

**IN THE INCOME TAX APPELLATE TRIBUNAL
BANGALORE BENCHES "B", BANGALORE**

Before Shri George George K, JM & Shri Laxmi Prasad Sahu, AM

IT(TP)A No.291/Bang/2021 : Asst.Year 2016-2017

M/s.ON Semiconductor Technology India Private Limited #105, Prestige Saleh Ahmed Infantry Road Bangalore - 560 001. PAN : AADCP8949D.	v.	The Deputy Commissioner of Income-tax, Circle 3(1)(1) Bangalore.
(Appellant)		(Respondent)

Appellant by : Sri.Chavali Narayan, CA
Respondent by : Dr.Manjunath Karkihalli, CIT-DR

Date of Hearing : 12.07.2022	Date of Pronouncement : 21.07.2022
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ORDER

Per George George K, JM :

This appeal at the instance of the assessee is directed against final assessment order dated 30.04.2021 passed u/s 143(3) r.w.s. 144C(13) of the I.T.Act. The relevant assessment year is 2016-2017.

2. The issues raised in this appeal is with regard to Transfer Pricing Adjustment, namely -

- (i) Provision of software development services - The adjustment amounts to INR 3,93,70,344;
- (ii) Interest on delayed receivables - The adjustment amounts to INR 7,68,976.

3. The brief facts of the case are as follows:

The assessee-company was incorporated on 16.12.2019 under the Companies Act, 1956. The assessee is engaged in

the business of software development services. For the assessment year 2016-2017, the return of income was filed on 30.11.2016 declaring total income of Rs.5,85,64,250. The assessment was selected for scrutiny and notice u/s 143(2) of the I.T.Act was issued to the assessee. During the course of assessment proceedings, as the international transaction of the assessee with its Associated Enterprises (AEs) exceeded Rs.15 crore as per 3CEB report, the matter was referred to the Transfer Pricing Officer (TPO) to determine the Arm's Length Price (ALP) of the said transactions. The TPO vide order dated 30.10.2019 passed u/s 92CA of the I.T.Act, determined the TP adjustment of Rs.4,58,98,195. Pursuant to the TPO's order, draft assessment order was passed. The assessee filed objections before the Dispute Resolution Panel (DRP) against the draft assessment order disputing the adjustment made under Software Development Services (SWD) Segment and interest on delayed receivables. The DRP vide its directions dated 18.03.2021, provided partial relief to the assessee. Consequent to the DRP's directions, the transfer pricing adjustment was reduced to Rs.4,01,39,320 (instead of Rs.4,58,98,195 proposed by the TPO). The adjustment was incorporated in the final assessment order dated 13.04.2021.

4. Aggrieved by the final assessment order, the assessee has filed the present appeal before the Tribunal. We shall briefly describe the TP adjustments proposed by the TPO and what are the DRP's direction on the same. The TP adjustment made by the TPO with reference to the provision for SWD to

its AEs and interest on outstanding receivables are detailed below:-

(i)	SWD – TP adjustment	Rs.4,27,00,084
(ii)	Interest on outstanding receivables – TP adjustment	Rs.31,98,111

		Rs.4,58,98,195
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5. As regards TP adjustment of SWD (TP adjustment of Rs.4,27,00,084 proposed by the TPO), the comparables selected by the TPO, the arm's length range, the computation of ALP by the TPO and the adjustment made, are as under:-

Comparables selected by TPO and arm's length range:

Sl. No.	Name of comparable company	Weighted average unadjusted margin (%)
1.	KALS Information Systems Pvt. Ltd.	8.60
2.	Rheal Software Pvt. Ltd.	14.50
3.	Sybrant Technologies Pvt. Ltd.	14.74
4.	Harbinger Systems Pvt. Ltd.	15.06
5.	C G Vak Software & Exports Ltd.	18.50
6.	R S Software (India) Ltd.	20.87
7.	Larsen & Toubro Infotech Ltd.	24.83
8.	Orion India Systems Pvt. Ltd.	25.64
9.	Nihilent Ltd.	26.36
10.	Inteq Software Pvt. Ltd.	28.20
11.	Persistent Systems Ltd.	30.89
12.	Infobeans Technologies Ltd.	32.42
13.	Thirdware Solution Ltd.	36.90
14.	Infosys Ltd.	38.61
15.	Aspire Systems (India) Pvt. Ltd.	39.28
16.	Cybage Software Pvt. Ltd.	66.45
	35th Percentile	20.87%
	Median	26%
	65th Percentile	30.89%

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

Particulars	Amount (INR)
Arm's length median margin as per comparable set	26%
Operating Cost (OC)	38,18,66,189
Arm's Length Price ('ALP') = 126% of OC	48,11,51,398
Price Received	43,84,51,314
Short fall being adjustment u/s. 92CA	4,27,00,084

6. The DRP accepted the contention of the assessee that without prejudice to other objections, the adjustment if any in relation to SWD segment should be made only on the SWD segment operating revenue and not on an entity-wide basis figures. This resulted in the TP adjustment for SWD segment to be reduced to Rs.3,93,70,344 (instead of Rs.4,27,00,084 proposed by the TPO).

7. As regards the adjustment in respect of interest on delayed receivables, the TPO did not accept the submission of the assessee that the trade receivables are not a separate international transaction and are to be considered closely related to the main international transaction of SWD services. The TPO has further rejected the assessee's plea for working capital adjustment on the operating margins of the comparables. In this regard, the TPO has proceeded to re-characterize the trade receivable from AEs as loan to AEs and imputed interest on trade receivables (invoice wise) during the year for a period of 335 days (i.e., allowing a credit period of 30 days) at 6 month LIBOR plus 450 bps (resulting in 4.985%). The same has resulted in an adjustment amounting to Rs.31,98,111.

8. The DRP rejected the interest rate of LIBOR plus 45 bps points used to benchmark the interest on delayed receivables and has directed the TPO to adopt the SBI short term deposit interest rate for the subject year as the ALP interest rate on delayed receivables and re-compute the adjustment to be

made to the total income. Further, the DRP directed the TPO to compute the adjustment on the basis of invoice-wise realization and period of delay. Based on the above directions of the DRP, the TPO reduced the adjustment on account of interest on receivables to Rs.7,68,976.

9. Though several grounds are raised, the learned AR during the course of hearing, had only pressed following grounds / issues:-

“5.2 The ld.AO/TPO/DRP erred, in law and facts, by incorrectly applying the following quantitative and qualitative filters:

(f) Applying only the lower turnover filter of less than INR 1 crore as a comparability criterion and not applying a higher threshold limit for turnover filter.

5.4 The learned AO/TPO/DRP have erred, in law and facts, by accepting / rejecting the following comparables based on unreasonable comparability criteria:

(a) Accepting the following companies that cannot be considered as comparable to the Appellant in law and facts, on one or more grounds:

- (i) Rheal Software Private Limited*
- (ii) Larsen and Toubro Infotech Limited*
- (iii) Nihilent Technologies Limited*
- (iv) Inteq Software Private Limited*
- (v) Persistent Systems Limited*
- (vi) Infobeans Technologies Limited*
- (vii) Thirdware Solutions Limited*
- (viii) Infosys Limited*
- (ix) Aspire Systems (India) Private Limited*
- (x) Cybage Software Private Limited.*

(b) Rejecting the following comparable companies selected by the Appellant in its TP documentation even though the companies are functionally comparable to the Appellant.

- (i) Octo International Limited*

- (ii) *Sasken Communication Technologies Limited*
- (iii) *R Systems International Limited*
- (iv) *TVS Infotech Limited.*

(c) *Rejecting companies additionally introduced by the Appellant even though the companies are functionally comparable to the Appellant.*

- (i) *Minvesta Infotech Limited*
- (ii) *Ace Software Exports Limited*
- (iii) *Sagarsoft Limited*
- (iv) *Agilisys IT Services India Private Limited*
- (v) *Batchmaster Software Private Limited*
- (vi) *DCIS DOT COM solutions Private Limited*
- (vii) *Evoke Technologies Limited*
- (viii) *Isummation Technologies Private Limited*
- (ix) *Eluminous Technologies Private Limited.*

5.5 *The Ld.AO/TPO/DRP erred in law and facts, by not making suitable adjustment to account for differences in working capital position of the Appellant vis-à-vis the comparable companies.*

5.7 *The Ld.AO/TPO/DRP have erred, in law and in facts, by wrongly computing the operating margins of some of the comparable companies considered in the TP order.*

6. *Adjustment on account of notional interest on outstanding receivables.*

6.1 *The ld.AO/TPO/DRP grossly erred in determining a transfer pricing adjustment on account of the interest on outstanding receivables.*

6.2 *Without prejudice to our ground of objection 6.1 above, the ld.AO/TPO/DRP have erred, in law and in facts, by not appreciating that the outstanding trade receivables from its AE's is arising from the provision of software development services transaction which is to be considered as closely linked to such transaction and should not be tested separately from arm's length perspective.*

6.3 *Without prejudice to our ground of appeal no.6.1 above, the ld.AO/TPO/DRP erred in law and facts, by re-characterizing the outstanding receivables as on 31 March 2016 as a loan transaction.*

6.4 Without prejudice to our ground of appeal no.6.1 above, the ld.AO/TPO/DRP have erred in law and on facts, by questioning the business rationale of the transaction undertaken by the Appellant thereby questioning the commercial expediency of the transaction entered into by the Appellant.

6.5 Without prejudice to our ground of appeal no.6.1 above, the ld.AO/TPO/DRP have erred on facts, by not appreciating that the Appellant does not have a policy of charging interest from other unrelated parties nor has it paid any interest on its outstanding trade payable at year end to unrelated vendors.

6.6 Without prejudice to our ground of appeal no.6.1 above, the ld.AO/TPO/DRP have erred in law and facts, by not providing the basis for arriving at the arm's length interest rate of Libor plus 450 basis point for computing notional interest to be charged on the alleged delay in collection of receivables.

Ground of appeal relating to other matters

7. The ld.AO grossly erred in computing the Total Income and Tax liability by considering TP adjustment as INR 4,58,98,195 instead of taking INR 4,01,39,320 which was proposed in the Final assessment order post giving effect to DRP Directions.

Additional Ground

That the learned AO/TPO has erred, in law and in fact, by adopting an inconsistent approach in treating the foreign exchange gain / loss as non-operating in case of operating margins of the Appellant while considering foreign exchange gain /loss as operating in the case of margins of the comparable companies in the impugned TP order / final assessment order.

10. We shall adjudicate the above grounds as under:

Grounds 5.2(f) and 5.4(a)

11. By raising the above grounds, the assessee is seeking application of upper turnover filter and thereby exclusion of 7 companies from the comparable list. According to the learned

AR, since a lower turnover filter has been applied, the TPO/DRP ought to have applied a higher turnover filter to exclude companies. The learned DRP has rejected the objections of the assessee by observing that turnover does not have an influence on the margins of the company as far as the service sector is concerned. The learned AR has placed reliance upon the ruling of the Bangalore Bench of the Tribunal in the case of BORQS Software Solutions Pvt. Ltd. v. ITO in IT(TP)A No.310/Bang/2021 (order dated 25.10.2021) for assessment year 2016-2017.

12. The learned Departmental Representative supported the orders of the Income Tax Authorities.

13. We have heard rival submissions and perused the material on record. The Bangalore Bench of the Tribunal in the case of BORQS Software Solutions Pvt. Ltd. v. ITO (supra) has considered a host of rulings on this issue including that of Hon'ble High Courts wherein divergent views were taken with respect to the application of different filters. It was held by the Tribunal that the application of the turnover filter is justified on the basis of the classification of companies as per the report of Dun and Bradstreet. Since the assessee, in the present case, has disclosed an operating income of RS.39,91,36,436, companies reporting turnover above a threshold are considered not comparable. Accordingly, by following the order of the Tribunal, we direct the AO / TPO to apply the appropriate upper turnover filter and exclude the

following 7 companies having turnover in excess of Rs.200 crores:-

- (i) Larsen and Toubro Infotech Limited
- (ii) Nihilent Technologies Limited
- (iii) Persistent Systems Limited
- (iv) Thirdware Solutions Limited
- (v) Infosys Limited
- (vi) Aspire Systems (India) Private Limited
- (vii) Cybage Software Private Limited.

Therefore, grounds 5.2(f) and 5.4(a) is partly allowed as indicated above.

Grounds 5.4(b) and 5.4(c)

14. The assessee has sought for the inclusion of two comparable companies vide ground 5.4(b) and 5.4(c). The learned AR has submitted that Sagarsoft (India) Limited and Evoke Technologies Limited are comparable companies as they are operating in the business of software development and therefore liable to be included in the final list of comparables.

15. The DRP has rejected the objection of the assessee for its inclusion by claiming that the same does not feature in the TPO's search matrix, thereby amounting to cherry-picking of companies with low margins. Since the learned AR has demonstrated that the same is appearing in the TPO's list of

comparable companies and are deriving 100% of its revenue from software development services, we direct the AO / TPO to re-examine the compatibility of these two companies. We accordingly allow the grounds of the assessee for statistical purposes.

Ground 5.7

16. The learned AR has submitted that the TPO has erred in wrongly computing the operating margins of certain companies considered comparables which are arising out of arithmetical inaccuracies. In the view of principles of natural justice, we deem it appropriate to remand the matter back to the files of the AO / TPO to examine the claims of the assessee with regard to erroneous computation of operating margin. We direct the AO / TPO to specifically adjudicate each of the items of either expenses / income with respect to its inclusion or exclusion in calculating the operating margins. The ground of the assessee is accordingly allowed for statistical purposes.

Ground 5.5

17. Ground 5.5 is dealing with working capital adjustment. The assessee has submitted that TPO did not allow any adjustment on working capital. Further, the DRP did not allow relief on this count. The assessee has placed reliance on the decision of the Bangalore Bench of the Tribunal in the case of *M/s.Huawei Technologies India (P) Ltd. v. JCIT* reported in (2019) 101 taxmann.com 313 (Bangalore), wherein the

Tribunal has held that working capital should be allowed as per actual.

18. The learned Departmental Representative has reiterated the contentions of the DRP.

19. We have heard rival submissions and perused the material on record. In the view of the ruling in the case of M/s.Huawei Technologies India (P) Ltd. v. JCIT (supra), the basis of rejection of the relief by the DRP is no longer valid. The relevant findings of the Tribunal in the case of M/s.Huawei Technologies India (P) Ltd. (supra) read as follows:-

“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."

20. We therefore, direct the AO/TPO to consider the workings in the light of the aforesaid ruling and allow appropriate adjustment in arriving at an arm's length price. We hold and direct accordingly.

Grounds 6.1 to 6.6

21. With respect to the contentions on the issue of interest on outstanding receivables as contained in grounds 6.1 to 6.6,

the assessee has submitted that outstanding receivables cannot be treated as a separate international transaction and considering the aggregation approach, it is claimed that all service related costs are embedded in the remuneration received from the AEs. The learned AR has also stated that outstanding receivables from AEs cannot be characterized as loan advanced as receivables arising from international transactions are closely linked to the main transaction and should be benchmarked using a combined transaction approach.

22. Having noted the contentions of the assessee, in view of the amendment, the transaction of receivables has to be considered as an international transaction u/s 92B of the I.T.Act. Further, the learned AR has advanced an argument that it is only such receivable which is outstanding for a period exceeding the period allowed under the Master Service Agreement, is to be considered as an international transaction. On the basis of the strength of the ruling in the case of Galax E Solutions India Private Limited v. DCIT [IT(TP)A No.389/Bang/2021 – order dated 31.05.2022], the learned AR submitted that the debtors were realized within the allowed credit period and therefore computation of interest on outstanding receivables does not arise. Further, the learned AR has provided computation of debtors holding period of the comparables which was 65.63 days (whereas that of assessee was 65 days as per Master Service Agreement).

23. The learned Departmental Representative supported the order of the DRP.

24. We have heard rival submissions and perused the material on record. The details with respect to the terms of the Master Service Agreement, credit period allowed thereunder, invoicing details, the realization data, and such other particulars as may be relevant to adjudicate on this issue, are not emanating from the DRP's directions / TPO's order. We accordingly direct the AO / TPO to examine the factual aspect. The AO / TPO is also directed to examine computation of debtors holding period of comparable vis-à-vis that of the assessee. If the debtors holding period of comparable is higher than that of the assessee, then prima facie, no TP adjustment is required on the amounts outstanding from the AEs. We, accordingly, allow the ground 6.1 to 6.6 for statistical purposes.

Ground 7

25. It is submitted by the learned AR that the AO vide final assessment order dated 30.04.2021 has made TP adjustment of Rs.4,01,39,320 as per TPO's OGE to DRP directions dated 30.04.2021. However, in the demand notice and computation sheet annexed to the final assessment order, the A.O. has considered the TP adjustment of Rs.4,58,998,195 in arriving at the assessed income. It is claimed that a rectification application has been filed before the A.O. dated 30.05.2021. However, the same is pending. We direct the A.O. to verify the

matter and pass appropriate order. It is ordered accordingly. Therefore, ground 7 is allowed for statistical purposes.

Additional Ground

26. It was submitted by the learned AR that the assessee could not raise this ground before the DRP / AO /TPO on account of omission. The Assessee has claimed that the same was inadvertent simpliciter and was neither willful nor wanton. It was stated that the same does not require investigation of new facts and therefore, it was requested that the additional ground may be admitted in the interest of justice and equity.

27. The Hon'ble Apex Court in the case of CIT v. S.Nelliappan [1967] 66 ITR 722 held that "In hearing an appeal the Tribunal may give leave to the assessee to urge grounds not set forth in the memorandum of appeal, and in deciding the appeal the Tribunal is not restricted to the grounds set forth in the memorandum of appeal or taken by leave of the Tribunal." In view of the above judgment of the Hon'ble Apex Court since no new facts is required to be examined for adjudication of the additional ground, we take the same on record and proceed to adjudicate the additional ground.

28. It is the submission of the AR that the TPO vide OGE to DRP Directions dated 30.04.2021 has computed operating margins of the Assessee considering foreign exchange gain as

non-operating by taking the values as per TP study. However, the TPO in its initial orders under section 92CA dated 31.10.2019 has considered the foreign exchange gain/loss as operating in computing the operating margins of comparable companies. The Assessee has claimed an inconsistent approach in the computation of operating margins of the tested party vis-a-vis the comparable companies. It is well accepted that the benchmarking exercise should result in a comparison of Apple with Apple. Since there is inconsistency in computing the margins, we direct the AO / TPO to verify the issue afresh. It is ordered accordingly. In the result, the additional ground raised by the assessee is allowed for statistical purposes.

29. In the result, the appeal filed by the assessee is partly allowed.

Order pronounced on this 21st day of July, 2022.

Sd/-
(Laxmi Prasad Sahu)
ACCOUNTANT MEMBER

Sd/-
(George George K)
JUDICIAL MEMBER

Bangalore; Dated : 21st July, 2022.
Devadas G*

Copy to :

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