPO (ITes income of only 5.68%)
- (c) Significant R&D activities.
- (d) Extraordinary growth during the year (growth of 43%)
- (e) Higher scale of operations.

7.3 We have heard rival submissions and perused the material on record. The Bangalore Bench of the Tribunal in the case of M/s.Ocwen Financial Solutions Private Limited (supra), had excluded M/s.Microland Limited from the list of

comparable company. The relevant finding of the Bangalore Bench of the Tribunal, reads as follows:-

“8.4.1 We have considered the rival contentions / submissions put forth and perused the material on record. This company, ‘Microland’ was selected as a comparable by the TPO. In his order, the TPO has stated that this company ‘Microland’ is currently organized in business segments, comprising of infrastructure management services and IT Enabled Services (ITES). On the objections raised by the assessee that ‘Microland’ is not functionally comparable, the TPO rejected the same by holding that both its segments are in the nature of ITES only, considered its entire operations as ITES and held the company to be comparable to the assessee at entity level. In respect of the objections raised by the assessee before the DRP, it is seen that the DRP concurred with the TPO’s view that both the segments of ‘Microland’ are in the nature of ITES only and held that its entire operations to be comparable to the assessee at entity level.

8.4.2 We have perused the Annual Report of the company ‘Microland’, placed at pages 140 to 277 of the paper book. At page 14 of the Annual Report, this company has characterized itself as a service company primarily rendering Infrastructure Management Services. At page 97 of the Annual Report, it is mentioned that the company is organized in business segments comprising of infrastructure services and ITES thereby clearly indicating that the services rendered in both segments are different and distinct from each other. In our view, the TPO / DRP have not brought on record any evidence to support their contention that both the aforesaid segments are rendering ITES only. If that were so, there was no reason whatsoever for the company to show Infrastructure Management Services as different and distinct segment from the ITES.

8.4.3 From an appraisal of the details submitted, it is seen that the services rendered by ‘Microland’ under Infrastructure Management services are Server Management, Database Management, storage management, Archival Management, Network Management, etc., which has been classified as different from the back office processing services rendered by companies like the assessee in the case on hand. In our view, there is no basis for the TPO to contend that the aforesaid services rendered by ‘Microland’ are ITES, when the company itself has classified these services as different from ITES and characterized the same as a different business segment. In these factual circumstances, we are inclined to concur with the contention of the learned AR that the Infrastructure Management services segment of ‘Microland’ is different and distinct with ITES as has been classified by the company in its Annual Report for the year under consideration. We also observe that the TPO himself has reached the same conclusion in the subsequent Assessment Year 2015-16; that the Infrastructure segment services segment is not comparable to ITES.

8.4.4 At page 97 of the Annual Report of 'Microland' for the year under consideration, the segmental details of the two business segments are provided from which it is seen that out of the total revenue of Rs.34,471 lakhs, the revenue from ITES segment is Rs.1959 lakhs; which is 5.68% of the total revenue. As we have concluded that the infrastructure services segment is a different business segment not comparable to ITES rendered; this company, 'Microland' fails the filter adopted by the TPO that companies whose service income is less than 75% of total operating revenue are to be excluded. In view of the facts and circumstances of the case, as discussed above, and in view of the above factual findings, we hold that Microland Ltd., should be excluded from the final set of comparables in the case on hand."

7.3.1 In the light of the order of the co-ordinate Bench of the Tribunal, we hold that the AO/TPO is not justified in including the above company in the list of comparable companies. Accordingly, we direct the AO/TPO to exclude the Microland Limited from the list of comparables.

7.3.2 In the result, ground 23 is partly allowed.

Inclusion of comparable companies, viz., (i) Informed Technologies Limited, (ii) Crystal Voxx Limited, (iii) Jindal Intellicon Limited (Ground 24)

The AO/TPO has excluded the above companies from the list of comparables.

(i) Informed Technologies Ltd., ('Informed')

8.1 The assessee has objected to the exclusion of this company Informed Technologies Limited on the following grounds:-

- (a) The ratio of service income to sales of the company is 100%.
- (b) The company is functionally similar and qualifies all the filters applied by the TPO in the TP order.

8.2 The learned AR relied on the order of the ITAT in the case of M/s.Ocwen Financial Solutions Private Limited (supra).

8.3 We have heard rival submissions and perused the material on record. The Bangalore Bench of the Tribunal in the case of M/s.Ocwen Financial Solutions Private Limited (supra), had included M/s.Informed Technologies Limited in the list of comparable company. The relevant finding of the Bangalore Bench of the Tribunal, reads as follows:-

“10.4.1 We have considered the rival submissions and carefully perused the material on record. On a perusal of the Annual Report of this company ‘Informed’, it is seen that at page 12 thereof it is stated that this company is engaged in and operating as an ITES provider. A perusal of the TPO’s order also indicates that the TPO has not disputed that this company is functionally comparable to the assessee in the case on hand; which is rendering back office ITES. From a perusal of the profit and loss account at page 30 of the Annual Report of ‘Informed’ it is seen that the total revenue is shown as Rs.3,81,38,665/- and ‘other income’ of Rs.1,22,85,303/-. As can be seen from Schedule 19 on page 40 of the Annual Report, the ‘other income’ comprises of non-operating income, interest, dividend, sale of current investments and miscellaneous income and evidently these incomes cannot be considered as operating income. The percentage of 67.7% worked out by the TPO is after considering these “other income” as service income; which is factually incorrect. It is evident from a perusal of the profit and loss account of ‘Informed’ that the service income is Rs.2,58,53,362/- which is entirely the revenue from operations and therefore in our considered view, the service income filter of 75% of service income to be from ITES as applied by the TPO, is satisfied in this case. In view of this factual finding rendered in the matter, we hold that this company ‘Informed Technologies Ltd.,’ satisfies the service income filter and is therefore to be included in the final set of comparables. We hold and direct the AO/TPO accordingly.”

8.3.1 In the light of the order of the co-ordinate Bench of the Tribunal, we hold that the AO/TPO is not justified in excluding the above company from the list of comparable companies. Accordingly, we direct the AO/TPO to include

Informed Technologies Limited in the list of comparables.

(ii) **Crystal Voxx Limited ('Crystal')**

9.1 The assessee has objected to the exclusion of this company Crystal Voxx Limited for the following reasons:-

- (a) The TPO has wrongly stated that the company does not report export earnings.
- (b) The company has earned 97.33% of income from export of services.

9.2 The learned AR relied on the order of the ITAT in the case of M/s.Ocwen Financial Solutions Private Limited (supra).

9.3 We have heard rival submissions and perused the material on record. The Bangalore Bench of the Tribunal in the case of M/s.Ocwen Financial Solutions Private Limited (supra), had included Crystal Voxx Limited in the list of comparable company. The relevant finding of the Bangalore Bench of the Tribunal, reads as follows:-

“11.4 We have considered the rival contentions / submissions and perused the material on record. We have carefully perused the Annual Report of this company, ‘Crystal’. At Note 3 of the Notes forming part of the accounts, at page 491 of the paper book, it is stated that the operations of the company predominantly relate to a single segment, namely “BPO Activity”. At note 6, the income in foreign currency is shown as Rs.3,23,08,386/-. In the Director’s Report, at page 480 of the paper book, the foreign exchange earnings is given as Rs.3,23,08,386/-. In the factual matrix of the matter, as laid out above, we are of the considered opinion that the reason ascribed by the TPO and DRP for exclusion of this company, ‘Crystal’ is factually incorrect. Taking into consideration that the company ‘Crystal’ is otherwise comparable to the assessee in the case on hand as it is operating as a BPO company which is a provider of ITES, we direct that this company, Crystal Voxx Ltd., be included as a comparable company in the final set of comparables in the case on hand. The AO / TPO are accordingly directed.”

9.3.1 In the light of the order of the co-ordinate Bench of the Tribunal, we hold that the AO/TPO is not justified in excluding the above company from the list of comparable companies. Accordingly, we direct the AO/TPO to include Crystal Voxx Limited in the list of comparables.

(iii) **Jindal Intellicom Limited ('Jindal')**

10. The assessee has objected to the exclusion of this company Jindal Intellicom Limited for the following reasons:-

- (a) Call center services would be classified under ITeS.
- (b) As the company is operating in only one segment – ITeS, no segmental data is required.

10.2 The learned AR relied on the order of the ITAT in the case of M/s.Ocwen Financial Solutions Private Limited (supra).

10.3 We have heard rival submissions and perused the material on record. The Bangalore Bench of the Tribunal in the case of M/s.Ocwen Financial Solutions Private Limited (supra), had included Jindal Intellicom Limited in the list of comparable company. The relevant finding of the Bangalore Bench of the Tribunal, reads as follows:-

“12.4.1 We have considered the rival contentions / submissions put forth and perused the material on record. We have also perused the Annual Report of this company, ‘Jindal’; which is placed at pages 498 to 975 of the paper book. At page 130 of the Annual Report (i.e., page 627 of the paper book), it is mentioned that the company is engaged in providing call centre services, both in the overseas and domestic market; export of call centre services forming a major part of its business activities. In these circumstances, the observation of the DRP that this company ‘Jindal’ is

engaged in software development services and ITES and segmental information is not available is not a factually correct observation; as borne out from the Annual Report of this company. Further, at page 160 of the Annual Report (i.e., page 657 of the paper book), it is seen that the segmental data of domestic and international segments of operation are given; thereby rendering the observations of the TPO is factually incorrect. 12.4.2 As far as the functional comparability of this company, 'Jindal' is concerned, we find that the Co-ordinate Bench of this Tribunal, in the case of CGI Information Systems and Management Consultants Pvt. Ltd., (supra) for Assessment Year 2012-13 has held that this company should be included in the set of comparables for companies rendering ITES and in this regard at para 56 thereof has held as under:-

56. The same reasoning given for including Informed Technologies India Ltd., would apply for including Jindal Intellicom Ltd., also. This company was selected by the Assessee in its TP study and accepted by the TPO as being comparable to it (pages 16-17 of the TP order). Since it passed all the filters applied by the TPO, as subsequently upheld by the DRP, it was rightly included in the list of comparables. In the proceedings before the DRP, the Assessee did not object to its inclusion in the list of comparables. However, despite the above, the DRP on its own directed its exclusion on the premise that since it catered only to customers in USA, where there was allegedly an adverse business climate for outsourcing work, its profitability was impacted. According to the DRP the Assessee's AE was in Netherlands where there was no adverse market conditions and therefore Jindal Intellicom Ltd., was liable to be excluded from the list of comparable companies. The DRP did not put the Assessee on notice as to its proposed action of excluding this company. We find that the Assessee does not merely provide services to its AE in Netherlands. It also provides ITE services to its AE's in UK, Finland, Germany, Sweden, Belgium, Denmark, Norway and USA. A perusal of its Form 3CEB for the instant assessment year which is produced at pages 1035-1046 of the paper book, shows that it provided services to AE's at USA also. Therefore, the entire basis for its exclusion is wholly misconceived and erroneous and, accordingly, its suo motu exclusion by the DRP is not proper. The functions performed by this company are comparable to the services provided by the Assessee and have not been disputed whatsoever by the DRP. That apart, Jindal has been selected by the TPO as a comparable to the Assessee for the assessment years 2008-09, 2011-12 and 2013-14 and its inclusion for those assessment years has not been objected to by the Assessee either. Moreover, it is consistently figuring in the list of comparables in companies providing ITES. We therefore direct inclusion of this company in the list of comparable companies

12.4.3 In respect of the assessee in the case on hand also, the facts are similar to the cited case (supra). It is also seen that this company, 'Jindal' was chosen / accepted by the TPO as comparable to the assessee in the case on hand both in the earlier Assessment Years 2011-12 and 2012-13 and again in the immediately subsequent Assessment Year 2015-16. In this view of the matter, as discussed above, we are of the view that the above cited decision in the case of CGI Information System and Management Consultant Pvt. Ltd., (supra) would apply to the facts and circumstances of the case on hand also being similar; as seen from the acceptance of the company 'Jindal' by the TPO in both earlier and subsequent Assessment Years. Therefore, taking into consideration the factual matrix of the case as discussed above, Revenue's stand of accepting this company as a comparable both in earlier Assessment Years and the immediately subsequent Assessment Year 2015-16 and respectfully following the decision of the Co-ordinate Bench of this Tribunal in the case of CGI Information Systems and Management Consultants (P) Ltd., (supra), we direct the AO / TPO to include this company 'Jindal Intellicom Ltd.,' in the final set of comparables."

10.3.1 In the light of the order of the co-ordinate Bench of the Tribunal, we hold that the AO/TPO is not justified in excluding the above company from the list of comparable companies. Accordingly, we direct the AO/TPO to include Jindal Intellicom Limited in the list of comparables.

10.3.2 In the result, ground 24 is partly allowed.

Working Capital Adjustment (Ground 26)

11. The next grievance of the assessee in the ITeS segment is in respect of not granting of working capital adjustment.

11.1 We have considered the rival submissions and perused the material on record, including the judicial pronouncement cited. We find that the assessee has filed the computation of working capital adjustment before the DRP; but the DRP has not considered the same. We also find that the Co-ordinate Bench of this Tribunal in the case of Huawei Technologies India (P.) Ltd. 101 taxmann.com 313 has discussed all the reasons on the issue and held that working capital shall be allowed; holding as under at paras 10 to 18 thereof-

“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 insofar 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)****

(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 transaction 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 DECO 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 DECO 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 effect 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 DECO 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 in 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, (ij) 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 or 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 Servc.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 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 raters) of interest applicable 10 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 108(l)(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 108(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.

11.2 Respectfully following the above decision of the Coordinate Bench in the case of Huawei Technologies India (P.) Ltd. (supra), we also hold that the working capital adjustment is to be allowed as per actuals, after considering the decisions rendered in this order on the exclusion/inclusion of comparable companies out of/into the final set of comparables. The TPO/ AO are accordingly directed.

11.3 In the result, ground 26 is allowed for statistical purposes.

Management fees (Ground 35 to 37) (Corporate Tax Issue)

12. After proposing the TP adjustment on account of management fees, the DRP suo moto proposed disallowance of the same management fees u/s 37 of the I.T.Act. This disallowance had been proposed on the ground that the assessee has not furnished the details of the expenses.

12.1 After hearing both the sides, we are of the view that the protective disallowance of management fees u/s 37 of the I.T.Act needs to be considered afresh since the issue of transfer pricing adjustment of management fees has already been remitted back to the AO/TPO for fresh examination. It is ordered accordingly.

12.2 In the result, ground 35 to 37 are allowed for statistical purposes.

13. In the result, the appeal filed by the assessee in IT(TP)A No.790/Bang/2019 is dismissed and IT(TP)A No.103/Bang/2019 is partly allowed.

Order pronounced on this 22nd day of March, 2022.

Sd/-
(Padmavathy S)
ACCOUNTANT MEMBER

Sd/-
(George George K)
JUDICIAL MEMBER

Bangalore; Dated : 22nd March, 2022.
Devadas G*

Copy to :

1. The Appellant.
2. The Respondent.
3. The DRP-1, Bangalore.
4. The Pr.CIT-1, Bangalore.
5. The DR, ITAT, Bengaluru.
6. Guard File.

Asst.Registrar/ITAT, Bangalore