

**IN THE INCOME TAX APPELLATE TRIBUNAL
BANGALORE BENCH 'B, BANGALORE**

**BEFORE SHRI ASHA VIJAYARAGHAVAN, JUDICIAL MEMBER
AND
SHRI INTURI RAMA RAO, ACCOUNTANT MEMBER**

**IT(TP)A No.757(Bang.)/2011
(Assessment year : 2007-08)**

M/s Avnet India Pvt.Ltd.,
No.402, 4th Floor, RMZ Infinity, Tower B,
No.3, Old Madras Road,
Bangalore-560 016

PAN No.AACCA0481G

Appellant

Vs

The Deputy Commissioner of Income-tax,
Central Circle-11(1),
Bangalore

Respondent

**Assessee by : Shri Padamchand Khincha, CA
Revenue by : Smt Neera Malhotra, CIT**

Date of hearing : 09-11-2015

Date of pronouncement : 18-11-2015

ORDER

PER SHRI INTURI RAMA RAO, AM

This appeal by the assessee company directed against the order dated 09.06.2011 passed by the DCIT, Circle-11(1), Bangalore u/s. 143(3) r.w.s. 144C of the Income-tax Act, 1961 [hereinafter referred to as "the Act" in short"] relating to assessment year 2007-08.

2. The grounds of appeal raised by the assessee-company are as under:

“1.The order the learned AO and the directions of the ld.DRP is opposed to the law and facts of the case.

2. The order of the ld.AO and the directions of the ld.DRP is fraught with the following errors in judgment.

a. Widening of the definition of the term International Transactions is not permissible.

i. The delay in the collection of the amount due by its customer who is an Associated Enterprise being treated as a loan by bringing it within the purview of the definition of ‘International Transaction’ as defined under section 92B(1) of the Act. It is submitted is erroneous.

ii. Definition of the term ‘international transaction’ as defined in the statute does not include delay in the collection from the customer as a transaction as the collection of amount against sales/services rendered is part of the sales transaction itself and hence, there cannot be another independent transaction in the form of collection of the dues for the services rendered.

iii. Without prejudice to the above, the assessee objects that the reference made by the ld. AO related only to the point of ALP in respect of international transactions of provision of service and the said reference does not cover an alleged interest free loan transaction’ supposed to have been entered into by the assessee and the potential loss

raising there from and, therefore prior to the insertion of sec.92CA(2A) w.e.f.1.6.2011, the TPO could not have exercised jurisdiction on any new transaction which was not referred to him and hence the adjustment directed by the TPO on the question of interest chargeable to outstanding receivables is without jurisdiction and against the law.

iv. The ld.TPO ought to have appreciated that neither accounting principles nor trade practice consider delayed payments by a customer, as an independent transaction as the same is part of the sale transaction and generally, when the customer delays the payment the seeler/supplier always first tries to recover the goods back and hence, viewing such customer dues as an independent transaction is incorrect and unknown to the trade and law.

v. The direction by the DRP, is an attempt to widen the scope of the definition of international transaction even by importing a deeming fiction to the section –which is against the well settled principles of interpretation of statutes.

vi. The direction has erred in holding that the decision by the Hon'ble Mumbai ITAT in the case of Nimbus Communications Ltd. Vs ACIT is not applicable to the facts of the current case.

Vii. Without prejudice to the above, the ld.TPO has erred in presuming a market-lending rate for a loan transaction as the rate of interest chargeable to a customer upon the delay of dues. The ld.TPO has erred in comparing a delayed payment by a customer with a lending transaction

for the purpose of ascertaining the rate of interest chargeable.

viii. Without prejudice to the above, even presuming that interest is recoverable from a customer who delayed the payments, the ld.TPO ought to have considered only similar transaction in the case of comparable companies. The learned TPO ought to have verified the debts due for more than six months in the case of all published accounts and found out the interest charged/earned by the comparable companies in such a situation and applied the same rate of interest in the instant case.

ix. The ld.TPO ought to have appreciated that in the case of comparable companies, when their customer delay the dues, no interest is levied and normally, certain discounts are given to the customer to induce him to make the payment and thus, the ld.TPO has erred in levying interest at the market rate for the delayed payment by the customer who is an AE.

b. The ld.AO has erred in not appreciating the fact that neither the amount of Capital expenditure of Rs.6,00,000/- debited under the head "Other Expenses" nor the adjustments being made to the returned income under section 92CA constitutes an intentional concealment of income/a deliberate act to conceal any particular – thus not warranting levy of penalty under section 271.

c. For these and other grounds that may be urged at the time of hearing, it is prayed that the order of the AO in so far as it relates to above issue may be dropped.

d. The assessee craves leave to add, alter, amend and delete any of the grounds that may be urged at the time of hearing”.

2.1 The assessee company has also raised additional grounds which are as under;

Additional Grounds:

“1. The ld. ADIT, TP-IV, Bangalore has erred in making an adjustment to total turnover on a premise that interest ought to have been received on the over dues from the AE’s ignoring the dues owed by the assessee to AEs in such calculation, which when considered would warrant no adjustment total income.

2. The ld. ADIT,TP-IV, Bangalore has erred in making an adjustment to the total income by inputting interest without appreciating that the same was outside the fold of section 5 not having been accrued or received or deemed to be so accrued or received.

3. At any rate and without prejudice, outstanding are not an international transactions but only represent the effect of an international transaction to which the provisions of Chapters X do not apply.

4. Without prejudice, the rate of interest adopted for imputing the interest income is very excessive”.

3. The facts of the case are that the assessee company is a 100% subsidiary of Avnet Holdings LLC. Since its inception it has been

providing marketing services to its holding company and also in the trading of electronic products. The return of income for the assessment year 2007-08 was filed on 30-01-2008 declaring taxable income of Rs.172,162,090/-. The assessee company is compensated for its services rendered to its holding company in the form of commission at a fixed percentage of value of goods sold. The assessee company also engaged in the trading activities for which it purchases the goods from its holding company. For the assessment year under consideration, the assessee company had reported the following international transaction with its AE in Form 3CEB, as under;

<i>Nature of Transaction</i> <i>3CEB</i>	<i>Amount in INR</i>	<i>Clause Ref of</i>
<i>Purchase of Traded goods</i>	<i>184,140,707</i>	<i>8(B)</i>
<i>Commission earned on services</i>	<i>248,414,083</i>	<i>10</i>
<i>Reimbursement of expenses</i>	<i>28,544,874</i>	<i>10</i>
<i>Cost allocation (payable)</i>	<i>2,636,880</i>	<i>12</i>

4. The learned TPO found the above transactions at Arm's Length. However, the TPO made adjustment of Rs.2,66,55,491/- on account of delay in realization of dues from its AE. The findings of the learned TPO are as under;

"7. The tax payer has extended credit facility similar to a working capital loan to its AEs without charging any interest.

Similar uncontrolled transaction would have provided for interest. In view of this fact the international transaction representing extended credit facility without charging interest in not at arm's length price within the meaning of Sec.92C(3)(a)(b) and (c) of the IT Act, r.w.Rule 10B(1)(a) of the IT Act, the arm's length interest is determined by following CUP method wherein the interest rate is determined under the circumstances in which the tax payer and its associated enterprises are opening i.e what is the interest that would have been earned if such credit in the form of working capital loan given to unrelated parties in similar situation as that of associated enterprises. Since the tested party is tax payer, the prevalent interest that could have earned by the tax payer by advancing similar to an unrelated party in India with the same financial health as that of the tax payer's associated enterprises is considered,

In view of the above discussion, the interest rate of 14% p.a (average yield on unrated bonds for the AY: 2006-07) was proposed to be adopted as the uncontrolled interest rate to arrive at the interest charged at arm's length. The tax payer in its letter dated 05-03-2010 did not raise any specific objection on the interest rate except arguing that no interest is chargeable on the receivables based on business prudence”.

4.1 Consequent to the TPO order, the learned AO passed a draft assessment order dated 25-08-2010 incorporating the adjustment proposed by the learned TPO.

5. Being aggrieved by the draft assessment order, the assessee company filed objections before the Hon'ble DRP contending inter-alia that extension of credit period cannot be treated as international transaction, and the TPO had no jurisdiction to determine whether a transaction is at arm's length or not which had not been referred to him by the AO. The objections have been overruled by the Hon'ble DRP and confirmed the action of the learned TPO.

6. Being aggrieved by this action, the assessee company is before us with the present appeal.

6.1 The learned counsel for the assessee company argued that;

a) The transaction of receivable is outside the purview of international transactions

b) Even assuming that it is an international transaction, the notional interest should be calculated on the net amount i.e after adjusting the amount due and paid to the AE by the assessee company

c) Since the main transaction of sales to the AE is found to be at arm's length, no further adjustment is required to be made. In support of this proposition of law, he relied on the decision of the Co-ordinate Bench of Mumbai Tribunal in the case of M/s Goldstar Jewellery Ltd. Vs JCIT in ITA No.6570/Mum/2012 dated 14-01-2015 also in the case of CIT Vs M/s Cotton Naturals (I) Pvt. Ltd in ITA No.233/2014 of the Hon'ble Delhi High Court dated 27-03-2015.

7. On the other hand, learned DR relied on the orders of the lower authorities.

8. We have heard the rival submissions. The assessee company reported international transactions in its TP report. On a reference by the AO, the learned TPO accepted that the price charged by the assessee company on these transactions are at arm's length. However, the TPO made adjustments on account of notional interest for the excess period allowed by the assessee- company to its AE for realization of its dues. The TPO applied 14% of interest on the outstanding amount of Rs. The learned DRP also had also concurred with the finding of learned TPO. There is no dispute that the transaction in question falls within the ambit of international transactions u/s 92B of the IT Act. However, this transaction is not an independent transaction. It is an integral part of transaction of sale made to the AE and therefore, it has to be considered alongwith the main transaction. The similar issue had come up for consideration before the Co-ordinate Bench of Mumbai in the case of M/s Goldstar Jewellery Ltd. (Supra), wherein it was observed as under;

“ However, this transaction of allowing the credit period to AE on realization of sale proceeds is not an independent international transaction but it is closely linked or continuous transaction along with sale transaction to the AE. The credit period allowed to the arty depends upon various factors which

also includes the price charged by the assessee from purchaser. Therefore, the credit period extended by the assessee to the AE cannot be examined independently but has to be considered along with the main international transaction being sale to the AE. As per Rule 10A(d) if a number of transactions are closely linked or continuous in nature and arising from a continuous transactions of supply of amenity or services the transactions is treated as closely linked transactions for the purpose of transfer pricing and, therefore, the aggregate and clubbing of closely linked transaction are permitted under said rule. This concept of aggregation of the transaction which is closely linked is also supported by OCED transfer pricing guidelines. In order to examine whether the number of transactions are closely linked or continuous so as to aggregate for the purpose of evaluation what is to be considered is that one transaction is follow-on of the earlier transaction and then the subsequent transaction is carried out and dependent wholly or substantially on the earlier transaction. In other words, if two transactions are so closely linked that determination of price of one transaction is dependent on the other transaction then for the purpose of determining the ALP, the closely linked transaction should be aggregated and clubbed together. When the transaction are influenced by each other and particularly in determining the price and profit involved in the transaction then those transactions can safely be regarded as closely lined transactions. In the case in hand, the credit period extended to the AE is a direct result of sale transaction. Therefore, no question of credit period allowed to the AE for realization of sale proceeds without having sale to AE. The credit period

extended to the AE cannot be treated as a transaction stand alone without considering the main transaction of sale. The sale price of the product or service determined between the parties is always influenced by the credit period allowed by the seller. Therefore, the transaction of sale to the AE and credit period allowed in realization of sale proceeds are closely linked as they are inter linked and the terms and conditions of sale as well as the price are determined based on the totality of the transaction and not on individual and separate transaction. The approach of the TPO and DRP in analyzing the credit period allowed by the assessee to the AE without considering the main international transaction being sale to the AE will give distorted result by disregarding the price charged by the assessee from AE. Though extra period allowed for realization of sale proceeds from the AE is an international transaction, however, for the purpose of determining the ALP, the same has to be clubbed or aggregated with the sale transactions with the AE. Even by considering it as an independent transaction the same has to be compared with the internal CUP available in the shape of the credit allowed by the assessee to non-AE. When the assessee is not making any difference for not charging the interest from AE as well as non-AE then the only difference between the two can be considered is the average period allowed along with outstanding amount. If the average period multiplied by the outstanding amount of the AE is at arm's length in comparison to the average period of realization and multiplied by the outstanding from non-AEs then no adjustment can be made being the transaction is at arm's length. The third aspect of the issue is that the arm's length interest for making the adjustment. Both the TPO and

the DRP has taken into consideration the lending rates, however, this is not a transaction of loan or advance to the AE but it is only an excess period allowed for realization of sales proceeds from the AE. Therefore, the arm's length interest in any case would be the average cost of the total fund available to the assessee and not the rate at which a loan is available. Accordingly, we direct the AO/TPO to re-do the exercise of determination of the ALP in terms of above observation”.

Respectfully following the above decision, we hold that there can be no separate international transaction of 'interest' in the international transaction of sale. Early or late realization of sale proceeds is only incidental to transaction of sale, but not a separate transaction in nature. Since we hold that the impugned transaction of interest on delayed realization of sale proceeds is not international transaction, it is not necessary to adjudicate upon the additional grounds raised by the assessee company. Hence, the appeal is treated as partly allowed for statistical purposes.

9. In the result, the appeal filed by the assessee is partly allowed for statistical purpose.

Order pronounced in the open Court on the 18th November, 2015.

Sd/-
(ASHA VIJAYARAGHAVAN)
JUDICIAL MEMBER
 Place : Bangalore
 Dated : 18-11-2015
am*

Sd/-
(INTURI RAMA RAO)
ACCOUNTANT MEMBER

Copy to :

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

By order

AR, ITAT, Bangalore