

आयकर अपीलीय अधिकरण, हैदराबाद पीठ में  
IN THE INCOME TAX APPELLATE TRIBUNAL  
HYDERABAD BENCHES "A", HYDERABAD

BEFORE  
SHRI RAMA KANTA PANDA, VICE PRESIDENT  
&  
SHRI K. NARASIMHA CHARY, JUDICIAL MEMBER

आ.अपी.सं / ITA No. 225/Hyd/2021  
(निर्धारण वर्ष / Assessment Year: 2016-17)

Medtronic Engineering and Innovation Centre Private Limited,  
Hyderabad  
[PAN No. AA ECC3572C]

Vs. DCIT, Circle-5(1),  
Hyderabad

अपीलार्थी / Appellant

प्रत्यर्थी / Respondent

निर्धारिती द्वारा / Assessee by: Shri Aliasgar Rampurwala and  
Shri Pratik, ARs

राजस्व द्वारा / Revenue by: Ms. TH. Vijaya Lakshmi, CIT-DR

सुनवाई की तारीख / Date of hearing: 14/02/2024

घोषणा की तारीख / Pronouncement on: 06/03/2024

आदेश / ORDER

**PER K. NARASIMHA CHARY, J.M:**

Aggrieved by the final assessment order dated 09/04/2021 passed consequent to the directions of Hon'ble Dispute Resolution Panel, Bengaluru ("DRP"), in the case of Medtronic Engineering and Innovation Centre Private Limited, ("the assessee") for the assessment year 2016-17, under section 143(3) r.w.s. 144C(13) r.w.s. 143(3A) & 143(3B) of the Income Tax Act, 1961 (for short "the Act"), assessee filed this appeal.

2. Though this appeal has been filed on as many as 11 grounds, at the time of arguments, all the grounds except the grounds relating to working capital adjustment and interest on External Commercial Borrowing (ECB) are given up. Now what remains to be adjudicated are these two grounds only.

3. Insofar as the working capital adjustment is concerned, it was denied by the Revenue authorities on the grounds that the assessee has not demonstrated that the working capital differences had impacted its profits; that the segmental working capital is not disclosed in the annual reports of the comparable companies; and that cost of capital is different for different companies.

4. Learned AR submitted that under identical circumstances, the issue of grant of working capital adjustment has been considered by the Co-ordinate Benches of the Tribunal and it is granted. He brought it to our notice that the assessee furnished all the relevant information and working before the learned Transfer Pricing Officer (learned TPO) at page No. 325 to 337 at paper book under the head 'computation of working capital adjustment', but it missed the attention of both the Revenue authorities. He placed reliance on the view taken by a Co-ordinate Bench of the Tribunal in the case of Parexel International Clinical Research (P.) Ltd. vs. ACIT [2023] 152 taxmann.com 355 (Bangalore - Trib.) and also Parexel International (India) Private Limited [2023] 156 taxmann.com 609 (Hyderabad-Trib.).

5. Learned DR placed reliance on the orders of the Revenue authorities and more particularly the observations of the learned DRP at paragraph No. 2.6 of the learned DRP's directions, which read as follows:

*“2.6 Ground of objection No.6:*

*Objection No. 6.:1.: On the facts and circumstances of the case, and in law, Ld. TPO / Ld. AO erred in not granting working capital adjustment*

*2.6.1 Having considered the submissions, we note that Rule 10B provides for making reasonably accurate adjustment to the uncontrolled comparable transaction to eliminate the material effects of differences on the price, cost or profits. The assessee has argued for working capital adjustment contending that there exist differences in the payable and receivable position between the assessee and the comparables. However, it was not demonstrated with any data or information as to the impact of such difference on the price, cost or profits and as to whether such difference materially affects the price, cost or profits. The 'Accounts payables' and 'Receivables' shown in the balance sheet only reflects the position as at the end of the financial year, and as such it would not enable to measure the impact of working capital on the costs, price or profits. The working capital requirements and impact depends on various factors such as business cycle the nature of business activity with its correlation on the general economic trends, the fund and capital position of the company, its marketing strategies, its market share etc. all of which cannot be captured in the year end Receivable or Payable position. Besides, the 'Payable' and 'Receivable' position stated in the Balance Sheet may not exactly reflect as to whether it arises from transaction relating to Revenue Account or Capital Account as there is no uniformity in the accounting or reporting requirements, and an intermixing is generally possible. The cost ascribable to the working capital would be different to different enterprises depending on the cost of fund to the enterprise; the cost of money in the economy it operates etc. In view of these, a reasonable accurate adjustment is not possible, as the differences in working capital requirements itself is based on various assumptions. Besides, we also note that the- assessee had failed to demonstrate such material differences so as to warrant an adjustment. In these circumstances, we are inclined to uphold the TPO's reasoning and reject the assessee's claim for working capital adjustment.”*

6. We have gone through the record in the light of the submissions made on either side. In the paper book vide page Nos. 325 to 337, the assessee had given the computation of working capital adjustment and in

the orders of the Revenue authorities, this material has not been referred to. As extracted supra, the learned DRP went on to say that it was not demonstrated with any data or information as to the impact of such difference on the price, cost or profits, and as to whether such difference materially affects the price, cost or profits. It further observed that the 'Accounts payables' and 'Receivables' shown in the balance sheet only reflects the position as at the end of the financial year, and as such it would not enable to measure the impact of working capital on the costs, price or profits, and the working capital requirements and impact depends on various factors such as business cycle the nature of business activity with its correlation on the general economic trends, the fund and capital position of the company, its marketing strategies, its market share etc. all of which cannot be captured in the year end Receivable or Payable position. According to the learned DRP, the 'Payable' and 'Receivable' position stated in the Balance Sheet may not exactly reflect as to whether it arises from transaction relating to Revenue Account or Capital Account as there is no uniformity in the accounting or reporting requirements, and an intermixing is generally possible, and the cost ascribable to the working capital would be different to different enterprises depending on the cost of fund to the enterprise; the cost of money in the economy it operates etc.

7. In the cases of Parexel International Clinical Research (P.) Ltd. and also Parexel International (India) Private Limited (supra), the identically worded observations of the learned DRP were considered and a Co-ordinate Bench of the Tribunal thought it fit to set aside the issue to the file of the learned Assessing Officer/learned TPO to decide the issue afresh, after considering the information furnished by the assessee. For the sake

of completeness and also for ready reference, we deem it just and proper to reproduce the relevant observations of the Bangalore Bench of the Tribunal in the case of Parexel International Clinical Research (P.) Ltd. (supra),-

*“8.1 The Id. DRP observed that Rule 10B provides for making reasonably accurate adjustment to the uncontrolled comparable transaction to eliminate the material effects of differences on the price, cost or profits. The assessee has argued for working capital adjustment contending that there exist differences in the payable and receivable position between the assessee and the comparables. However, it was not demonstrated with any data or information as to the impact of such difference on the price, cost or profits, and as to whether such difference materially affect the price, cost or profits. The 'Accounts payables' and 'Receivables' shown in the balance sheet only reflects the position as at the end of the financial year, and as such it would not enable to measure the impact of working capital on the costs, price or profits. The working capital requirements and impact depends on various factors such as business cycle, the nature of business activity with its correlation on the general economic trends, the fund and capital position of the company, its marketing strategies, its market share etc. all of which cannot be captured in the year end Receivable or Payable position. Besides, the 'Payable' and 'Receivable' position stated in the Balance Sheet may not exactly reflect as to whether it arises from transaction relating to Revenue Account or Capital Account as there is no uniformity in the accounting or reporting requirements, and an intermixing is generally possible. The cost ascribable to the working capital would be different to different enterprises depending on the cost of fund to the enterprise, the cost of money in the economy it operates etc. In view of these, a reasonable accurate adjustment is not possible, as the differences in working capital requirements itself is based on various assumptions. Besides, the assessee had failed to demonstrate such material differences so as to warrant an adjustment. In these circumstances, the Id. DRP inclined to uphold the TPO's reasoning and rejected the assessee's claim for working capital adjustment. Against this assessee is in appeal before us.*

*9. After hearing both the parties, we are of the opinion that similar issue came for consideration before this Tribunal in Parexel International Clinical Research (P.) Ltd. v. Dy. CIT [IT (TP) Appeal No.*

3270 (Bang.) of 2018, in assessee's own case vide order dated 18-4-22] wherein held as under:

"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;



*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."*

The above view is followed by the Hyderabad Bench of the Tribunal in the case of Parexel International (India) Private Limited (supra) and the learned Assessing Officer/learned TPO was directed to grant working capital adjustment after obtaining and considering the relevant information from the assessee.

8. Since the view taken in the cases of Parexel International Clinical Research (P.) Ltd. and also Parexel International (India) Private Limited (supra) is directly and substantially on the issue of allowability of working capital adjustment under identical circumstances, while respectfully following the same, we set aside the issue to the file of the learned Assessing Officer/learned TPO to decide the issue afresh, after considering the information furnished by the assessee.

9. Coming to the other issue under contest, it relates to the benchmarking of the interest paid on ECBs. Revenue authorities recorded that the taxpayer paid interest on ECB loan at 11.75% on the average loan amount of Rs. 508,78,85,130/- during the financial year 2015-16, after taking into the foreign exchange fluctuation. According to the learned TPO, this rate of interest cannot be accepted, because it works out to the interest rate of LIBOR+275 points. Learned TPO placed reliance on the decisions of the Co-ordinate Bench of the Tribunal in the case of Dr. Reddy's Laboratories Ltd. vs. CIT in ITA No. 2229/Hyd/2011 & 85/Hyd/2013, by order dated 02/01/2017 and Infotech Enterprises Limited vs. Addl.CIT in ITA No. 115/Hyd/2011, by order dated 16/01/2014 and reached a conclusion that the interest rate at LIBOR+200 points would be the proper arm's length interest rate and determined the excess interest at Rs. 10,74,705/-. According to the learned DRP if the loan is for a term for five years, then the interest rate could be of spread of 300 basis points, but since the term of the loan of the assessee is only for four years, interest rate paid by the assessee is beyond the prescribed interest rate as per RBI guidelines and it shall be below LIBOR+200 basis points.

10. It is the submission of the learned AR that there is a factual error in the findings of the learned DRP that the term of loan of assessee is for four years, but as a matter of fact, it is for five years and, therefore, the spread of bps points could be 300. He further submitted that for the assessment years 2012-13 and 2013-14, the learned TPO accepted the transaction of payment of interest on ECB at LIBOR+2.75%.

11. Learned DR heavily relied on the orders of the Revenue authorities.

12. We have gone through the record in the light of the submissions made on either side. There is no denial of the fact that the term of the impugned ECB loan is not four years, but five years, and as observed by the learned DRP, such loan can have a spread of 300 bps. We have also perused the copies of the orders dated 29/01/2016 and 30/09/2016 under section 92CA(3) of the Act, evidencing the fact that the assessee paying interest on ECB loan at LIBOR+2.75% was accepted. In these circumstances, we find that the payment of interest on ECB by the assessee at LIBOR+275 basis points need not be interfered with. Ground is accordingly allowed.

13. In the result, appeal of the assessee is partly allowed for statistical purposes.

Order pronounced in the open court on this the 6<sup>th</sup> day of March, 2024.

Sd/-  
**(RAMA KANTA PANDA)**  
**VICE PRESIDENT**

Sd/-  
**(K. NARASIMHA CHARY)**  
**JUDICIAL MEMBER**

Hyderabad, Dated: 06/03/2024

TNMM

Copy forwarded to:

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2. The DCIT, Circle-5(1), Hyderabad.
3. The Dispute Resolution Panel (DRP), Bengaluru.
4. The Director of Income Tax (IT & TP), Hyderabad.
5. The Addl. Commissioner of Income Tax (Transfer Pricing), Hyderabad.
6. DR, ITAT, Hyderabad.
7. GUARD FILE.

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ITAT, HYDERABAD