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

BEFORE SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER
AND
SMT. BEENA PILLAI, JUDICIAL MEMBER

IT(TP)A No. 451/Bang/2022
Assessment Year : 2017-18

M/s. Medreich Ltd., No. 12/8, Medreich House, Saraswati Ammal Street, Maruti Seva Nagar, Bangalore – 560 033. **PAN: AABCM1458Q**	**Vs.**	The Assistant Commissioner of Income Tax, Central Circle – 1(2), Bangalore.
APPELLANT		**RESPONDENT**

Assessee by	**:**	Shri Padam Chand Khincha, CA
Revenue by	**:**	Shri Praveen Karanth, CIT-DR

Date of Hearing	**:**	27-07-2022
Date of Pronouncement	**:**	21-10-2022

ORDER

PER BEENA PILLAI, JUDICIAL MEMBER

Present appeal is filed by assessee against the final assessment order passed by the Ld.ACIT, Central Circle – 1(2), Bangalore dated 26/04/2022 for A.Y. 2017-18 on following grounds of appeal:

> *"General Ground*
> *1.1 The learned Assistant Commissioner of Income Tax, Central Circle-1(2), Bangalore (`A0') erred in passing the assessment order under section 143(3) r.w.s 144C(13) of the Income Tax Act, 1961 (`the Act) in the manner passed*

by him. The same in bad in law and liable to be quashed in its entirety.

Transfer Pricing Grounds

2. Grounds relating to transfer pricing adjustments

2.1 The learned AO has erred in making a reference to TPO for determining arm's length price without demonstrating as to why it was necessary and expedient to do so. The Honorable DRP has erred in confirming the action of the learned AO:

2.2 The learned AO, TPO and Hon'ble DRP have erred in

a) making transfer pricing adjustment of Rs. 29,12,546;

b) not appreciating that there is no amendment to the definition of "income" and charging or computation provision relating to income under the head "Profits & Gains of Business or Profession" do not refer to or include the amounts computed under Chapter X and therefore addition made under Chapter X is bad in law; and

c) passing the orders without considering all the submissions and/or without appreciating properly the facts and circumstances of the case and the law applicable.

3. Grounds relating to computation of Ali' for transaction relating to Corporate Guarantee Fees

3.1 The learned TPO and Hon'ble DRP erred in making an addition of Rs. 25,80,266 on account of corporate guarantee fees received from its Associated Enterprise (`AE').

3.2 The learned TPO and Hon'ble DRP erred in considering the transaction of corporate guarantee as an international transaction under section 92B of the Act.

3.3 The learned TPO and Hon'ble DRP erred in not demonstrating as to how the transaction of providing corporate guarantee has an impact on the profits, incomes, losses or assets of the Appellant.

3.4 The learned TPO and Hon'ble DRP failed to appreciate that the transaction of providing corporate guarantee:

a) is the nature of a shareholder activity/quasi capital and hence is not an international transaction under section 92B of the Act;

b) does not entail provision of any services to the AE as per section 92B of the Act.

Without prejudice to the above

3.5 The learned TPO and llon'ble DRP failed to follow the order of the Hon'ble ITAT in the appellant's own case for the AY 2012-13 to AY 2014-15 wherein the ALP of corporate guarantee fees was benchmarked at 0.5%.

3.6 On the facts and circumstance of the case and in law, the corporate guarantee fees should not be considered as

an international transaction under section 92B of the Act. In any case, the adjustment if any, should not exceed 0.5% of the corporate guarantee provided.

4. Grounds relating interest on receivables

4.1 The learned TPO and the Hon'ble DRP erred in making an adjustment towards interest on delayed receivables amounting to Rs. 3,32,280 by applying an interest rate of 5.875% i.e., LIBOR + 4.50%.

4.2 The learned TPO and the Hon'ble DRP erred in:

a) Re-characterisation of the outstanding receivables as a deemed loan;

b) adopting the RBI ceiling rate applicable to ECB and trade credits, as . appropriate CUP to benchmark the transaction relating to trade receivable;

c) not restricting the computation of interest on delayed receivables to the interest accruing for the year under consideration;

d) not providing working capital adjustment as prescribed under rule 10B of the Income Tax Rules, 1962.

4.3 The learned TPO and Hon'ble DRP failed to appreciate that:

a) when the primary transaction has already been benchmarked using TNMM and the transaction relating to outstanding receivables cannot be benchmarked separately;

b) no interest was charged to non-AE's for similar transactions;.

c) on providing working capital adjustment no adjustment is required to be made for notional interest on outstanding receivables.

4.4 On the facts and circumstances of the case and in law, no adjustment can be made towards notional interest. In any case, if an adjustment is made the same is to be restricted to the LIBOR rate.

5. Grounds relating to disallowance under section 14A

5.1 The learned AO and Hon'ble DRP erred in making a disallowance amounting to Rs. 1,59,79,272 under section 14A of the Act.

5.2 The learned AO erred in not recording satisfaction regarding the incorrectness of the claim made by the Appellant.

5.3 Without prejudice, the learned AO and Hon'ble DRP erred in:

a) making disallowance under section 14A on entire investments appearing in the balance sheet of the financial year.

b) not restricting the disallowance made under section 14A to the investments yielding exempt income.

5.4 On facts and circumstances of the case and in law, the addition made under section 14A of the Act amounting to Rs. 1,59,79,272 is excessive and bad in law.
6. Levy of interest under section 234C
6.1 The learned AO erred in levying interest under section 234C of the Act amounting to Rs.12,64,495 of the Act. The Appellant denies its liability to pay interest under section 234C.
The Appellant prays accordingly."

2. Ground nos. 1-2 are general in nature and does not require adjudication. The Ld.AR summarised that the appeal pertains to only three issues that are as under:

i) Disallowance under corporate guarantee at 2%

ii) Interest on delayed receivables

iii) Disallowance u/s. 14A r.w.Rule 8D(2)(iii)

He submitted that all the above three issues are covered by various decisions.

3. The only issue that has been raised by assessee in respect of the international transaction is regarding the addition made of bank guarantee amounting to Rs.25,80,266/-. The Ld.AR at the outset submitted that the issue has been considered by *Coordinate Bench of this Tribunal* in assessee's own case for A.Ys. 2012-13 to 2014-15 in *ITA Nos. 1574 to 1576/Bang/2019* by order dated 12/04/2021. The Ld.AR submitted that the *Hon'ble Court* has restricted the corporate guarantee of 0.50% by observing as under:

"4. The brief facts of the case are as follow:
The assessee is a company engaged in the business of manufacture and sale of pharmaceutical formulations. The assessee has a 100% subsidiary / Associate Enterprise (AE) in United Kingdom by the name Medreich PLC, UK (Medreich PLC). The Medreich PLC is engaged in the marketing abroad the products manufactured by the assessee. The assessee during the relevant assessment year had given corporate guarantee on behalf of Medreich PLC of Rs.25,76,50,000. Medreich PLC had availed a

working capital loan of US$ 5 Million from EXIM Bank in India. The assessee had given guarantee for this loan by pledging movable and immovable properties of one of the plant located in Bangalore.

5. During the course of assessment proceedings for assessment years 2012-2013 to 2014-2015, the Assessing Officer made a reference to Transfer Pricing Officer (TPO) u/s 92CA(3) of the I.T.Act in order to determine the Arms Length Price (ALP) of international transactions. The TPO passed an orders u/s 92CA(3) of the I.T.Act, rejecting the ALP analysis undertaken by the assessee and proposed an aggregate transfer pricing adjustment of Rs.51,53,000, 53,80,000 and 59,95,000 being as 2% on corporate guarantee given by the assessee for the loan taken by the AE for A.Y's 2012-2013 to 2014-2015. The TPO had imputed the guarantee fee of 2% by adopting the commission charged by bank to similar entities (by taking credit rating of the tax payer).

6. Aggrieved by the orders passed by AO/TPO for A.Y's 2012- 2013 to 2014-2015, , the assessee preferred appeals to the first appellate authority. The CIT(A) confirmed the view taken by the AO/TPO. The relevant finding of the CIT(A) reads as follow:-

"11. In this context, it may be noted that undisputed facts show the appellant had provided security for its AE to obtain Bank Guarantee. The appellant had not also not charged its AE any amount for doing so. The same involves an element of commercial cost and the same will not be provided to any third party, irrespective of the presence of a commercial relationship or otherwise with the said party, free of cost. There is a huge commercial risk that is run by the provider, in this case., the appellant. The appellant has relied upon the decision of the Mumbai ITAT in the case of Nimbus Commercials & Godrej Household Products Ltd. In both these cases the ITAT looking into the facts involved sustained addition @ 0.5% of the Value of Bank Guarantee. In the present case, the AO has determined the cost @ 2% of the bank Guarantee Value, which is found not to be unreasonable. The addition made by the AO, based on the TPO order is therefore sustained."

7. Aggrieved by the orders of the CIT(A), the assessee has preferred these appeals before the Tribunal. The learned AR has no objection treating corporate guarantee as an international transaction. The learned AR's grievance is only adoption at the rate of 2% by the TPO for arriving at ALP of the international transaction. The AR relied on the order of Bangalore Bench of the Tribunal in the case of Manipal Global Education Services Pvt. Ltd. v. DCIT in

ITA No.388/Bang/ 2016, which had in turn followed the judgment of the Hon'ble Bombay High Court in the case of CIT v. Everest Kento Cylinders Ltd (IT Appeal No.1165 of 2013 - judgment dated 08.05.2015).

8. The learned Departmental Representative, on the other hand, relied on two orders of the Hyderabad Bench of the Tribunal in the case of (i) Infotech Enterprises Ltd. v. Addl.CIT (2014) 41 taxmann.com 364 (Hyd.Trib.) and (ii) Prolific Corporation Ltd. v. DCIT(2015) 55 taxmann.com 225 (Hyd.Trib.). The learned DR submitted that the orders of the Hyderabad Bench of the Tribunal is essentially on the question whether the corporate guarantee given to the bank on behalf of the AE, whether it is an international transaction or not. In this context the Hyderabad Bench of the Tribunal had decided that the corporate guarantee on behalf of an AE is an international transaction. The learned DR submitted that the Hyderabad Bench had imputed the cost of 0.53% for the corporate guarantee stood by the assessee's in those case on behalf of its AE.

9. We have heard rival submissions and perused the material on record. The learned AR has not disputed the fact that corporate guarantee commission is an international transaction. The AR only disputes 2% attributed for imputing ALP of corporate guarantee commission. On identical facts in the case of Manipal Global Education Services Pvt. Ltd. v. DCIT (supra), the Bangalore Bench of the Tribunal had imputed 0.50% as cost, instead of 2% arrived by the TPO. (A copy of TPO's order u/s 92CA in the case of Manipal Global Education Services Pvt.Ltd. is placed on record). The TPO in the cited case also arrived at 2% by taking the credit rating of the tax payer just like this case. The relevant finding of the ITAT in the case of Manipal Global Education Services Pvt. Ltd. v. DCIT (supra), reads as follow:-

"8. We have heard the parties on this issue and perused the record. We notice that the Tribunal is consistently holding the transaction of providing Corporate Guarantee as an international transaction. Hence the same is required to be examined under Arms length principles. There should not be any dispute that the provision of Corporate guarantee to its subsidiary in order to enable it to avail loans would bring benefit to the subsidiary, in which case, it is proper to compensate the assessee for those benefits under Arms length principles. We notice that the TPO has made an adjustment of 2%, considering the interest benefit @ 4% and taking the view that half of the same should be attributed to the benefit of the assessee. However, we notice that the Hon'ble Bombay High Court

has approved the T.P. adjustment of 0.50% in respect of Corporate guarantee given in the case of Everest Kento Cylinders Ltd. (supra). Though the Ld AR has pleaded for an adjustment of 0.20% by placing reliance on the decision of Asian Paints Ltd. (supra), yet we notice that the Ld.AR did not highlight the parity of facts between the assessee and the case of Asian Paints Ltd. Hence, on the conspectus of the matter, we are of the view that the T.P. adjustment in respect of Corporate Guarantee may be made @ 0.50% as per other decisions of Tribunal and Hon'ble Bombay High Court referred above. Accordingly we set aside the order passed by the A.O. on this issue and direct the AO/TPO to make T.P adjustment in respect of Corporate Guarantee @ 0.50% in all the years under consideration."

10. In the light of the above order of the Bangalore Bench of the Tribunal in the case of Manipal Global Education Services Pvt. Ltd. v. DCIT (supra), which is identical to the facts of the instant case, we direct the AO/TPO to make TP adjustment in respect of corporate guarantee at 0.50% for the assessment years under consideration. It is ordered accordingly."

4. Admittedly both sides submitted that the facts in the present case is also identical wherein the Ld.TPO computed the rate of corporate guarantee at 2% on the amount of Rs.18,41,28,233/-. The Ld.DR on the contrary relied on the orders passed by authorities below.

We have perused the submissions advanced by both sides in the light of records placed before us.

5. We note that this issue stands squarely covered in assessee's own case, the relevant observation that has been restricted hereinabove. The facts being identical, we direct the Ld.AO/TPO to make the TP adjustment in respect of the corporate guarantee at 0.5% as has been held in the preceding assessment years.

Accordingly, ground no. 3 raised by assessee stands allowed partly.

6. **Ground no. 4** is in respect of the notional interest charged by the Ld.TPO towards the interest on receivables amounting to

Rs.3,32,280/- by applying interest rate of 5.875% i.e. LIBOR + 450 basis points.

7. The Ld.AR placed reliance on decision of *Hon'ble Delhi Tribunal* in *Kusum Healthcare Pvt.Ltd vs. ACIT* reported in *(2015) 62 Taxmann.com 79*, deleted addition by considering the above principle, and subsequently *Hon'ble Delhi High Court* in *Pr. CIT vs. Kusum Health Care Pvt. Ltd.* reported in *(2017) 398 ITR 66*, held that, no interest could have been charged as it cannot be considered as international transaction. He also placed reliance upon decision of *Hon'ble Delhi Tribunal* in case of *Bechtel India vs DCIT* reported in *(2016) 66 taxman.com 6* which subsequently upheld by *Hon'ble Delhi High Court* vide order dated 21/07/16 in ITA No. 379/2016, also upheld by *Hon'ble Supreme Court* vide *order dated 21/07/17, in CC No. 4956/2017*.

8. It was submitted by Ld.AR that outstanding receivables are closely linked to main transaction and so the same cannot be considered as separate international transaction. He also submitted that into company agreements provides for extending credit period with mutual consent and it does not provide any interest clause in case of delay. He also argued that the working capital adjustment takes into account the factors related to delayed receivables as assessee adopted TNMM as the MAM for computing its margin, and therefore no separate adjustment is required to be made.

9. On the contrary, Ld.CIT.DR submitted that, interest on receivables is an international transaction and Ld.TPO rightly determined its ALP. In support of her contentions, she placed reliance on decision of *Delhi Tribunal order* in *Ameriprise India*

Pvt. Ltd. vs. ACIT (2015- TII-347-ITAT-DEL-TP) wherein it is held that, interest on receivables is an international transaction and the transfer pricing adjustment is warranted. He stated that Finance Act, 2012 inserted Explanation to Section 92B, with retrospective effect from 1.4.2002 and sub-clause (c) of clause (i) of this Explanation provides that:

> *(i) the expression "international transaction" shall include--*
> *..... (c) capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business;....' .*

10. Ld.CIT DR submitted that expression 'debt arising during the course of business' refers to trading debt arising from sale of goods or services rendered in course of carrying on business. Once any debt arising during course of business is an international transaction, he submitted that any delay in realization of same needs to be considered within transfer pricing adjustment, on account of interest income short charged or uncharged. It was argued that insertion of Explanation with retrospective effect covers assessment year under consideration and hence under/non- payment of interest by AEs on debt arising during course of business becomes international transactions, calling for computing its ALP. He referred to decision of *Delhi Tribunal in Ameriprise (supra)*, in which this issue has been discussed at length and eventually interest on trade receivables has been held to be an international transaction. Referring to discussion in said order, it was stated that *Hon'ble Delhi Bench* in this case referred to the decision of the *Hon'ble Bombay High Court* in the case of *CIT vs. Patni*

Computer Systems Ltd., reported in *(2013) 215 Taxmann 108*, which dealt with question of law:

> *(c) `Whether on the facts and circumstances of the case and in law, the Tribunal did not err in holding that the loss suffered by the assessee by allowing excess period of credit to the associated enterprises without charging an interest during such credit period would not amount to international transaction whereas section 92B(1) of the Income-tax Act, 1961 refers to any other transaction having a bearing on the profits, income, losses or assets of such enterprises?' 3.5.6. She submitted that, while answering above question, Hon'ble Bombay High Court referred to amendment to section 92B by Finance Act, 2012 with retrospective effect from 1.4.2002. Setting aside view taken by Tribunal, Hon'ble Bombay High Court restored the issue to file of Tribunal for fresh decision in light of legislative amendment. It was thus argued that non/under-charging of interest on excess period of credit allowed to AEs for realization of invoices, amounts to an international transaction and ALP of such international transaction has to be determined by Ld.TPO. In so far as charging of rate of interest is concerned, he relied on decision of the Hon'ble Delhi High Court in CIT vs. Cotton Naturals (I) Pvt. Ltd (2015) 276 CTR 445 (Del) holding that currency in which such amount is to be re-paid, determines rate of interest. He, therefore, concluded by summing up that interest on outstanding trade receivables is an international transaction and its ALP has been correctly determined.*

He thus submitted that the Interest on outstanding receivables have been rightly constituted as independent international transaction

We have perused the submissions advanced by both the sides in the light of the records placed before us.

11. This Bench referred to decision of *Special Bench of this Tribunal* in case *Instrumentation Corpn. Ltd. v. Asstt. DIT* in *ITA No. 1548 and 1549 (Kol.) of 2009,* dated *15/07/2016*, held that outstanding sum of invoices is akin to loan advanced by assessee to foreign AE., hence it is an international transaction as per explanation to section 92 B of the Act. Alternatively, it has been argued that working capital adjustment subsumes sundry

creditors. In such situation computing interest on outstanding receivables and lones and advances to international transaction would amount to double taxation. *Hon'ble Delhi Tribunal* in case of *Orange Business Services India Solutions Pvt. Ltd. vs. DCIT* in *ITA No. 6570/Del/2016 vide its order dated 15.2.2018* observed that:

> *"There may be a delay in collection of monies for supplies made, even beyond the agreed limit, due to a variety of factors which would have to be investigated on a case to case basis. Importantly, the impact this would have on the working capital of the assessee would have to be studied. It went on to hold that, there has to be a proper inquiry by the TPO by analysing the statistics over a period of time to discern a pattern which would indicate that vis-à-vis the receivables for the supplies made to an AE, the arrangement reflected an international transaction intended to benefit the AE in some way. Similar matter once again came up for consideration before the Hon'ble Delhi High Court in Avenue Asia Advisors Pvt. Ltd. vs. DCIT (2017) 398 ITR 120 (Del). Following the earlier decision in Kusum Healthcare (supra), it was observed that there are several factors which need to be considered before holding that every receivable is an international transaction and it requires an assessment on the working capital of the assessee. Applying the decision in Kusum Health Care (supra), the Hon'ble High Court directed the TPO to study the impact of the receivables appearing in the accounts of the assessee; looking into the various factors as to the reasons why the same are shown as receivables and also as to whether the said transactions can be characterized as international transactions."*

12. In view of the above, we deem it appropriate to set aside the impugned order on this issue and remit the matter to the file of the Ld.AO/TPO for deciding it in conformity with the above referred judgment. We also direct the Ld.TPO that in the event the WCA subsumes the outstanding recivables, no separate characterisation is to be made. However for those recivables that fall out of the WCA pertaining to year under consideration, then, the rate of interest to be charged must be in accordance with the principles laid down by *Hon'ble Delhi High Court* in case of *CIT vs.*

Cotton Naturals (I) Pvt.Ltd., reported in *(2015) 276 CTR 445* by considering a credit of 90 days.

Needless to say, the assessee will be allowed a reasonable opportunity of being heard in such fresh proceedings.

Accordingly this ground raised by the assessee stands allowed for statistical purposes.

13. The next issue is in respect of disallowance made u/s. 14A of the Act. The Ld.AR submitted that assessing officer disallowed sum of Rs.1,59,79,272/- u/s. 14A of the Act r.w.Rule 8D. It was submitted that no expenditure was incurred during the year for earning the exempt income and therefore the disallowance should be restricted to the investments that yielded the exempt income.

14. The Ld.AR further submitted that assessee has also earned exempt income from the investments made in foreign companies which cannot form part of 14A disallowance. The Ld.AR placed reliance on the following decisions.

- *Decision of Hon'ble Delhi Tribunal in case of CIT vs. Holcim India (P.) Ltd. reported in [2015] 57 taxmann.com 28 (Delhi)*
- *Decision of Hon'ble Mumbai Tribunal in case of JM Financial Ltd. in ITA No. 4521/M/2012*
- *Decision of Hon'ble Delhi Special Bench in case of ACIT vs. Vireet Investment Pvt. Ltd. reported in 165 ITD 27.*

On the contrary, the Ld.DR relied on the orders passed by authorities below.

We have perused the submissions advanced by both sides in the light of records placed before us.

15. We note that the disallowance under Rule 8D(iia) has been made by the Ld.AO by applying 1% on the entire investments.

The *Hon'ble Special Bench* of this *Tribunal* in case of *ACIT vs. Vireet Investment Pvt. Ltd.(supra)* has held that only those

investments that have yielded the exempt income should be considered. Accordingly, we direct the Ld.AO to recomputed the disallowance under Rule 8D(2)(iii) by restricting to only those investments that have yielded the exempt income for the year under consideration. Accordingly this ground raised by assessee stands allowed.

16. Ground no. 6 is consequential in nature and therefore do not require any adjudication.

In the result, the appeal filed by the assessee stands allowed as indicated hereinabove.

Order pronounced in the open court on 21st October, 2022.

Sd/-	Sd/-
(CHANDRA POOJARI)	(BEENA PILLAI)
Accountant Member	Judicial Member

Bangalore,
Dated, the 21st October, 2022.
/MS /

Copy to:

1. Appellant	4. CIT(A)
2. Respondent	5. DR, ITAT, Bangalore
3. CIT	6. Guard file

By order

Assistant Registrar,
ITAT, Bangalore