

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

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

<b>IT(TP)A No. 189/Bang/2021</b>
<b>Assessment Year : 2016-17</b>

M/s. Parexel International Clinical Research Pvt. Ltd., CoWrks, RMZ EcoWorld, Ground floor, Bay Area- Adjacent to Building 6A, Outer Ring Road, Devarabeesanahalli Village, Bangalore – 560 103. <b>PAN: AADCP9318C</b>	<b>Vs.</b>	The Assistant Commissioner of Income Tax, Circle 5(1)(2), Bangalore.
<b>APPELLANT</b>		<b>RESPONDENT</b>

Assessee by	:	Ms. Chandini Shah, 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 order passed by National e-Assessment Centre, Delhi dated 26/03/2021 for A.Y. 2016-17 on following grounds of appeal:

Each of the grounds and/ or sub-grounds of the appeal mentioned here-in are independent and without prejudice to each other.

1. On the facts and in the circumstances of the case and in law, the final assessment order passed by National e-Assessment Centre, Delhi, pursuant to the directions of the Hon'ble Dispute Resolution Panel ('DRP'), under Section 143(3) read with Sections 144C(13), 143(3A) and 143(3B) of the Act to the extent prejudicial to the Appellant, is bad in law and is liable to be quashed.
2. On the facts and in the circumstances of the case and in law, the Hon'ble DRP erred in upholding the action of the Ld. Transfer Pricing Officer ('TPO') / Ld. Assessing officer ('AO') in proposing an adjustment of INR 1,07,62,545 to the international transaction pertaining to provision of facilitation and coordination services by the Appellant to its associated enterprises ('AEs').
3. On the facts and in the circumstances of the case and in law, Ld. AO / Ld. TPO / Hon'ble DRP erred in:
  - a. rejecting the transfer pricing documentation which was maintained in good faith and with due diligence by the Appellant;
  - b. rejecting certain filters as applied by the Appellant in selection of the comparable companies at the time of preparation of the transfer pricing documentation; and
  - c. applying certain filters not relevant to the Appellant while undertaking fresh comparability analysis.
4. On the facts and in the circumstances of the case and in law, Ld. AO / Ld. TPO / Hon'ble DRP erred in including following companies in the final set which are not comparable to the Appellant's functions, asset base and risk profile and fails the filters applied by the Ld. TPO:
  - a. Icon Clinical Research India Pvt. Ltd.; ✓
  - b. Lambda Therapeutic Research Ltd.; - ✓
  - c. Syngene International Ltd.; and
  - d. Cliantha Research Ltd. ✓
5. On the facts and in the circumstances of the case and in law, Ld. AO / Ld. TPO/ Hon'ble DRP erred in:
  - a. not granting working capital adjustment; and
  - b. not granting risk adjustment.

6. On the facts and in the circumstances of the case and in law, Ld. AO / Ld. TPO/ Hon'ble DRP erred in treating recovery of pass through cost by the Appellant as operating in nature and disregarding the fact that the Appellant merely acted as a co-ordinator and facilitator for the performance of clinical trials and that the reimbursement of investigator fees do not represent any functions performed so as to consider it for profitability purposes and also that there is no profit element in the hands of the AE in relation to such recoveries.
7. On the facts and in the circumstances of the case and in law, the Ld. AO / Ld. TPO erred in levying interest under Section 234B and 234C of the Act.
8. On the facts and in the circumstances of the case and in law, the Ld. AO/ Ld. TPO erred in imposing penalty under Section 271(1)(C) of the Act.

The Appellant prays that appropriate relief be granted. The above grounds are without prejudice to each other.

The Appellant craves leave to add to, alter, omit or substitute any or all of the above grounds of appeal or produce further documents at any time before or at the time of the appeal.

For Parexel International Clinical Research Private Limited



  
Name: Sanjay Champalal Vyas  
Designation: Director

At the outset, the Ld.AR submitted that **Ground nos. 4-6** are the only grounds that assessee wish to argue before this *Tribunal*. It is further submitted that in Ground no. 4, assessee wish to argue only exclusion of Icon Clinical Research India Pvt. Ltd. and Syngene International Ltd.

## **2. Brief facts of the case are as under:**

2.1 Parexel International Clinical Research Private Limited (herein after referred to as 'assessee' or 'Parexel India') is engaged in the business of facilitating and coordinating clinical trial services for its Associated Enterprises (AE).

2.2. During the year under consideration, the assessee has earned a margin of 13.89% on cost (excluding pass through

costs). The international transactions undertaken by the assessee were benchmarked using the Transactional Net Margin Method (TNMM.) and adopting the Profit Level Indicator (PLI) of Operating Profit / Total Cost (OP/TC).

2.3. The assessee conducted a detailed search for comparable companies and arrived at a set of 5 companies whose arithmetic mean margin was computed as 9.81%. Since the assessee had earned a higher margin i.e., 13.89% than the comparable companies, the international transactions were determined to be at Arm's length.

2.4. During the assessment proceedings, the Ld. Transfer Pricing Officer (TPO) has considered the pass-through cost as a part of the assessee's cost-base and thereby recomputed the margin (operating profit/operating costs) of the assessee at 9.42% (refer Pg. no. 33 of TPO Order).

2.5. Further, the Ld. TPO also rejected the assessee's benchmarking analysis and conducted a fresh search for comparable companies. After considering the various submissions made by the assessee, the Ld. TPO ultimately arrived at a set of 10 comparables, having the arm's Length Median Margin @ 13.91% (refer Pg. no. 32 of TPO order) and thereby proposed a transfer pricing adjustment of Rs. 1,07,62,545.

2.6 On receipt of the order of Ld.TPO, the assessing officer passed the draft assessment order on 15/11/2019 in compliance with the order u/s. 92CA.

2.7 Aggrieved by the draft assessment order, assessee filed objections before the DRP. The DRP upheld the actions of the

Ld.TPO. On receipt of the DRP directions, the Ld.AO passed the impugned order by making addition in the hands of the assessee to the extent of Rs.1,07,62,545/-.

Aggrieved by the order of the Ld.AO, the assessee is in appeal before this *Tribunal*.

3. Before we start the comparability analysis, it is necessary to understand the functions performed by assessee, assets owned and risks assumed.

Group.

### 5.2.2. Functions performed by Parexel Clinical

Parexel Clinical is involved in providing following services to Parexel Group in relation to clinical trial process –

1. **Assistance in feasibility study:** The client requests Parexel Group to carry out a feasibility study for the conduct of clinical trial in India. The feasibility study is carried out to find out if a particular drug can be useful to be marketed and sold in India. The basic factors which are considered while carrying out a feasibility study are the prevalence of the disease, availability of infrastructure and investigators etc.
2. **Details for feasibility study:** Parexel Clinical prepares the feasibility study report of Indian clinical trial and research scenario. Parexel Clinical would evaluate the factors such as patient type, patient load, hospitals, investigators information, infrastructure facilities, investigator's experience etc. which are required to evaluate whether the study can be conducted in India.
3. **Qualification visits:** Parexel Clinical conducts qualification visits to all the hospital that have been selected during the feasibility study. The basic criteria which are looked into while conducting qualification visits includes availability of well-equipped laboratory, number of volunteer patients, infrastructure, pharmacy, investigators (doctors) etc. This involves physical verification of instruments, patient load etc.

Once the qualification visit is conducted, the following documents are sent:

- *Investigation brochure:* The investigation brochure is provided to the physicians to make them understand the safety, purpose, efficacy of drug trials.
  - *Protocol:* The protocol developed by the sponsor in consultation with CRO is also provided to the physicians.
  - *Inform Consent Form:* The consent form is provided to the patients who would participate in the Clinical Trials. The patient is allowed to evaluate the consent form and accept it before any trials are done with the patients. This is translated into different languages (i.e. the local language where the test have to be conducted). For this purpose, Parexel Clinical hires agencies who translate the documents.
  - *Case Report Form:* A case report form is also prepared which contains the details of the entire case.
  - *Questionnaire:* A detailed questionnaire is issued by the physician to the patients and they are asked to fill effects of the drug.
4. **(a) Obtaining Regulatory approvals:** The clinical trial and testing services in India has to be Drugs Controller General of India ("DCGI") Office in India. The clinical trials are classified into Category A and Category B in India. Category A includes those clinical trials whose protocols are already approved by regulatory authorities of some of the recognized and developed countries, viz. USA, UK, Switzerland, Australia, Canada, Germany, South Africa, Japan, EMEA etc. . Where the protocol in Category A is already approved in the other countries, the time line approved by the regulatory authorities in India may be shorter. However in case of all other applications which are not covered under Category A, i.e. Category B applications, the regulatory authority would take more time as the adequacy of the protocol has to be verified in detail to protect the subjects (or the patients). Parexel Clinical is involved in obtaining the approval from the following authorities for all the clinical trials conducted in India:



- *DCGI:* The DCGI is the regulatory authority for clinical trials. Schedule Y of the Drugs and Cosmetics Act applies to trials of new drugs after obtaining permission from the DCGI. The drugs which are approved in other countries but have to be marketed in India also require approval from DCGI. Parexel Clinical is involved in obtaining the permission from DCGI. For this purpose, Parexel Clinical has hired Regulatory consultants who assist in coordination with DCGI. Parexel Clinical sets up a study start-up team for every new trial who are involved in preparation of Dossier. This dossier is sent to Parexel Group for verification, who in turn discusses the content of the dossier with the sponsor. Upon confirmation, Parexel Clinical arranges to file the dossier with DCGI.

Whenever any clinical trial project is outsourced, Parexel Clinical approaches DCGI and Ethics committee of the hospitals to commence the process in India after getting their approvals. The document filed with DCGI and Ethics committee contains the following: Protocol document, Case report form, Investigator Brochure, Patient diagnosis, Phase I and II trials report and Investigation Medical Product Document (IMPD) and Local Insurance Coverage for the no. of patients to be trialled. Any sort of queries raised by the regulatory authorities are addressed in coordination with consultant and sponsor.

- *Adverse Event / Serious Adverse Event:* Any Serious Adverse Event (SAE) occurring during the clinical trial due to the drug has to be immediately reported. The physician carrying out the clinical trial diagnoses the reason for SAE and evaluates if it has occurred due to the intake of medicine.

Any Serious Adverse event needs to be reported to DCGI within 14 calendar days of the incident. However, the same has to be reported immediately within 24 hours to sponsors and 7 working days to the ethical committee. In addition, information is reported to Parexel Group also so that the trials happening in other countries can be informed and for submission to various representative authorities in respective countries. There were few instances of SAE's reported by PI during the year.

4. **(b) Submission with DCGI and Ethical committee:** The entire documents mentioned above are submitted with DCGI and Ethical committee for approval. Parexel Clinical obtains all the approvals before commencement of the trials.

- *Import of drug samples:* Parexel Clinical through various agencies imports the drug sample for distribution to various hospitals conducting the clinical trials.
- *Site visit:* The clinical research associates of Parexel Clinical visit the site office and initiate the site for commencing the enrolment of patients. Thereafter the clinical research officer briefs regarding the entire protocol and explain the team.
- *Commencement of trials:* The physicians commence the clinical trials of patients and explain the patient regarding the entire trial process. The physicians obtain consent of the patient for undergoing the trial.
- *Follow up procedure:* The CRO follows up with the physicians and ensures if the study is being conducted as per the protocol. This requires the CRO to visit the hospitals and review the case sheet of the patients on a periodic basis. The monitoring report (CRF) is filled by the physician

5. **General Management Functions:** The functions addressed below are common functions that are carried out by any business irrespective of their size and type. These functions are drivers of every business and are indispensable in the economic environment.



- *Finance, Accounting and Legal Function:* The management of Parexel clinical is responsible for managing the finance, legal and accounting functions. Parexel clinical is also responsible for all local statutory compliance.
- *Human Resource Management Function:* The HR function at Parexel clinical is coordinated by its management, which is responsible for recruitment, development and training of the personnel including the emolument structure. In this respect, where appropriate, it is guided by AE policies.
- *IT Infra Group:* This group provides IT infrastructure support service to Parexel clinical.

### 5.3. Assets employed

Any business requires assets (tangible or intangible) without which it cannot carry out its activities. Intangibles play a significant role in the functioning of a business and are accordingly more important. An understanding of the assets employed and owned by Parexel Clinical provides an insight into the resources deployed by Parexel Clinical and their contribution to the business processes / economic activities of Parexel Clinical.

#### 5.3.1. Tangibles owned by Parexel Clinical

Parexel Clinical utilises its facilities, office premises, communication facilities, etc. for the purpose of its business. All assets of Parexel Clinical such as equipment, software tools etc. are either directly or indirectly used for the purpose of carrying out its operations<sup>17</sup>.

**Table 2: Assets owned by Parexel Clinical as on 31 March, 2016<sup>18</sup>**

S. No.	Particulars of assets	Amount (Rs.)
1	Computers equipment	2,87,96,695
2	Office equipment	1,10,11,396
3	Furniture and fixtures	4,83,359
4	Leasehold improvements	11,18,649
5	Software	15,44,569
	<b>Total</b>	<b>4,29,54,668</b>

#### 5.3.2. Intangibles

Parexel Clinical enjoys a non-exclusive, royalty free right to make use of trademarks and any other intellectual property owned by Parexel Group or its affiliates, to the extent necessary to support Parexel Clinical's operations.

Parexel Group has the right to supervise Parexel Clinical's use of any such trademarks or other intellectual property to the extent reasonably necessary to preserve the utility of such trademarks or other intellectual property and their legal protection.

<sup>17</sup> Based on the audited financial statements for FY 2015-16

<sup>18</sup> The amount represent the gross block of asset



## 5.4. Risks assumed

The risk profile of Parexel clinical vis-à-vis its AEs in relation to the international transaction is provided in Table 3 below:

**Table 3: Risk Profile**

Risk Category and Description	Exposures of Parexel Clinical	Exposures of AEs
<b>Market Risk:</b> Market risk arises for a business due to increased competition and relative pricing pressures, change in demand patterns and needs of customers, inability to develop / penetrate in a market, etc.	Parexel Clinical's function is limited to providing services to AEs for which it is remunerated on a cost-plus mark-up basis and it does not enter into any end customer contracts or render any services to third parties.	Market risks with respect to the clinical trial services are borne by Parexel Group since it holds the responsibility of marketing the services and maintain the customer relationship. Further, as R&D is an investment activity that yield results in 2-3 years, with fixed budget estimates, risks related to budget overruns are borne by Parexel Group.
<b>Service Liability Risk:</b> Risks associated with product / service failures including non-performance to generally accepted or regulatory standards. This could result in product recalls and possible injuries to end-users.	Parexel Clinical is indemnified with any failure occurred during the clinical trials by Parexel Group. Further being a captive service provider, all service liability risk is borne by Parexel Group.	Parexel Group remains liable / responsible to third party for any shortcomings arising during the trials. Therefore, the service liability risks are entirely borne by Parexel Group.
<b>Research &amp; Development ('R&amp;D') Risk:</b> Represents risk that R&D activities performed by an enterprise may not be successful.	Parexel Clinical does not bear research related risks. It follows the procedures provided by Parexel Group and hence it does not bear any risk on this account.	All Research activities are directly under the domain of Parexel Group and therefore the risks associated therewith are borne by it.
<b>Credit Risk:</b> This is the risk arising from default in payment of receivables by customers.	Parexel Clinical is assured of its payment from AE and hence does not bear any risk of non-payment for provisioning of facilitation and coordination services for clinical trial services provided.	Parexel Group provides clinical trial and research services to a number of customers worldwide, which might result in non-payments and bad debts. Hence, Parexel Group bears this risk.
<b>Foreign Exchange Risk:</b> This risk relates to the potential impact on profits that may arise because of changes in foreign exchange rates.	Since the contract terms between Parexel Clinical and Parexel Group is denominated in foreign exchange, Parexel Clinical is exposed to foreign exchange risk. However, the risk is minimised as Parexel Clinical includes any loss on account of foreign exchange in the cost for the purpose of invoicing to Parexel Group.	Parexel Group has business dealings with a number of companies in different parts of the world. Therefore, Parexel Group is exposed to foreign exchange risks.



### ***5.5. Characterisation***

Based on the facts as presented in the above analysis of functions performed, assets employed and risks assumed by Parexel Clinical, it is possible to characterize Parexel Clinical as a facilitator and coordinator for clinical trial services providing routine services to Parexel Group.

4. Based on the above, we shall consider the comparables sought for exclusion by the assessee which are as under:

- a) Icon Clinical Research India Pvt. Ltd. and
- b) Syngene International Ltd.

#### **5. Icon Clinical Research India Pvt. Ltd.**

5.1 The Ld.AR submitted that this company has a high level RPT transaction and hence liable to be excluded. It is the submission of the Ld.AR that this comparable has 100% RPT transaction whereas the Ld.TPO has applied filter of RPT transaction at 25%. He submitted that this comparable did not satisfy the filter applied by the Ld.TPO itself.

5.2 On the contrary, the Ld.DR referring to page 21 of the order u/s. 92CA, submitted that the objection of assessee was also raised before the Ld.TPO which were rejected. He thus submitted that as there is no functional dissimilarities between the assessee and this comparable, the company must be retained.

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

5.3 The annual report of this company is placed at pages 393-497 of the supplementary paper book. The details of the related party transaction has been disclosed at page 483 which are as under:

Particulars	FY 2015-16 (Rs.)	Paperbook References
Provision of Data Management services	1,59,82,47,326	Pg. no. 483
Provision of Clinical research services	18,20,13,431	
Provision of Lab Operations services	6,03,81,042	
<b>Total related party income (A)</b>	<b>1,84,06,41,799</b>	
Revenue from Operations (B)	1,84,06,41,799	Pg. no. 488
<b>RPT income/sales (A/B)</b>	<b>100.00%</b>	

5.4 We note that the DRP did not verify the computation of RPT by the assessee and that of the Ld.TPO. The Ld.TPO also did not consider the computation of RPT of this company as per the accounts aspect and therefore is remanded in the interest of justice. We direct the Ld.TPO to verify the same and to consider this comparable, only if the RPT transaction fits within the relevant criteria of 25% as applied by the Ld.TPO.

## **6. Syngene International Ltd.**

6.1 The Ld.AR submitted that, this comparable is engaged in providing contract research and manufacturing services. He submitted that this comparable has dedicated R&D centres, discovery services and development and manufacturing services. Development and manufacturing services includes manufacturing of molecules for clinical supplies and commercialization.

6.2 The Ld.AR referred to the annual report placed at pages 666 and 667 of the paper book wherein all the above details have been referred to. Further, he submitted that in the notes to the financial statement at page 743, this company also renders services in the stream of discovery chemistry and biology services, toxicology, pharmaceutical development, process

development / manufacture of advanced intermediates, active pharmaceutical ingredients and bio-therapeutics. We therefore direct the Ld.TPO to exclude this company from the list.

**Accordingly, Ground no. 4 raised by assessee stands allowed partly.**

**7. Ground no. 5** is raised by assessee seeking working capital adjustment. It is submitted that *Coordinate Bench of this Tribunal* in assessee's own case for A.Y. 2014-15 have granted Working Capital Adjustment by observing as under:

*"21. The next ground raised by the assessee is with respect to not granting working capital adjustment. The assessee for the relevant assessment year has considered 14.59% towards working capital adjustment taking State Bank of India's primary lending rate as the basis. The justification for such adjustment as given by the assessee in the TP study is that the effect on profits from investing in different levels of working capital must be taken into account for the purpose of comparison. The TPO rejected the working capital adjustment done by the assessee on the basis that the assessee has not been able to demonstrate that the working capital differences had impacted its profits and that the adjustment as done based on broad approximations estimations and assumptions which may not lead to reliable results. The assessee raised its objections before the DRP stating that the assessee acts as a facilitator and coordinator service provider in relation to Paraxel group assuming less than normal risk and accordingly the assessee does not bear any working capital risk since it is fully funded by its AE with no working capital contingencies. The DRP rejected the submissions of the assessee and confirmed the decision of the TPO.*

*22. With regard to the question whether working capital adjustment should be given or not, we find that the reasons given by the DRP for not allowing working capital adjustment are the same reasons as was given in the case of Huawei Technologies India Pvt. Ltd. v. JCIT [2019] 101 taxmann.com 313 (Bang. Trib.). In the aforesaid decision on an identical issue, the Tribunal held that working capital adjustment has to be given. The following are the relevant observations of the Tribunal :-*

*“10. The next grievance projected by the Assessee in its appeal is with regard to the action of the CIT (A) in not allowing any adjustment towards working capital differences. On this issue we have heard the rival submissions. The relevant provisions of the Act in so far as comparability of international transaction with a transaction of similar nature entered into between unrelated parties, provides as follows:*

*Determination of arm's length price under section 92C.*

*10B. (1) For the purposes of sub-section (2) of section 92C, the arm's length price in relation to an international transaction [or a specified domestic transaction] shall be determined by any of the following methods, being the most appropriate method, in the following manner, namely ;—*

*(a) to (b)\*\* \*\* \*\**

*(e) transactional net margin method, by which,—*

*(i) the net profit margin realised by the enterprise from an international transaction [or a specified domestic transaction] entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;*

*(ii) the net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;*

*(iii) the net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction [or the specified domestic transaction] and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;*

*(iv) the net profit margin realised by the enterprise and referred to in sub-clause (i) is established to be the same as the net profit margin referred to in sub-clause (iii);*

*(v) the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction [or the specified domestic transaction];*

*(f) \*\* \*\* \*\**

*(2) For the purposes of sub-rule (1), the comparability of an international transaction [or a specified domestic transaction] with an uncontrolled transaction shall be judged with reference to the following, namely:—*

*(a) the specific characteristics of the property transferred or services provided in either transaction;*

*(b) the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;*

*(c) the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;*

*(d) conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.*

*(3) An uncontrolled transaction shall be comparable to an international transaction [or a specified domestic transaction] if—*

*(i) none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market; or*

*(ii) reasonably accurate adjustments can be made to eliminate the material effects of such differences.*

*11. A reading of Rule 10B(l)(e)(iii) of the Rules read with Sec.92CA of the Act, would clearly shows that the net profit margin arising in comparable uncontrolled transactions has to be adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, which could materially affect the amount of net profit margin in the open market.*

*12. Chapters I and III of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (hereafter the "TPG") contain extensive guidance on comparability analyses for transfer pricing purposes. Guidance on comparability adjustments is found in paragraphs 3.47-3.54 and in the Annex to Chapter III of the TPG. A revised version of this guidance was approved by the Council of the OECD on 22 July 2010. In paragraph 2 of these guidelines it has been explained as to what is comparability adjustment. The guideline explains that when applying the arm's length principle, the conditions of*

*a controlled transaction (i.e. a transaction between a taxpayer and an associated enterprise) are generally compared to the conditions of comparable uncontrolled transactions. In this context, to be comparable means that:*

- ◆ None of the differences (if any) between the situations being compared could materially affect the condition being examined in the methodology (e.g. price or margin), or*
- ◆ Reasonably accurate adjustments can be made to eliminate the effect of any such differences. These are called "comparability adjustments."*

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

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

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

*15. A company with high levels of inventory would similarly need to either borrow to fund the purchase, or reduce the amount of cash surplus which it is able to invest. Note that the interest rate July 2010 Page 6 might be affected by the funding structure (e.g. where the purchase of inventory is partly funded by equity) or by the risk associated with holding specific types of inventory)*

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

◆ *A company will need funding to cover the time gap between the time it invests money (i.e. pays money to supplier) and the time it collects the investment (i.e. collects money from customers)*

◆ *This time gap is calculated as: the period needed to sell inventories to customers + (plus) the period needed to collect money from customers - (less) the period granted to pay debts to suppliers."*

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

15. *In the present case the TPO allowed working capital adjustment accepting the calculation given by the Assessee. The CIT (A) in exercise of his powers of enhancement held that no adjustment should be made to the profit margins on account of working capital differences between the tested party and the comparable companies for the following reasons:*

(i) *The daily working capital levels of the tested party and the comparables was the only reliable basis of determining adjustment to be made on account of working capital because that would be on the basis of working capital deployed throughout the year.*

(ii) *Segmental working capital is not disclosed in the annual reports of companies engaged in different segments and therefore proper comparison cannot be made.*

*(iii) Disclose in the balance sheet does not contain break up of trade and non-trade debtors and creditors and therefore working capital adjustment done without such break up would result in computation being skewed.*

*(iv) Cost of capital would be different for different companies and therefore working capital adjustment made disregarding this different based on broad approximations, estimations and assumptions may not lead to reliable results.*

*16. The CIT (A) also placed reliance on a decision of Chennai ITAT in the case of Mobis India Ltd. v. Dy. CIT [2013] 38 taxmann.com 231/[2014] 61 SOT 40. That decision was based on the factual aspect that the Assessee was not able to demonstrate how working capital adjustment was arrived at by the Assessee. Therefore nothing turns on the decision relied upon by the CIT (A) in the impugned order. In the matter of determination of Arm's Length Price, it cannot be said that the burden is on the Assessee or the Department to show what is the Arm's Length Price. The data available with the Assessee and the Department would be the starting point and depending on the facts and circumstances of a case further details can be called for. As far as the Assessee is concerned, the facts and figures with regard to his business has to be furnished. Regarding comparable companies, one has to fall back upon only on the information available in the public domain. If that information is insufficient, it is beyond the power of the Assessee to produce the correct information about the comparable companies. The Revenue has on the other hand powers to compel production of the required details from the comparable companies. If that power is not exercised to find out the truth then it is no defence to say that the Assessee has not furnished the required details and on that score deny adjustment on account of working capital differences. Regarding applying the daily balances of inventory, receivables and payables for computing working capital adjustment, the Delhi Bench of ITAT in the case of ITO v. E Value Serve.com [2016] 75 taxmann.com 195 (Delhi - Trib.). has held that insisting on daily balances of working capital requirements to compute working capital adjustment is not proper as it will be impossible to carry out such exercise and that working capital adjustment has to be based on the opening and closing working capital deployed. The Bench has also observed that that in Transfer Pricing Analysis there is always an element of estimation because it is not an exact*

science. One has to see that reasonable adjustment is being made so as to bring both comparable and test party on same footing. Therefore there is little merit in CIT (A)'s objection on working adjustment based on unavailable daily working capital requirements data. There is also no merit in the objection of the CIT (A) regarding absence of segmental details available of working capital requirements of comparable companies chosen and absence of details of trade and non-trade debtors of comparable companies as these details are beyond the power of the Assessee to obtain, unless these details are available in public domain. Regarding absence of cost of working capital funds, the OECD guidelines clearly advocates adopting rate(s) of interest applicable to a commercial enterprise operating in the same market as the tested party. Therefore this objection of the CIT (A) is also not sustainable.

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

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

*(i) none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged to paid in, or the profit arising from, such transactions in the open market; or*  
*(ii) reasonably accurate adjustments can be made to eliminate the material effects of such differences."*

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

*23. The aforesaid decision clearly lays down the proposition that working capital adjustment is to be given effect to while determining ALP while adopting TNMM method. Respectfully following the said decision, we allow this issue in favour of the assessee."*

Respectfully following the above, we direct the Ld.AO/TPO to compute the Working Capital Adjustment on actuals. The assessee has also sought risk adjustment in this ground which may be considered by the Ld.TPO only if the assessee is able to establish the difference in risk undertaken by assessee with the comparables that remains for computing the margin.

**Accordingly, this ground raised by assessee stands allowed.**

**8. Ground no. 6** is in respect of treating the recovery of pass-through costs by the assessee as operating in nature. Both sides submitted that this issue stands settled by the decision of *Coordinate Bench of this Tribunal* in assessee's own case for A.Y. 2013-14 in *ITA No. 2634/Bang/2017* by order dated 07/10/2021 which has been followed in Assessment Year 2014-15 in *ITA No. 3270/Bang/2018* by order dated 18.04.2022. We shall

reproduce the observations of this *Tribunal* in A.Y. 2013-14 on this issue which is as under:

*“52. Thus, new word ‘pass through cost’ was introduced to show the amount incurred by the assessee to be reimbursed by the parent company and called the investigation fees as part of pass through cost. The ld. AR argued that there is no investigation fees payable to assessee for the work done on behalf of parent company. In our opinion, the Addendum is w.e.f. 1.4.2012 wherein no date of execution is mentioned therein. The Addendum was solely made with an intention to evade payment of taxes and this is only a self-serving document by the assessee with the sole intention to evade taxes. Since both the parties were in a position to enter into this agreement being inter-related companies, that agreement cannot be given any credence which is a non-genuine and make believe story and it cannot be recognized as a true agreement and no benefit can be given on the basis of this agreement. Therefore, the lower authorities are justified in not giving any credence to this Addendum entered into by the assessee on the basis of which assessee has claimed that assessee is not entitled to receive any consideration for facilitating investigations. Further, it is to be noted that in the earlier years, investigator payments were reimbursed to the assessee with a mark-up. However, for the assessment year under consideration, it was treated as pass through cost under the head ‘recovery of expenses’ and there was no mark-up paid to the assessee. The assessee failed to explain why in this assessment year there was no mark-up on the investigator payments. The assessee only relied on the Addendum filed by the assessee, wherein it was mentioned that it was only pass through costs. As discussed earlier, this Addendum is only a make believe story and the AO has right to go beyond this document to find out the real intention of the parties. We observe that the real intention to this Addendum is different from what it appears ex facie. Hence, we have to proceed on the basis of the professed intention and the AO is justified in finding out the real intention of the parties by ignoring the apparent and the conceded intention was to evade the tax liability. The lower authorities merely removed the facade to expose the real intention of the parties cleverly cloaked and discovered the real intention was to evade the taxes and Addendum cannot be given effect and the overall arrangement made by the assessee was to evade the taxes. We are well aware that all commercial arrangements and documents or transactions*

*have to be given effect even though they result in avoidance of tax liability, provided that they are genuine, bonafide and not colourable transaction.”*

9. Considering the fact that there is no change in facts and the nature of pass-through costs being identical, respectfully following the above view taken by this *Tribunal*, in assessee's own case for A.Y. 2013-14, we hold that the recovery of expenses is a separate international transaction that needs to be determined and the Ld.TPO has rightly computed the markup of such transaction.

**Accordingly, this ground raised by assessee stands dismissed.**

Except for the above grounds and comparables, no other issues have been argued by the Ld.AR.

**10. Ground nos. 7 and 8** are consequential in nature and therefore do not require adjudication.

**In the result, the appeal filed by the assessee stands partly allowed.**

**Order pronounced in the open court on 21<sup>st</sup> October, 2022.**

Sd/-  
(CHANDRA POOJARI)  
Accountant Member

Sd/-  
(BEENA PILLAI)  
Judicial Member

Bangalore,  
Dated, the 21<sup>st</sup> October, 2022.  
/MS /

Copy to:

1. Appellant
2. Respondent
3. CIT

4. CIT(A)
5. DR, ITAT, Bangalore
6. Guard file

By order

Assistant Registrar,  
ITAT, Bangalore