

**IN THE INCOME TAX APPELLATE TRIBUNAL, 'J' BENCH
MUMBAI**

**BEFORE: SHRI AMIT SHUKLA, JUDICIAL MEMBER
&
SHRI MAKARAND VASANT MAHADEOKAR,
ACCOUNTANT MEMBER**

**ITA No.3853/Mum/2025
(Assessment Year :2016-17)**

Red Hat India Private Limited A-201, Supreme Business Park, Supreme City, Hiranandani Gardens Powai, Mumbai- 400 076	Vs.	Assistant Commissioner of Income Tax, Circle 15(3)(1), Mumbai
PAN/GIR No.AABCR7097N		
(Appellant)	..	(Respondent)

Assessee by	Shri Ajit Jain a/w Shri Akshay Jain & Ms.Archita Singhal
Revenue by	Shri Pankaj Kumar. CIT DR
Date of Hearing	07/01/2026
Date of Pronouncement	12/01/2026

आदेश / O R D E R

PER AMIT SHUKLA (J.M):

The present appeal has been preferred by the assessee assailing the Order Giving Effect dated 31 December 2024 passed by the learned Assessing Officer under section 143(3) read with section 254 of the Income Tax Act, 1961 for the Assessment Year 2016-17, pursuant to the directions issued by the Dispute Resolution Panel-2, Mumbai. The appeal

arises in the second round of proceedings, the matter having earlier travelled to this Tribunal, which had partly set aside the assessment and restored the issue to the file of the Transfer Pricing Officer for limited and specific purposes. The impugned order, therefore, is required to be examined not only on its own merits but also strictly in the light of, and in faithful conformity with, the binding directions issued by this Tribunal in the first round.

2. The assessee company forms part of the globally renowned Red Hat Group and is ultimately held by Red Hat Inc., USA. The assessee is engaged in the business of providing open-source software solutions to customers across jurisdictions. Owing to the intrinsic nature of open-source software, the business model of the group does not envisage charging customers for the software itself. Instead, the commercial value is realised through subscription-based services, updates, support, and enterprise solutions, with Red Hat Enterprise Linux constituting the principal driver of the group's worldwide growth strategy. This fundamental business architecture has a direct bearing on the transfer pricing analysis and cannot be viewed in isolation or through a narrow lens.

3. In the original transfer pricing proceedings, the learned Transfer Pricing Officer observed that during the relevant previous year the assessee had entered into several international transactions with its Associated Enterprises. These transactions included payment of royalty and service fees under the subscription and services segments, provision

of software development services, and provision of IT enabled services to group entities. The complete details of such international transactions, along with the Associated Enterprises involved, the amounts transacted, and the most appropriate method applied, are tabulated and are reproduced hereunder.

S No.	International transaction	AE	Amount	Method
1	Payment of royalty and service fee to Red Hat US for Subscription segment	Red Hat Inc., USA	94,99,29,936/-	TNMM
2	Payment of royalty and service fee to Red Hat US for Services segment	Red Hat Inc., USA	13,43,704/-	TNMM
3	Provision of software development services	Red Hat Inc., USA	55,82,40,145/-	TNMM
4	Provision of IT enabled Services	Red Hat Inc., USA	83,76,55,778/-	TNMM
5	Provision of IT enabled Services	Red Hat Limited, Ireland	20,94,13,945/-	TNMM

4. The learned TPO, vide order dated 31 October 2019 passed under section 92CA(3) of the Act, proposed an aggregate transfer pricing adjustment of INR 32,51,93,181. The adjustment was made on multiple counts, including alleged excess payment of royalty and service fees under both

segments, as well as margin adjustments in respect of software development and IT enabled services. The issue-wise and amount-wise break-up of the proposed adjustment, as recorded by the learned TPO, is reproduced hereunder.

S.no	Issue	Amount (INR)
1	Payment of Royalty and Service Fees (Subscription Segment)	17,14,07,494
2	Payment of Royalty and Service Fees (Services Segment)	2,74,51,259
3	Provision of Software Development Services	8,56,29,184
4	Provision of IT enabled services	4,07,05,244
	Total	32,51,93,181

5. Thereafter, a rectification order under section 154 read with section 92CA(5) was passed on 18 December 2019, whereby the total adjustment was reduced to INR 30,31,89,144. The assessee, being aggrieved, carried the matter before the Dispute Resolution Panel, which issued its directions, pursuant to which a final assessment order dated 26 March 2021 came to be passed.

6. The assessee challenged the said final assessment order before this Tribunal. The coordinate bench of this Tribunal, vide order dated 25 February 2022 in ITA No. 1379/Mum/2021, partly allowed the appeal. While

adjudicating the matter, the Tribunal specifically held that the assessee was entitled to working capital adjustment and proportionate adjustment, and accordingly restored the matter to the file of the TPO with clear and categorical directions to verify the computations furnished by the assessee in its transfer pricing study and detailed working capital adjusted margin computation, and thereafter grant appropriate adjustment in accordance with settled judicial principles. The directions issued by the Tribunal were neither tentative nor discretionary, but binding in nature.

7. Pursuant to the aforesaid directions, the learned TPO initiated remand proceedings and passed a fresh order under section 92CA(3) on 27 January 2024, proposing a revised adjustment of INR 6,09,14,692. Once again, the assessee approached the DRP. The DRP, vide its directions dated 28 November 2024, restricted the adjustment only to payment of royalty and service fees under the subscription segment. Consequently, the learned Assessing Officer passed the impugned Order Giving Effect dated 31 December 2024, incorporating an adjustment of INR 4,23,90,382, while deleting all other adjustments. The details of the surviving adjustment are reproduced hereunder.

S.no	Issue	Amount (INR)
1	Payment of Royalty and Service Fees (Subscription Segment)	4,23,90,382
2	Payment of Royalty and Service	Nil

	Fees (Services Segment)	
3	Provision of Software Development Services	Nil
4	Provision of IT enabled services	Nil
	Total	4,23,90,382

8. Being aggrieved, the assessee has approached the Tribunal raising multiple grounds, including legal grounds challenging the very validity of the impugned assessment proceedings, grounds relating to denial of statutory credits, and substantive grounds assailing the transfer pricing adjustment. The assessee has also raised an additional ground challenging the validity of the order on account of absence of digital signature. The complete set of grounds of appeal, as raised by the assessee, is reproduced hereunder.

“On the facts, and in the circumstances of the case, and in law, the Appellant craves to prefer an appeal against order dated 31st December 2024 (communicated to Appellant on 01st March 2025) passed by Assistant Commissioner of Income Tax, Circle- 15(3)(1), Mumbai (hereinafter referred to as the ‘Ld. AO’), under Section 143(3) r.w.s 254 of the Income-tax Act, 1961 (‘the Act’), on the grounds as set out herein:

Final Assessment Order is in violation of CBDT Circular No. 19 of 2019 dt. 14th August 2019

1. On the facts and circumstances of the case and in law, the final assessment order dated 31st December 2024 (communicated to Appellant on 01st March 2025) passed by Ld. AO under section 143(3) r.w.s. 254 of the Act is in violation of CBDT Circular No. 19 of 2019 dated 14 August 2019 as the Document Identification Number borne by it is not valid, and hence is liable to be quashed.

Assessment proceedings are Barred by Limitation

2. On the facts and circumstances of the case and in law, the assessment proceedings are barred by limitation in view of section 153 read with section 144C(1) of the Act and hence is liable to be quashed, in line with the judgement of jurisdictional High Court in the case of Shelf Drilling Ron Tappmeyer Ltd. vs. ACIT, International Taxation [2023] 153 taxmann.com 162 (Bombay).

Notice of demand under section 156 of the Act not served on Assessee

3. Without prejudice, on the facts and circumstances of the case and in law, in the absence of notice of demand under section 156 of the Act being served on the Assessee by the Ld. AO, the final assessment order issued under section 143(3) r.w.s. 254 of the Act is bad in law, and hence is liable to be quashed.

Henceforth all the grounds are without prejudice to the Ground No. 1-3 above.

Grounds relating to Corporate Tax

4. The Ld. AO erred in short granting credit of Taxes Deducted at Source to the extent of INR 4,91,39,976.

5. The Ld. AO erred in not granting Minimum Alternate Tax Credit under section 115JAA of the Act amounting to INR 1,70,215.

6. The Ld. AO erred in not granting Foreign Tax Credit under section 90 of the Act amounting to INR 3,61,224.

7. That Ld. AO erred in not granting credit of Self-Assessment Tax paid vide Challan dated 19 October 2024 (S. No. 18904) amounting to INR 10,00,00,000.

8. The Ld. AO erred in on facts and in law in not granting interest under section 244A of the Act.

Grounds relating to Transfer Pricing Adjustment – INR 42,390,382-

Adjustment relating to international transaction pertaining to payment of royalty and service fee (Subscription Segment) – INR 42,390,382

9. On the facts and circumstances of the case and in contrary to law, Ld. AO and the Ld. TPO erred in making an addition of INR 42,390,382 to the Appellant's taxable income by incorrectly determining the arm's length price for payment of royalty and service fees under subscription segment.

10. On facts and circumstances of the case and in contrary to law, Ld. AO/ Ld. TPO erred in rejecting the claim of working capital adjustment based on conjectures and surmises which is in contradiction to the settled principles laid down by various judicial precedents. Thereby, contravening the provisions of Rule 10B(1) and Rule 10B(3) of the Rules. In doing so, grossly erred in:

- Ignoring the detailed submissions and computation of working capital adjustment filed on record by the Appellant which clearly demonstrates that differences in the Appellant's working capital vis-à-vis comparable companies has affected its profit margin;
- Rejecting all the judicial precedents submitted by the Appellant in the above matter;
- Rejecting grant of working capital adjustment on an ad-hoc basis citing reasons such as lack of information regarding daily balances of working capital, difference in cost of capital of companies and such similar reasons; and
- Not appreciating that it was beyond the power of Appellant to obtain the information which is not available in public domain. If at all the said information was critical for grant of working capital adjustment, the Ld. TPO ought to have exercised its power u/s 133(6) of the Act to obtain such details from comparable companies).

11. On the facts and circumstances of the case and in contrary to law, Ld. AO/ Ld. TPO erred in arbitrarily rejecting the following comparable companies selected by the Appellant in the TP Documentation without appreciating that such companies are functionally similar to the Appellant-

- Funny software Limited
- Empower India Limited
- PS IT Infrastructure & services Limited
- JMD Ventures Limited (formerly JMD Telefilms)
- Unisys Software & Holding Industries Limited
- Compuage Infocom Limited
- Advance Technologies Limited"

The assessee also filed an additional ground on 15 July 2025 which is reproduced hereunder:

“12. On facts and circumstances of the case and in contrary to the law, Ld. AO erred in passing the order under section 143(3) r.w.s 254 of the Income tax Act 1961, without affixing digital signatures on the order, thus rendering such order to be bad in law and liable to be quashed.”

9. During the course of hearing, the learned Authorised Representative appearing for the assessee advanced elaborate submissions. At the threshold, it was contended that the impugned order giving effect itself does not conform to the mandate of section 144C(13) of the Act and is therefore legally untenable. On merits, it was emphatically submitted that the sole surviving transfer pricing adjustment would not survive if the working capital adjustment and proportionate adjustment, as already directed by this Tribunal in the first round, are properly granted. It was further submitted that once the working capital adjustment is allowed, the assessee's margin falls comfortably within the arm's length range, rendering the dispute on comparables entirely academic.

10. We have carefully considered the rival submissions, perused the material available on record, and examined the impugned order in the context of the binding directions issued by this Tribunal in the earlier round. At the outset, we consider it appropriate to first adjudicate Ground No. 10 relating to denial of working capital adjustment, as the same goes to the root of the sole surviving transfer pricing adjustment.

11. It is an admitted and undisputed position that in the first round of litigation, the coordinate bench of this Tribunal unequivocally held that the assessee is entitled to working capital adjustment. The Tribunal directed the learned TPO to verify the computation furnished by the assessee in its transfer pricing study and the detailed working capital adjusted margin computation, and thereafter grant such adjustment in accordance with law. The relevant extract from the Tribunal's order, which is binding on the lower authorities, is reproduced hereunder.

“64.....So we are of the considered view that the assessee is entitled for working capital adjustment. The Ld. TPO is directed to verify the computation furnished in transfer pricing study and detailed working capital adjusted margin computation furnished by the assessee and accordingly provide the working capital adjustment to the assessee in view of the settled principle laid down by the Tribunal, in order to provide level playing field for assessee as well as comparable company.”

12. Despite such clear and categorical directions, the lower authorities have once again declined to grant working capital adjustment, citing reasons such as non-availability of daily working capital balances, differences in cost of capital, and other generalized considerations. In our considered view, such an approach is wholly unsustainable. Once this Tribunal has laid down the principle and issued a specific direction, the lower authorities are duty-bound to carry it out in letter and spirit. The objections raised by the TPO are neither new nor insurmountable and have repeatedly been rejected by judicial forums.

13. We further note that in the assessee's own case for Assessment Year 2018–19, the coordinate bench of this Tribunal has reiterated and reinforced the principle that working capital adjustment must be granted to neutralise differences arising from varying levels of receivables, payables, and inventory between the assessee and comparable companies. The Tribunal, after detailed analysis, also placed reliance on the decision of the Bangalore Bench in Huawei Technologies India (P.) Ltd., wherein the methodology for computing working capital adjustment has been elaborately examined. The relevant observations are reproduced hereunder.

“..26. We have given our thoughtful consideration to the rival submissions and perused the material available on record. It is noted that in assessee's own case for Assessment Years 2016–17 and 2017–18, the coordinate benches of this Tribunal have already accepted the principle that working capital adjustment (WCA) ought to be granted to the assessee, so as to neutralise the differences arising on account of varying levels of receivables, payables, and inventory maintained by the assessee vis-à-vis the comparables. Such adjustments are in recognition of the fact that differences in working capital deployment can materially affect profit margins, thereby distorting comparability unless neutralised through appropriate adjustments.

It is further relevant to note that not only has this Tribunal in assessee's own earlier years consistently upheld the claim of working capital adjustment, but even other judicial forums, including the Hon'ble Bangalore Tribunal in the case of Huawei Technologies India (P.) Ltd. v. JCIT [(2019) 101 taxmann.com 313], have affirmed that proportionate working capital adjustments are a

legitimate part of transfer pricing analysis to ensure a level playing field between tested party and comparables.

Respectfully following the aforesaid binding precedents, and in the absence of any distinguishing feature brought on record by the Revenue, we hold that the assessee is entitled to working capital adjustment, along with any other proportionate adjustment, wherever the differences in working capital materially impact the margin computation of the comparables. The assessee shall furnish the requisite details before the Ld. AO/TPO, who shall compute and grant such adjustments in accordance with law.”

14. Respectfully following the binding precedents in the assessee's own case for earlier assessment years, and in the absence of any distinguishing facts brought on record by the Revenue, we hold that the assessee is clearly entitled to working capital adjustment. The insistence on impractical parameters such as daily balances, particularly when data is not available in the public domain, cannot be a ground to deny a legitimate adjustment which is otherwise warranted to ensure comparability.

15. We further observe that once the working capital adjustment is granted in accordance with the methodology already furnished by the assessee and verified by the lower authorities, the margins of the comparable companies, as adjusted, fall within the permissible tolerance range prescribed under section 92C(2) of the Act. The working capital adjusted margins of the comparables, the arithmetic mean, the assessee's margin, and the tolerance limit are reproduced hereunder.

Comparable	Working Capital Adjusted NCP margin (%)
Sonata Information Technology Limited	2.20%
Dynacons Technologies Limited	-1.53%
Virtual Galaxy Inftech Private Limited	4.21%
Arm's length arithmetic mean	1.626%
Assessee's margin	1.40%
Tolerance limit of +/- 3% as per Sec. 92C(2) of the Act	3.37%

16. On a holistic appreciation of the aforesaid computation, it becomes evident that the assessee's margin is well within the arm's length range after grant of working capital adjustment. Consequently, the transfer pricing adjustment of INR 4,23,90,382 made by the lower authorities is unsustainable in law and on facts.

17. Accordingly, Ground No. 10 raised by the assessee is allowed and the adjustment of INR 4,23,90,382 is hereby deleted.

18. In view of the deletion of the sole surviving transfer pricing adjustment, the grounds relating to validity of assessment proceedings, selection of comparables, and other transfer pricing aspects, namely Grounds No. 1, 2, 3, 9, 11 and the additional ground, are rendered academic and are therefore left open.

19. As regards Grounds No. 4 to 8 relating to grant of TDS credit, MAT credit, foreign tax credit, self-assessment tax, and interest under section 244A of the Act, we direct the

Assessing Officer to verify the claims of the assessee on the basis of evidence placed on record and after affording due opportunity of being heard. If the claims are found to be in accordance with law, the same shall be granted. These grounds are allowed for statistical purposes.

20. In the result, the appeal of the assessee is allowed.

Order pronounced on 12th January, 2026.

Sd/-
(MAKARAND VASANT
MAHADEOKAR)

ACCOUNTANT MEMBER

Mumbai; Dated 12/01/2026
KARUNA, sr.ps

Sd/-
(AMIT SHUKLA)

JUDICIAL MEMBER

Copy of the Order forwarded to :

1. The Appellant
2. The Respondent.
3. CIT
4. DR, ITAT, Mumbai
5. Guard file.

//True Copy//

BY ORDER,

(Asstt. Registrar)
ITAT, Mumbai