आयकर अपीलीय अधिकरण, हैदराबाद पीठ में

IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCHES "A", HYDERABAD
BEFORE
SHRI MANJUNATHA G., ACCOUNTANT MEMBER
&
SHRI K.NARASIMHA CHARY, JUDICIAL MEMBER

आ.अपी.सं / **ITA No.2379/Hyd/2018**
(निर्धारण वर्ष / Assessment Year: 2014-15)

OSI Systems Private Limited Hyderabad [PAN : AAACO4438M]	Vs.	Dy.Commissioner of Income Tax, Circle-16(2), Hyderabad
अपीलार्थी / Appellant		प्रत्यर्थी / Respondent

निर्धारिती द्वारा/Assessee by: Shri Darpan Kirpalani, AR
राजस्व द्वारा/Revenue by: Shri B.Balakrishna, CIT-DR

सुनवाई की तारीख/Date of hearing: 01/10/2024
घोषणा की तारीख/Pronouncement on: 09/10/2024

आदेश / ORDER

PER K. NARASIMHA CHARY, J.M:

Aggrieved by the assessment order dated 26/10/2018 passed consequent to the directions of Hon'ble Dispute Resolution Panel, Bengaluru ("DRP") in the case of OSI Systems Private Limited ("the assessee") for the assessment year 2014-15, under section 143(3) r.w.s. 92CA(3) of the Income tax Act, 1961 ("the Act"), assessee preferred this appeal.

2. Assessee is engaged in manufacture of optoelectronic components, provision of software services, provision of IT enabled services (ITeS) and distribution of medical equipment. For the assessment year 2014-15, assessee filed the return of income on 29/11/2013 declaring an income of Rs.14,35,91,640/-. Assessee has been in the certain international transactions with its Associated Enterprises ("AEs") and for the purpose of this appeal provision of software services and provision of IT enabled services are relevant. Assessee carried out the economic analysis and summarized the same to state that the volume of the provision of software services was about Rs.19.91 crores and the provision of IT enabled services was about Rs.6.96 crores. Assessee adopted TNMM as the most appropriate method and taking OP by OC as PLI, calculated its margin at 17.95% in respect of provision of software services and 20.25% in respect of provision of IT enabled services. Assessee selected 22 comparables in respect of provision of software services and determined the margin of the comparables at 17.54% whereas it selected 11 comparables and determined the margin at 19.05% in respect of the provision of IT enabled services.

3. Learned Assessing Officer rejected the taxpayer's TP study conducted fresh search finally proposed 13 comparables, which the assessee objected apart from proposing some more comparables by the assessee. It could be seen from the impugned order that the assessee pleaded before the Learned Transfer Pricing Officer (TPO) that the company is with the turnover filter of rupees one crore to Rs.200 crores should alone be considered as comparables. But the learned TPO based on the view of the Mumbai Bench of the Tribunal in the case of Willis processing services (I) P.Ltd vs. DCIT (TS-49-ITAT-2013 (mum)-TP) and held that the turnover band of Rs.1 to Rs.200 crores is bereft of any rationality as the application of this rule does not enable comparison of a company with Rs.200 crores with another company having turnover of Rs.201 crores. Same was the case in respect of ITeS services.

4. Finally learned TPO reached the margin of the comparable set 34.31% suggested an adjustment of Rs.4,52,78,127/- in respect of the software segment; and a margin of 33.13% of the comparables and adjustment of Rs.1,43,75,767/- in respect of IT enabled services. Apart from this learned TPO found that an amount of Rs.44,79,21,480/- of trade receivables were outstanding from related parties with an average delay of 12 months and after allowing one month credit, calculated interest for 11 months and suggested an adjustment of Rs.3,07,94,609/-.

5. Aggrieved assessee filed objections before the Learned Dispute Resolution Panel (DRP), and the learned DRP by way of impugned order issued certain instructions pursuant to which the assessment order dated 26/10/2018 was passed pursuant to which the ALP adjustment was revised from Rs.9,04,48,503/-to Rs.9,02,53,964/-. Assessee, therefore, filed this appeal challenging the adjustment on 2 segments and the notional interest on trade receivables.

6. Learned AR submitted that the assessee submitted before the learned TPO that though the lower limit of turnover was prescribed in the filters, no such filter was prescribed for the upper limit of the turnover and suggested to take the filter of Rs.1 to Rs.200 crores, but the learned TPO did not accept such a suggestion resulted in the learned TPO considering the entities with huge turnover of Rs.44,341 crores in case of Infosys Ltd etc., and therefore if this issue is decided, it would obviate many comparables on that score. He placed reliance on the view taken by a Coordinate Bench in the case of M/s Clinasia Labs in ITA-TP No.202/Hyd/2021 dated 11/06/2024, wherein, a company with Rs.16.12 crores was not comparable to the companies with more than Rs.200 crores turnover. He submitted that if this filter of upper limit of turnover at Rs.200 crores, is accepted only one entity namely, InfoBeans Technologies Limited needs to be considered. He further submitted that in respect of Sagar Soft India Ltd, the learned DRP prima facie felt that this entity is functionally comparable but directed the learned TPO to examine whether it satisfies the other filters adopted by him

and in such case to consider this entity as a comparable. Grievance of the assessee on this aspect, learned AR submitted that the learned TPO did not give effect to this direction.

7. So also, in respect of the ITeS services, learned AR submitted that the upper filter of Rs.200 crores may be considered in respect of the ITeS services also, and in that case only one entity, namely, MPS Ltd needs to be considered for exclusion on the ground of functional dissimilarity. According to the learned AR, MPS Ltd is engaged in high-end the activity, namely, typesetting, data digitization, content and product development for learners which falls in the domain of knowledge processing outsourcing service, and therefore is not a good comparable to the assessee. He placed reliance on the findings of a coordinate Bench of Pune Tribunal in the case of Symantec software India Pvt. Ltd vs. DCIT in ITA No. 1824/PUN/2018, order dated 17/2/2020 for this purpose.

8. In respect of the notional interest on the trade receivables, learned AR submitted that generally 120 days credit period is considered to be the reasonable and in respect of the subsequent period the interest at LIBOR +200 points is just and reasonable.

9. On the aspect of the upper filter of Rs.200 crores, learned DR vehemently relied on the view taken by the coordinate Bench of the Mumbai Tribunal in the case of Willis processing services (I) P.Ltd vs. DCIT (supra) and argued that there is no legal sanctity nor any rationality to accept the same because the application of such rule does not enable comparison of a company with an entity having turnover of Rs.201 crores apart from the fact that it was not a criteria prescribed under rule 10B of the Income Tax Rules, 1962 ("the Rules") for selection of comparables. He submitted that the turnover cannot be a relevant criteria in a service sector where fixed overheads are nominal and the cost of service is in direct proportion to the services rendered. He, therefore, vehemently resisted this argument of the learned AR.

10. In respect of InfoBeans Technologies Limited, he submitted that this company passed all the filters applied and hence cannot be rejected merely due to higher margins, because it's not the margin of this company alone that is going to influence the TP adjustment, but this company joins the other companies to determine the average margins. So also, in respect of the MPS Ltd sought to be excluded by the assessee in the ITeS segment, learned DR submitted that, as a matter of fact, this entity does not involve in any content development and it is only an outsourced publication facilitator involved in typesetting and data digitisation services, however high sounding words its services are described he submitted that this company itself does not claim to have been rendering any content and product development at all and therefore it cannot be said to have been involved in any knowledge processing outsourcing service. On the aspect of notional interest on the trade receivables, learned DR submitted that the normal credit period is only 60 days and it is only when the industry specific interest rate is established, it could be extended beyond that period. According to him there are no such circumstances involved in this case.

11. We have gone through the record in the light of the submissions made on either side, in the light of the decided case law. Insofar as the turnover filter is concerned, Hon'ble Delhi High Court in the case of Chryscapital Investment Advisors (India) (P.) Ltd. vs. DCIT [2015] 56 taxmann.com 417 (Delhi), held that huge profit or a huge turnover, ipso facto does not lead to its exclusion; whereas in the case of CIT vs. M/s. Pentair Water India Pvt. Ltd. (2016) 69 taxmann.com 180, the Hon'ble Bombay High Court held that turnover is a relevant criteria for choosing companies as comparables in determining the ALP in Transfer Pricing cases. Hon'ble Karnataka High Court, however, in the case of PCIT vs. M/s. Obopay Mobile Technology India Private Ltd., in ITA No. 586/2016, dated 23/07/2018, having noticed the view taken by the Hon'ble Delhi High Court in the case Chryscapital Investment Advisors (India) (P.) Ltd. (supra), and

also the decision of the Hon'ble Bombay High Court in the case of M/s. Pentair Water India Pvt. Ltd. (supra), upheld the Tribunal order excluding certain entities from the list of comparables on the ground of huge turnover, while following the principle that where two views are possible on an issue, the view favourable to the assessee has to be adopted.

12. In these circumstances, respectfully following the decision of the Hon'ble Karnataka High Court in the case of Obopay Mobile Technology India Private Ltd., (supra), we hold that the turnover is a relevant criteria for choosing companies as comparables in determining the ALP in Transfer Pricing cases.

13. Now turning to the next question as to the appropriate turnover filter, in a number of decisions including case of ACIT v. McAfee Software (India) Pvt Ltd [IT(TP)A No.1388/Bang/2011 and IT(TP)A No. 04/Bang/2012 – AY 2005-06] co-ordinate benches set aside the general practice of considering the range of Rs. 1 crore to Rs. 200 crore turnover for selecting comparables, and have taken a consistent view that the application of tolerance range of turnover of ten times on both sides of assessee's turnover was proper. Following the same, we direct the learned Assessing Officer to adopt the same for a fresh search. With this view of the matter, we direct the learned Assessing Officer/learned TPO to take the range of turnover filter at ten times on both the ends and conduct search afresh to take a plausible view. This finding is equally applicable for software development service as well as the IT enabled services.

14. On the aspect of comparability of InfoBean Technologies India Limited, learned TPO noted that the annual report for the financial year 2013-14 is not available in the public domain, whereas the learned DRP noted that on a perusal of the annual report, it was noticed that the entire Revenue of InfoBean Technologies India was derived from software services, and a particular information that was said to have been given in

CD about this company was not to be found since there was no such CD and, therefore, the learned DRP had taken only such information as was available in the annual report of the company and based on that learned DRP upheld the inclusion of this company in the list of comparables.

15. Learned AR invited our attention to the notes forming part of notes to financial statements to be found at page No. 972 and 973 of the paper book and submitted that the company is earning about Rs.33 crores from export of goods/services calculated on FOB basis and it is earning the same on the export sale of software, he also invited our attention to the entries in the sub notes forming part of notes to financial statements to be found at page No.970 of the paper book to show that sales tax deposits would show that this company is into sale of products. Basing on the said increase it is difficult to reach a conclusion that apart from the software services this InfoBean Technologies India is into the sales of certain products also. Software as a service or software is a product has to be looked into before reaching a final conclusion. Since the learned DRP recorded that though the assessee claimed to have given certain information in CD about this company, on verification learned DRP did not find any such information was furnished in CD. Such information must be considered for reaching a conclusion as to comparability of this entity. We, therefore, restore this issue to the file of the learned Assessing Officer/learned TPO to verify whether the software services and software is a product or integral part of the same service and also consider the information to be furnished by the assessee on this aspect and take a plausible view.

16. Coming to the request of the assessee to exclude MPS Ltd in the ITeS segment, according to the assessee this company is engaged in providing publishing solutions, namely, typesetting and data digitization services; that the company serves international publishers through author to reader publishing process; that the company has developed an end-to-end

publishing platform DIGI core; that it developed automated solutions such as Digi track, MPS Digi comp, automated solutions and the company is a full-fledged and Revenue bearing substantial risks and concerns. Learned AR drew our attention to the view taken by a coordinate Bench in the case of Symantec software India private Ltd (supra) and submitted that this company is engaged in carrying out content development activity which is in the nature of KPO service and therefore it is functionally not comparable to the technical support service segment of the assessee. Learned AR drew our attention to the Balance Sheet as on 31/3/2014 wherein under the current assets certain inventory is shown.

17. Learned DR submits that the assessee himself did not wait before the learned TPO or learned DRP that the MPS Ltd. is into any content and product development at all apart from this the consistent plea taken by the assessee is that this MPS Ltd. is engaged in the business of providing publishing solutions, namely, typesetting and data digitisation services. Absolutely no evidence is produced before any of the authorities to the aspect of any content or product development by this MPS Ltd. When it's not the case of MPS Limited themselves in their annual report that they are into the product of content development, is not open for the assessee to argue so before this Bench. Learned DR drew our attention to the annual report of MPS Ltd. to its report of the Board of Directors clause (D) wherein it is stated that MPS Ltd. is currently operating in a single segment of outsourced publishing services. Basing on this he submits that outsourced publishing services is a different from acting as a publisher or creator of product or content. Learned DR submits that mere presence of inventories does not automatically prove that MPS Ltd. is into manufacture of products also. Those could be the inventory is relating to the tools employed by the MPS Ltd.in its outsourcing publishing services.

18. On a careful consideration of the annual report of MPS Ltd. we find that the company itself declared that currently it operates only in one segment of outsourced publishing services like typesetting and data digitisation services, which are to be classified only as IT enabled services. Nowhere in the annual report MPS Ltd. claimed to have been providing product or content development activity took place in the category of knowledge processing activity. Merely an entry in the Balance Sheet to show that certain inventory is there, will not automatically make this entity as not comparable to other ITeS companies. Apart from this the learned TPO categorically observed that the contention of the assessee that the outsourced publishing solutions is different from operation of ITeS, cannot be countenanced. According to the learned TPO it should not matter how many types of ITeS services are provided by each company. Both the authorities have carefully gone through the financials of this company, combat the same with the functional profile of the assessee and reached a right conclusion that MPS Ltd. is functionally comparable to the assessee and there are no reasons to exclude the same. We do not find any material to come to a different conclusion. MPS Ltd. is not a publisher on its own. MPS Ltd. only provides outsourced publishing services by providing typesetting and digitization services. For these reasons, we do not find anything contrary to the finding of the authorities. We accordingly uphold the same.

19. Learned AR argued at length stating that the notional interest on the trade receivables is not covered in the definition of international transaction as defined under section 92B of the Act; that the receivables are consequential/closely linked to the principal transaction of provision of services; that the re-characterizing the outstanding receivables as unsecured loan extended by the assessee to its AEs is improper; that the assessee is fully funded by its AEs and does not bear any working capital risks; that the assessee does not chargeable interest on outstanding

receivables from third party customers as well; and that the assessee has outstanding payables due to AEs on which no interest has been levied by the AEs as well.

20. Learned AR in the alternative submitted that in the case of Afton Chemical India Private Limited vs. ITO in ITA No. 1467/Hyd/2019, by order dated 05/09/2022 had taken a view that in these sort of cases, the ends of justice would be met by accepting the interest rate on similar foreign currency receivables/advances as LIBOR+200 points, and if the Bench comes to the conclusion that the assessee is liable on this aspect, the same view may be adopted in this case also.

21. Per contra, learned DR submitted that this aspect does not leave any scope for any discussion in view of the decision of the Hon'ble Delhi High Court in the case of DCIT vs. McKensey knowledge Centre India Pvt. Ltd [2018] 96 taxmann.com 237 (Delhi) and the Co-ordinate Bench of the Delhi Tribunal in the case of Bhatia Airtel services Ltd vs. DCIT, [2021] 126 taxmann.com 315 (Delhi - Trib.) holding that with the introduction of the explanation to section 92B of the Act by Finance Act, 2012 it is a determinable that if there is any delay in the realization of credit arising from the sale of goods or services rendered in the course of carrying on the business, it is liable to be vested with the transfer pricing adjustment on account of interest income short charged/uncharged. Basing on the view taken in several decisions of the Tribunal of various Benches, authorities held that it is incumbent upon the taxpayer to separately benchmark the arm's length price of the international transaction relating to interest on overdue receivables from the AE by way of analysis of functions, assets and risks.

22. We have considered the submissions on either side. In the case of the DCIT vs. McKensey knowledge Centre India Pvt. Ltd [2018] 96 taxmann.com 237 (Delhi) Hon'ble Delhi High Court and in the case of Bhatia

Airtel services Ltd vs. DCIT, [2021] 126 taxmann.com 315 (Delhi - Trib.) the Co-ordinate Bench of the Delhi Tribunal it was held that with the introduction of the explanation to section 92B of the Act by Finance Act, 2012 it is a determinable that if there is any delay in the realization of credit arising from the sale of goods or services rendered in the course of carrying on the business, it is liable to be visited with the transfer pricing adjustment on account of interest income short charged/uncharged. It is, therefore, not open for the assessee to agitate this question as to whether or not the interest on outstanding receivables is an international transaction requiring separate benchmarking.

23. Lastly turning to the credit period, the learned TPO allowed only 30 days as reasonable credit period and levied interest for the remaining period beyond these 30 days. It is widely accepted that the normal credit period would be 60 days, and it is only when the assessee establishes any peculiar reasons concerned to the industry, in a further period is acceptable. Since there are no such peculiar circumstances connected to the activity of the assessee, we direct the learned Assessing Officer to allow 60 days as the credit period and to levy interest only in respect of the period beyond such 60 days.

24. Now what remains to be considered is in respect of the rate of interest, while placing reliance on the decisions reported in Tecnimont ICB House Vs. DCIT [2015] 60 taxmann.com 143 (Mumbai - Trib.), Hon'ble Bombay High Court in PCIT Vs. Tecnimont (P) Ltd., (supra) and CIT Vs. Cotton Naturals (I) (P.) Ltd. [2015] 55 taxmann.com 523 (Delhi). Assessee prayed that LIBOR+200 basis points may be adopted. This aspect is no longer res integra and dealt with by the Mumbai Bench of the Tribunal in the case of Tecnimont ICB House (supra) and confirmed by the Hon'ble Bombay High Court. Cotton Naturals (I) (P.) Ltd. (supra) is also on the same aspect.

25. Insofar as the interest on receivable is concerned, Mumbai Bench of the Tribunal, Tecnimont ICB House Vs. DCIT [2015] 60 taxmann.com 143 (Mumbai - Trib.) considered the view taken in Everest Kanto Cylinder Ltd. v. Asstt. CIT (LTU) [2014] 52 taxmann.com 395 (Mum.); PMP Auto Components (P.) Ltd. v. [IT Appeal No. 1484 (Mum.) of 2014, dated 22-8-2014]; Hinduja Global Solutions Ltd. v. Addl. CIT [2013] 145 ITD 361/35 taxmann.com 348 (Mum.); Tata Autocomp Systems Ltd. v. Asstt. CIT [2012] 52 SOT 48/21 taxmann.com 6 (Mum.); CIT v. Tata Autocomp Systems Ltd. [2015] 56 taxmann.com 206 (Bom.); Four Soft Ltd. v. Dy. CIT [2011] 142 TTJ 358 (Hyd.); and Everest Kanto Cylinder Ltd. v. Asstt. CIT (LTU) [2015] 56 taxmann.com 361 (Mum.) wherein the Hon'ble Tribunals have upheld use of LIBOR for the purpose of benchmarking loan/advance given to foreign AE's, and held that the notional interest has to be worked out for so called amount receivable from AE, by applying LIBOR interest rate for the purpose of computation of transfer pricing adjustment, if any. This view is affirmed by the Hon'ble Bombay High Court in the case of Tecnimont (P.) Ltd. [2018] 96 taxmann.com 223 (Bombay), holding that the extending of credit beyond the normal period of time is in substance a grant of loan to the Associated Enterprise (AE) so as to enjoy the funds which the AE would otherwise have to pay within the time, and interest thereon shall be computed at LIBOR rates as prevailing in the country where such loan was received/consumed. For the sake of completeness, we reproduce the relevant observations of the Hon'ble High Court hereunder,-

> *"...... In cases where any business enterprise is required to pay interest on delayed payment, it would examine the cost of interest and if the same is higher then the amount of interest payable on funds obtained locally, it would take a loan from local sources and pay the amounts payable for exports and expenses within time. Therefore, extending of credit beyond the normal period of 60 days is in substance a granting of loan to an AE so as to enjoy the funds, which the AE would otherwise have to repay within the period of 60 days. The aforesaid finding of ours also finds support from the question of law at Sr. No.2 as proposed by the Revenue. Thus, in these circumstances, in the facts*

of this case order of the Tribunal computing interest at LIBOR rates as the rate prevailing in country where the loan is received/consumed by the AE cannot in these facts be faulted as it is in line with the decision of this Court in Tata Autocomp Systems Ltd. …..”

26. In the case of CIT Vs. Cotton Naturals (I) (P.) Ltd. [2015] 55 taxmann.com 523 (Delhi) the Hon'ble Delhi High Court considered the question - whether the interest rate prevailing in India should be applied, for the lender was an Indian company/assessee, or the lending rate prevalent in the United States should be applied, for the borrower was a resident and an assessee of the said country, observed that such a question must be answered by adopting and applying a commonsensical and pragmatic reasoning and held that the interest rate should be the market determined interest rate applicable to the currency concerned in which the loan has to be repaid; that the interest rates should not be computed on the basis of interest payable on the currency or legal tender of the place or the country of residence of either party. It is further observed that the interest rates applicable to loans and deposits in the national currency of the borrower or the lender would vary and are dependent upon the fiscal policy of the Central bank, mandate of the Government and several other parameters; that the interest rates payable on currency specific loans/ deposits are significantly universal and globally applicable; that the currency in which the loan is to be re-paid normally determines the rate of return on the money lent, i.e. the rate of interest. While referring to the Klaus Vogel on Double Taxation Conventions (Third Edition) under Article 11 in paragraph 115, the Hon'ble High Court held that the PLR rate, therefore, would not be applicable and should not be applied for determining the interest rate and the PLR rates are not applicable to loans to be re-paid in foreign currency. Hon'ble Court accordingly held that whatever the principle that is applicable to the case of outbound loans, would be equally applicable to inbound loans given to Indian subsidiaries of foreign AEs, that the parameters cannot be different for outbound and

inbound loans, and a similar reasoning applies to both inbound and outbound loans.

27. Respectfully following the judicial opinion stated supra, we are of the considered opinion that the ends of justice would be met by accepting the interest rate on similar foreign currency receivables/advances as LIBOR+200 points. We direct the learned Assessing Officer / learned TPO to adopt the same. Grounds are partly allowed accordingly.

28. In the result, appeal of the assessee is allowed in part.

Order pronounced in the open court on this the 9th day of October, 2024.

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

Hyderabad,
Dated: 09/10/2024
L.Rama, SPS

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2. The Dy.Commissioner of Income Tax, Circle-16(2), Hyderabad
3. The Dispute Resolution Panel-1, Kendriya Sadan, 4th Floor, C Wing, Bengaluru
4. The Director of Income Tax (IT & TP), Hyderabad
5. The Addl.Commissioner of Income Tax (Transfer Pricing), Hyderabad
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