

**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. 258/Bang/2022
Assessment Year : 2017-18

M/s. EIT Services India Pvt. Ltd., #39/40, Digital Park, Electronic City Phase II, Hosur Road, Bangalore – 560 100. PAN: AAACD4078L	Vs.	The Deputy Commissioner of Income Tax, Circle – 2(1)(1), Bangalore.
APPELLANT		RESPONDENT

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

Date of Hearing	:	01-11-2022
Date of Pronouncement	:	04-01-2023

ORDER

PER BEENA PILLAI, JUDICIAL MEMBER

Present appeal is filed by assessee against the final assessment order dated 14/02/2022 passed by NFAC, Delhi for A.Y. 2017-18 on following grounds of appeal:

“1. General Ground

1.1. The orders passed by learned Additional / Joint / Deputy / Assistant Commissioner of Income Tax/ Income-tax Officer, National e-Assessment Centre, Delhi (hereinafter referred as "AO" for brevity), learned Deputy Commissioner of Income Tax (TP) — 1(2)(1), Bangalore (hereinafter referred as "TPO" for brevity) and the learned Dispute Resolution Panel - 1, Bengaluru (hereinafter referred as "DRP" for brevity) ("AO", "TPO" and "DRP"

collectively referred as "lower authorities" for brevity) are bad in law and liable to be quashed.

2. Grounds relating to transfer pricing adjustments

2.1. The learned AO/TPO has erred in making an addition of Rs. 2,61,60,320 on account of adjustment in the arms-length price under section 92CA(3) in respect of business support services segment for the transactions entered by the Appellant with its associated enterprises.

2.2. The lower authorities have erred, in law and in facts, a) by not accepting the transfer pricing analysis of the Appellant prepared in accordance with the provisions of the Act read with the Rules

b) in conducting a fresh economic analysis for the determination of the ALP in connection with the impugned international transactions and holding that the Appellants international transactions were not at arm's length

c) in selecting comparables engaged in the business of marketing and related activities whereas the Appellant is engaged in providing business support functions.

2.3. The lower authorities have erred, in law and in facts, in inconsistently applying the filters and cherry picking the comparable companies.

2.4. The lower authorities have erred in law and in facts, by rejecting the following companies forming part of Appellant's transfer pricing study without providing any cogent reasons for the same:

a) Adecco India Private Limited

b) Anlage infotech India Private Limited

c) BNR Udyog Limited — BSS Segment

d) Husys Consulting Limited

e) International Manpower Resources Private Limited

f) MPCON Limited

g) Magma Advisory Services Limited

h) Talent Maximus India Private Limited

i) Teamlease Services Limited

j) Verifacts Services Private Limited

2.5. The lower authorities have erred in law and in facts, by accepting the following companies as comparable though the same were not comparable to the Appellant on FAR analysis

a) Goldmine Advertising Ltd.

b) Pressman Advertising Ltd.

c) Scarecrow Communications Ltd.

d) Ugam Solutions Pvt. Ltd.

e) Majestic Research Services & Solutions Ltd.

2.6. The lower authorities have erred in selecting only those comparable companies whose data for FY 2016-17

was available without appreciating that the said action of the lower authorities, is contrary to Rule 10B(5) and therefore bad in law.

2.7. The lower authorities have erred, in law and in facts, by not making suitable adjustment to account for the differences in working capital position of the Appellant vis-à-vis the comparables.

2.8. The lower authorities have erred in rejecting the methodology/workings provided by the Appellant for computing the risk adjustment without providing any cogent reasons.

3. Grounds relating to disallowance of ESOP expenditure under section 37

3.1. The learned AO/DRP have erred in disallowing stock compensation expenses of Rs.43,65,82,925 reimbursed to the ultimate holding company, under section 37 of the Act.

3.2. The learned AO/DRP have erred in not appreciating the fact that the Appellant has disallowed Rs. 43,21,85,369 in computing income from business and a deduction was claimed of actual amount paid to the ultimate holding company of Rs. 86,87,68,294.

3.3. The learned AO/DRP have erred in stating that
a) the stock compensation expenses reimbursed to the ultimate holding company are notional in nature.
b) the amounts are contingent and uncertain in nature.
c) irrespective of the above, the amounts are ought to be the losses suffered by the ultimate holding company and reimbursement of the same is a colorable device aimed at reducing tax burden

3.4. The learned AO/DRP have erred in not appreciating that stock compensation expenses reimbursed to the ultimate holding company are allowable as a deduction under section 37 of the Act.

3.5. The learned DRP has erred in not following the ratio laid down by the jurisdictional High Court in C IT v Biocon Limited (2021) 430 ITR 151 (Kar), Jurisdictional ITAT, Bangalore in the case of Nova Nordisk India Private Limited (ITA NO 1275/Bang/201 1) and Jurisdictional ITAT, Bangalore in the case of Northern Operating Services Private Limited [IT(TP)A No.759/Bang/20 I 7].

3.6. Without prejudice to the above, the learned AO has erred in concluding that impugned reimbursement made to the ultimate holding company involve a

component of income and thus tax ought to have been deducted under section 195 of the Act.

3.7. Without prejudice to the above, the learned AO has erred in disallowing the impugned expenses under section 40(a)(ia) of the Act for failure to deduct tax at source under section 195 of the Act.

3.8. Without prejudice to the above, the learned AO has erred in not appreciating that the impugned reimbursement is made purely on cost-to-cost basis with no element of income present therein. In the absence of any element of income, no tax is required to be deducted under section 195 of the Act.

3.9. Without prejudice to the above, the learned AO has erred in not appreciating that tax is deductible at source under section 192 of the Act in the event an employee exercises his options by treating it as perquisite in his hands.

3.10. On facts and circumstances of the case and law applicable, the impugned disallowance under section 37 and/or under section 40(a)(ia) of the Act is bad in law and liable to be deleted.

4. Ground relating to disallowance of education cess

4.1. The learned AO/DRP have erred in not allowing deduction for education cess and secondary and higher education cess amounting to Rs.10,33,98,059 in computing the total income for the year under consideration.

5. Ground relating to grant of refund of excess dividend distribution tax (DDT) paid

5.1. The learned AO/DRP have erred in not restricting the dividend distribution tax payable on dividend paid to Hewlett Packard Colorado BV; ES Gatriam Holding BV; and ES Berlin BV to the rate of 5% under Article 10 of the India — Netherlands DTAA read with Protocol under the said treaty and erred in not refunding the amount paid as dividend distribution tax in excess of 5% along with interest.

5.2. The learned AO/DRP have erred in not restricting the dividend distribution tax payable on dividend paid to Hewlett Packard Emmen BV and ES Global Soft Hold Co BV to the rate of 10% under Article 10 of the India — Netherlands DTAA and erred in not refunding the amount paid as dividend distribution tax in excess of 10% along with interest.

6. Levy of consequential interest under sections 234B and 234C

6.1. *The learned AO has erred in levying consequential interest under section 234B and under section 234C of the Act. On facts and circumstances of the case and law applicable, levy of consequential interest under section 234B and under section 234C is incorrect. The appellant denies its liability to pay the consequential interest under section 234B and under section 234C.*

7. Prayer:- *The Appellant prays that directions be given to grant all such relief arising from the grounds of appeal mentioned supra and all consequential relief thereto.*

The grounds of appeal raised by the Appellant herein are without prejudice to each other. The Appellant craves leave to add to and/or to alter, amend, rescind, modify the grounds herein above or produce further documents before or at the time of hearing of this Appeal. The Appellant prays accordingly.”

2. Brief facts of the case are as under:

2.1 Assessee is a private limited company engaged in the business of rendering software development services and information technology enabled services to its AE. It filed its return of income on 30/11/2017 declaring total income of Rs.13,06,75,53,670/- and book profits declared was at Rs.13,16,86,08,998/-. The return was processed by CPC and the case was selected for scrutiny. Statutory notices were issued in response to which representatives of assessee before the Ld.AO and filed requisite details as called for.

2.2 The Ld.AO observed that assessee had international transactions with its associated enterprises that exceeded Rs. 15 crores and therefore reference was made to the transfer pricing officer for determining the arm's length margin of the transactions.

2.3 On receipt of the reference, the Ld.TPO called for economic details of the international transaction in form 3CEB.

2.4 The Ld.TPO noted that assessee was engaged in providing following services to its AE:

Particulars	As per Form No. 3CEB
Provision of IT Enabled Services	6,51,60,05,635
Provision of support services	32,46,98,551
Provision of Software Development	35,60,61,58,709
Purchase of Fixed assets & Components	19,38,62,395
Purchase of software	13,335
Receipt of Support Services	20,75,01,164
ESOP Charges cross charged	86,87,68,294
Reimbursement of expenses	2,57,84,557

2.5 A search to identify independent comparable companies that perform similar function and carry a risk profile similar to that of EIT Services in respect of provision of IT, ITES and BSS was conducted. The following were the search results:

2.5.1. IT Benchmarking Result: The assessee considered 19 comparable companies in its TP Study for IT Services segment and the weighted average of the NCP was ranged from 3.75 percent (i.e., 35th percentile) to 10.14 percent (i.e., 65th percentile) with a median of 5.15 percent. For the FY 2016-17, the Assessee had earned a NCP of 15.88 and therefore the transaction was held to be within the arm's length range as of the IT Services.

2.5.2. ITES Benchmarking Result: The assessee considered 10 comparable in the TP Study for ITES segment, and the weighted average of the NCP was ranged from 5.33 percent (i.e., 35th percentile) to 14.73 percent (i.e., 65th percentile) with a median of 6.06 percent. For the FY 2016-17, the Assessee had earned a

NCP margin of 14.87 percent which is within the arm's length range as determined above, with respect to the ITES Services.

2.5.3. **BSS Benchmarking result:** The assessee considered 10 comparables in its TP study and computed the margin at 35th percentile being 4.96% as against 8% margin of assessee. The assessee has thus treated its transaction under BSS segment to be at arm's length.

2.6 The Ld.TPO rejected the transfer pricing study of assessee and shortlisted set of following 5 comparables under BSS segment.

1. Goldmine advertising Ltd.
2. Pressman advertising Ltd.
3. Ugam Solutions Pvt. Ltd.
4. Scarecrow Communications Ltd.
5. Majestic Research Services and Solutions Ltd.

2.6.1. The above 5 comparables had an average mean at 15.88% thereby the Ld.TPO proposed a shortfall at Rs.2,36,35,280/- as adjustment under BSS segment.

2.7. In respect of Software Development service segment and ITeS segment, the Ld.AO selected following comparables.

SWD

SI. No.	Company Name	F.Year wise OP/OC WO			Wt. Average
		2016-17	2015-16	2014-15	
1	Rheal Software Pvt. Ltd.	-12.27	3.28	3.01	-1.85
2	Kals Information Systems Ltd	1.37	3.97	5.77	3.62
3	Infomile Technologies Ltd.	10.22	9.91	11.12	10.43
4	Harbinger Systems Pvt Ltd	12.28	12.69	17.18	14.1
5	C G-V A K Software & Exports Ltd.	11.65	16.95	17.3	15.09

6	Larsen & Toubro Infotech Ltd.	20.78	19.21	23.98	21.14
7	Great Software Laboratory Pvt. Ltd.	27.18	20.24	10.67	21.24
8	Mindtree Ltd.	20.12	26.11	27.51	24.17
9	R Systems International Ltd.	16.74	31.05	26.44	24.40
10	Persistent Systems Ltd.	25.05	23.95	30.39	26.17
11	Tata Elxsi Ltd.	24.90	29.13	24.45	26.19
12	Infobeans Technologies Ltd.	23.89	34.98	20.46	26.44
13	Aptus Software Labs Pvt. Ltd.	24.83	27.67	26.72	26.46
14	Nihilent Ltd.	34.26	24.46	30.80	29.82
16	OFS Technologies Ltd.	19.88	26.47	67.57	29.93
15	Cygnnet Infotech Pvt. Ltd.	25.24	30.45	36.61	30.19
17	Infosys Ltd.	38.79	38.30	41.40	39.50
18	Threesixty Logics Testing Services Pvt. Ltd.	36.63	48.46	42.02	41.94
19	Cybage Software Pvt. Ltd.	41.89	62.90	68.68	57.82
20	Consilient Technologies Pvt. Ltd.	54.85	71.82	69.51	65.14
	35 th Percentile				21.24
	Median				26.18
	65 th Percentile				26.46

ITeS

Sl. No.	Company Name	F.Year wise OPIOC (%)			Wt. Average
		2016-17	2015-16	2014-15	
1	Sundaram Business Services Ltd.	9.21	0.99	-3.95	2.08
2	Jindal Intellicom Ltd.	8.66	2.78	11.07	7.41
3	Fuzen Software Pvt. Ltd	15.07	16.06	16.98	15.93
4	Microland Ltd.(seg)	18.72	14.02	19.30	17.53
5	Tech Mahindra Business Services Ltd.	18.51	19.09	29.92	22.37
6	Datamatics Business Solutions Ltd.	6.21	33.46	36.22	22.64
7	Infosys B P M Services Pvt. Ltd.	22.35	24.41	26.77	24.37
8	Vitae International Accounting Services Pvt Ltd	27.00	27.25	No data available	27.13

9	Manipal Digital Systems Pvt. Ltd.	30.16	22.65	29.89	27.41
10	CES Ltd.	31.21	34.18	27.93	31.45
11	Ultramarine & Pigment Ltd. (Seg.)	46.63	30.27	27.26	34.41
12	S P I Technologies India Pvt. Ltd.	37.61	40.70	32.18	36.95
13	Inteq B P O Services Pvt. Ltd.	36.64	48.47	32.81	39.51
	35th Percentile				22.37
	Median				24.37
	65th Percentile				27.41

The Ld.TPO thus proposed the shortfall as adjustment under SWD and ITeS segment at Rs.324,54,00,000/- and Rs.53,90,00,000/- respectively.

2.8. The total adjustment proposed by the Ld.TPO is as under:

Sl.No.	Description	Adjustment u/s. 92CA (In Rs.)
1	Software development segment	324,54,00,000
2	ITES segment	53,90,00,000
3	BSS Segment	2,36,35,280
Total adjustment u/s 92CA		380,80,35,280

2.9. On receipt of the transfer pricing order, the Ld.AO passed draft assessment order on 20/04/2021 by making further addition u/s.37 of Rs.43,65,82,925/- being the ESOP charge disallowed that was claimed by the assessee.

2.10. On receipt of the draft assessment order, assessee preferred objections before the DRP.

2.11. The DRP partly agreed with the submissions of the assessee in respect of the comparables sought for exclusion under SWD and ITeS segment. In respect of BSS segment, the DRP upheld the comparables by the Ld.TPO. However in respect of the disallowance made under ESOP expenses was upheld.

2.12. On receipt of the DRP directions, the Ld.AO passed the final assessment order.

2.13. The Ld.AO while passing the final assessment order, has disallowed the claim of refund of excess dividend distribution tax paid during the assessment year under consideration. In respect of transfer pricing addition, after following the DRP directions, the adjustment made under SWD and ITeS segment became Nil. In respect of the disallowance made under ESOP was added in the hands of the assessee.

Aggrieved by the final assessment order, the assessee has filed the present appeal before this *Tribunal*.

3. Before us, the Ld.AR submitted that assessee seeks to argue following grounds.

- **Ground no.2.4** wherein assessee seeks inclusion of 10 comparables under the BSS segment.
- **Ground no.2.5** – assessee seeks exclusion of 3 comparables under BSS segment being a) Scarecrow communications Ltd. b) Ugam Solutions Ltd. and c) Majestic Research Services and Solutions Ltd.
- **Ground no.3** is on disallowance of ESOP expenditure.
- **Ground no.5** is on disallowance of excess dividend distribution tax paid

3.1. The Ld.AR submitted that Ground no.4, 2.8 raised by assessee are not pressed and Ground nos. 1-2.3, 2.6 are general in nature.

Accordingly these grounds do not require any adjudication and are dismissed.

4. Before we do the comparability analysis, it is *sine qua non* to understand the functions performed by assessee, assets owned

and risks assumed by assessee under the Business Support Service segment.

4.1. Under the Business Support Service segment, assessee provides services to its AEs on the projects and has charged a mark-up of 8% on its operating cost. It is also been submitted in the transfer pricing study at page 721 of the paper book that assessee is rendering back office captive services to the AEs that bears substantially low business risk.

4.2. Based on the above, we shall undertake the comparability analysis of the assessee with the comparables sought for inclusion / exclusion in Ground nos. 2.4-2.5.

5. In Ground no. 2.4, the assessee is seeking the inclusion of the Adecco India Private Limited, Anlage infotech India Private Ltd, BNR Udyog Limited — BSS Segment, Husys Consulting Ltd, International Manpower Resources Private Ltd, MPCON Limited, Magma Advisory Services Ltd, Talent Maximus India Pvt Ltd, Teamlease Services Ltd, Verifacts Services Pvt Ltd in the list of comparables.

5.1. It is submitted that these companies are engaged in providing BSS services which were not considered by the Ld.TPO, as they did not appear in the search matrix carried out by him, which has been upheld by the DRP.

5.2 On similar situation, we have remanded the comparable to the Ld.AO/TPO for fresh consideration herein above following the decision of coordinate bench of this *Hon'ble Tribunal* in the case of *Prism Networks Pvt. Ltd. reported in (2022) 141 taxmann.com 163*.

Accordingly, these grounds raised by assessee stands allowed for statistical purposes.

6. Ground no. 2.5 – Assessee seeks exclusion of Ugam Solutions Pvt. Ltd., Majestic Research Services & Solutions Ltd. and Scarecrow Communications Ltd.

6.1. It is submitted that the *Coordinate Bench of this Tribunal* in case of *Epson India Pvt. Ltd. vs. DCIT* in *IT(TP)A No. 206/Bang/2021* by order dated *14/07/2022* in an identical circumstances, had considered exclusion of these comparables in case of captive service provider. The Ld.AR submitted that assessee in the present facts is only rendering support services to its AEs on the projects on which a mark-up is charged. The Ld.AR relying on the order of *Coordinate Bench of this Tribunal* submitted that the 3 comparables sought for exclusion deserves to be excluded as they are functionally not similar with assessee.

6.2. The Ld.DR on the contrary, could not controvert the observations in respect of the factual dissimilarity observed by the *Coordinate Bench of this Tribunal* in case of *Epson India Pvt. Ltd. vs. DCIT (supra)* vis-a-vis the functions of the assessee.

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

6.3. We note that this Tribunal while considering the case in *Epson India* has recorded that *Epson* was a captive service provider functioning with insignificant risk. In respect of the comparables alleged by the assessee hereinabove, this Tribunal observed as under:

“20.1 Ugam Solutions Pvt. Ltd.

20.1.1 Ld.AR submitted that, complete set of annual report of this comparable is not available in public

domain. He submitted that relevant extract of database available from website are placed at page 304-306 of Paper Book I. This company has been stated to be operating in one primary segment being managed analytics. He submitted that this company even otherwise going by the website information is functionally not similar with that of the assessee, as the clientele of this company services and provides solutions to global market research firms which include research operations, technology infrastructure transition, data warehousing aggregation and visualisation, sample management optimisation, global program management, custom panel solution, reporting solution and mobile solutions etc. He thus submitted that this comparable is functionally not similar with that of the assessee, who is a captive service provider and provides limited functions required by the associated enterprise.

20.1.2 Ld.CIT DR relied upon authorities below.

20.1.3 We have perused submissions advanced by both sides on the basis of records placed before us. Admittedly this company is into managed analytical services and provides solutions to global market research firms, retailers, leading brands as has been observed by DRP in para 8.2.1. On comparing the functions rendered by the assessee to the associated enterprise, this company cannot be a fit comparable, due to functional dissimilarities and risk assumed by this company.

Accordingly we direct this comparable to be excluded from the final list.

20.3 Majestic Research Services & Solutions Ltd.

It is submitted that this comparable is a market research agency relying exhaustively on usage of technology for data acquisition, it offers a wide range of quantitative and qualitative research both nationally and internationally. The company focuses on market research, advertising research, and brand research, thus making it entirely different from the services provided by Epson India to its associated enterprises.

The Ld.AR submitted that this is functionally different and not be considered a comparable to business support services segment of the assessee.

The Ld.AR also submitted that this company fails RPT filter of 25% of sales adopted by the Ld.TPO. In support he referred to page 309 of Paper Book-I. We are of the view that this company is rendering advertisement functions which are not akin to Business Support Services rendered by the assessee.

Therefore we do not hold this comparable to be included in the final list. Accordingly this comparable is directed to be excluded from the final list.

20.4 Scarecrow Communications Ltd.

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

This company is rendering service pertaining to advertisement in radio and television and public shows which are different from the business support service rendered by the assessee. Pages 315-316 of Paper Book Vol. I gives the details of revenue generated by this comparable. Further, this comparable is rendering services not on the similar profile as that of assessee. Therefore we do not hold this comparable to be included in the final list. Accordingly this comparable is directed to be excluded from the final list.

Accordingly ground nos. 11(iv) raised by assessee stands allowed.

Respectfully following the above, we direct the Ld.TPO to exclude these comparables from the final list.

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

7. **Ground no.2.7** raised by assessee is for providing with appropriate working capital adjustment that was not granted while computing the margins.

7.1 It has been submitted by Ld.AR that working capital and risk adjustment has been denied to assessee on the ground that assessee failed to demonstrate such differences could have any impact on assessee's profit. It has been submitted by Ld.AR that the submissions advanced by assessee demonstrating computational impact has not been considered by the Ld.AO/TPO.

7.2 Before us, Ld.AR submitted that it is an accepted principle upheld in various decisions of this *Tribunal* that working capital adjustment should be allowed on actual. It has been submitted

that all relevant details for computation of working capital was provided to AO/DRP which has been disregarded. He placed reliance upon the decision of coordinate bench of this *Tribunal* in case of *Huawei Technologies India (P.) Ltd. v. Jt. CIT* reported in (2019) 101 *taxmann.com* 313, wherein it has been held that the working capital has to be granted in actual.

7.3 On the contrary, Ld.CIT DR placed reliance upon orders passed by authorities below.

7.4 We have perused submissions advanced by both sides in light of records placed before us including the decision relied upon by Ld.AR in case of *Huawei Technologies India Pvt. Ltd. (supra)*.

7.5 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.

7.6. Chapters I and III of OECD Transfer Pricing Guidelines contain guidelines on comparability analyses for transfer pricing purposes. Guidelines on adjustments to be provided is found in paragraphs 3.47-3.54 and in the Annex to Chapter III. The guidelines must be followed for computing arm's length principle, and for comparing comparable uncontrolled transactions. Reasonably accurate adjustments should be made to eliminate effect of any such differences.

7.7. Paragraphs 13 to 16 of OECD guidelines, emphasizes need for working capital adjustment in terms of receivables and payables as under:

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

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

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

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

- A company will need funding to cover the time gap between the time it invests money (i.e. pays money to supplier) and the time it collects the investment (i.e. collects money from customers)*
- This time gap is calculated as: the period needed to sell inventories to customers + (plus) the period needed to collect money from customers - (less) the period granted to pay debts in suppliers"*

7.8. The reverse applies to huge accounts payable. By having 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. 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. 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. Methodology to compute working capital adjustment is given in Paragraphs 13 to 16 of the aforesaid *OECD Guidelines (supra)*. These guideline also indicate factors that needs to considered like;

7.9. The point in time at which the Receivables, Inventory and Payables should be compared between tested party and comparables, and whether it should be the figures of receivables, inventory payable at the yearend or beginning of the year or average of these figures that should be considered,;

7.10. 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 Department should 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 its business must be furnished. In so far as applying inventory, receivables and payables for computing working capital adjustment alleged by DRP/TPO in case of certain comparables, *Hon'ble Delhi Bench* in case of *ITO v. E Value Servc.com* reported in (2016) 75 *taxmann.com* 195 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.

7.11. It must not be forgotten that transfer pricing analysis is estimation and not an exact science. One has to see that, reasonable adjustment must be made where ever it is needed, so as to bring both comparable and test party on same footing. In present facts of case, DRP may be correct in denying working adjustment due to unavailability required data, however there is no merit in observations of DRP/TPO as supported by Ld.CIR DR, in denying working capital adjustment due to absence of details for working out adjustments in comparable companies chosen. If we appreciate the argument advanced by Ld.CIT.DR, there would remain no comparables for the purpose of comparability analysis to determine ALP of an international transaction, and this would be fatal to entire exercise of transfer pricing analysis.

7.12. Regarding comparable companies, one has to fall back upon only on information available in public domain. If that information is insufficient, it is beyond the power of the assessee to produce correct information about comparable companies. Revenue on the other hand has sufficient powers u/s.133(6) to

compel production of required details from comparable companies. If this power is not exercised to find to get information required, then it is no defense to say that Assessee has not furnished required details to deny any adjustment on account of working capital differences. Therefore this objection of DRP is not sustainable. Therefore in, endeavor should be made to bring in comparable companies for the purpose of broad comparison and working capital adjustment claimed by Assessee should be analysed, keeping in mind, OECD guidelines (supra).

7.13. Based on the above discussions, and respectfully following decision of coordinate Bench of this *Tribunal* in the case of *Huawei Technologies India (P.) Ltd. (supra)*, we direct working capital adjustment to be computed and to allow as per actual, after considering exclusion/inclusion of comparable companies in the final set of comparables as discussed hereinabove.

Accordingly this ground raised by assessee stands allowed.

8. **Ground no. 3** is in respect of the ESOP expenditure denied u/s. 37.

8.1. The Ld.AR submitted that the Ld.AO disallowed the expenditure on ESOP at Rs.43,65,82,952/- u/s. 37 of the Act by holding it to be a colourable device adopted for avoidance of tax.

8.2. The Ld.AR submitted that the employees of the assessee was eligible to participate in share based compensation scheme of the ultimate holding company, whereby the shares of the ultimate holding company are granted to the employees of the assessee on satisfying certain conditions. It was stated that the shares were issued below market price and the discounted value was treated as perquisite u/s 17(2) of the I.T.Act in the hands of

the employees and assessee had deducted appropriate TDS u/s 192 of the I.T.Act. It was stated that to the extent of discount, the holding company had cross charged the assessee. It was stated that it is in respect of cross charges incurred towards options exercised and shares purchased by employees of the assessee, the same was claimed as deduction u/s 37 of the I.T.Act. The A.O., however, held that ESOP expenditure booked by the assessee and reimbursed to the holding company is a fictitious expenditure and notional in nature. Though the A.O. had mentioned about the violation of the provisions of section 195(1) of the I.T.Act and consequent disallowance u/s 40(a)(i) of the I.T.Act, the A.O. held that the assessee has not satisfied conditions specified u/s 37 of the I.T.Act for claiming such expenditure. The objections filed before the DRP was rejected and the DRP agreed by the conclusions drawn by the A.O.

8.3. Aggrieved, the assessee has raised this issue before the *Tribunal*. The Ld.AR submitted that, the issue raised is squarely covered by the order of the *Tribunal* in assessee's group case in *EIT Services India Pvt. Ltd. v. DCIT (supra)*. It was stated that the *Tribunal* in the above mentioned case, had followed the dictum laid down by the *Hon'ble jurisdictional High Court* in the case of *CIT v. Biocon Limited* reported in *121 taxmann.com 351*, wherein it was categorically held that ESOP expenditure is deductible u/s 37 of the I.T.Act.

8.4. The Ld.DR was unable to controvert the submissions of the Ld.AR.

8.5. We have heard rival submissions and perused the material on record. In assessee's group case, namely, *EIT Services India*

Pvt. Ltd. v. DCIT (supra), had held that the ESOP expenditure is to be allowed as a deduction u/s 37 of the I.T.Act. The Tribunal had followed the judgment of the *Hon'ble jurisdictional High Court* in the case of *CIT v. Biocon Ltd (supra)*. The relevant finding of the *Tribunal* in assessee's group case, reads as follows:-

"20.27 We have heard the rival submissions and perused the materials available on record. This issue came up for consideration before the Hon'ble Karnataka High Court in the case of CIT Vs. Biocon Ltd. cited (supra) wherein it was held as under:-

"From a perusal of section 37(1) of the Income-tax Act, 1961 it is evident that the provision permits deduction of expenditure laid out or expended and does not contain a requirement that there has to be a payout. If an expenditure has been incurred, section 37(1) of the Act would be attracted. Section 37 does not envisage incurrence of expenditure in cash.

An assessee is entitled to claim deduction under the provision if the expenditure has been incurred. It is well settled in law that if a business liability has arisen in the accounting year, it is permissible as deduction, even though, the liability may have to be quantified and discharged at a future date.

Section 2(15A) of the Companies Act, 1956, defines "employees stock option" to mean option given to whole time directors, officers or the employees of the company, which gives such directors, officers or employees, the benefit or right to purchase or subscribe at a future rate to securities offered by the company at a pre-determined price. In an employees stock option plan a company undertakes to issue shares to its employees at a future date at a price lower than the current market price. The employees are given stock options at a discount and the same amount of discount represents the difference between market price of shares at the time of grant of option and the offer price. In order to be eligible for acquiring shares under the scheme, the employees are under an obligation to render their services to the company during the vesting period as provided in the scheme. On completion of the vesting period in the service of the company, the option vests with the employees.

The expression "expenditure" also includes a loss and therefore, issuance of shares at a discount where the assessee absorbs the difference between the price at which they are issued and the market value of the shares would be expenditure incurred for the purposes of section 37(1). The primary object of the exercise is not to waste capital but to earn profits by securing consistent services of the employees and therefore, it cannot be construed as short receipt of capital.

Held, dismissing the appeal, that the deduction of the discount on the employees stock option plan over the vesting period was in accordance with the accounting in the books of account, which had been prepared in accordance with Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999. For assessment year 2009-10 onwards the Assessing Officer had permitted the deduction of the employees stock option plan expenses. The Revenue could not be permitted to take a different stand with regard to the assessment year 200405. The expenses were deductible."

21. *In view of the above judgement of Hon'ble Karnataka High Court in the case of Biocon Ltd., we are in agreement with the contention of assessee's counsel in principle on this issue. However, we make it clear that the AO has to verify whether the said amount has been subject to TDS in the assessment year under consideration u/s 192/195 of the Act as argued by the Ld. A.R. before us. Accordingly, this issue is remitted to AO for fresh consideration in the light of above."*

8.6 The assessee has raised without prejudice ground on the issue that the assessee is not liable for TDS u/s 195 of the I.T.Act (refer grounds 3.8 to 3.10). We are of the view that these grounds need not be adjudicated, since, on perusal of the final assessment, it is clear that the disallowance of ESOP expenses has made under the provisions of section 37 of the I.T.Act (though there was some discussion in the draft assessment order with reference to disallowance u/s 40(a)(i) of the I.T.Act).

Therefore, grounds 3.1 to 3.7 are allowed and grounds 3.8 to 3.10 are not adjudicated.

9. Ground no. 5 is in respect of the excess dividend distribution tax disallowed by the Ld.AO.

9.1 This issue has been pending before *Hon'ble Special Bench* which is yet to be decided.

9.2 We accordingly remit this issue to the Ld.AO to consider the claim in accordance with the decision of *Hon'ble Special Bench*.

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

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

Order pronounced in the open court on 04th January, 2023.

Sd/-
(CHANDRA POOJARI)
Accountant Member

Sd/-
(BEENA PILLAI)
Judicial Member

Bangalore,
Dated, the 04th January, 2023.
/MS /

Copy to:

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

By order

Assistant Registrar,
ITAT, Bangalore