

IN THE INCOME TAX APPELLATE TRIBUNAL
“B” BENCH : BANGALORE

BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT
AND SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER

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| ITA No.2029/Bang/2017 |
| Assessment year : 2007-08 |

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| M/s GXS India Technology Centre Pvt. Ltd., No.436, Infinity, Ground 1 st , 3 rd & 4 th Floors, Off. Koramangala, Indiranagar, Intermediate Ring Road, Challaghatta-Domlur, Bangalore-560 071. PAN: AABCG 7972P | Vs. | The Income Tax Officer, Ward 11(2), Bangalore. |
| APPELLANT | | RESPONDENT |

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| IT(TP)A No.2142/Bang/2017 |
| Assessment year : 2010-11 |

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| The Deputy Commissioner of Income Tax, Circle-3(1)(2), Bangalore. | Vs. | M/s GXS India Technology Centre Pvt.Ltd. Bangalore. PAN: AABCG 7972P |
| APPELLANT | | RESPONDENT |

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| Assessee by | : | Shri K.R. Vasudevan, Advocate |
| Revenue by | : | Shri Priyadarshi Mishra, JCIT(DR)(ITAT), Bangalore. |

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| Date of hearing | : | 08.12.2020 |
| Date of Pronouncement | : | 04.01.2021 |

ORDER

Per N.V. Vasudevan, Vice President

ITA No.2029/Bang/2017 is an appeal by the assessee, while ITA No.2142/Bang/2017 is an appeal by the revenue. Both these appeals are

directed against the order dated 18.8.2017 of the CIT(Appeals)-IV, Bangalore relating to assessment year 2007-08.

2. First we shall take up for consideration appeal by the assessee. At the time of hearing, Id. Counsel for the assessee submitted that except ground Nos.9 and 11 raised by the assessee in the grounds of appeal, none of the other grounds are pressed for adjudication.

3. Ground Nos.9 and 11 raised by the assessee reads as follows:-

“9. The learned AO/learned TPO/Hon'ble CIT(A) has grossly erred in not rejecting the following companies from the list of comparable companies:

- Infosys Ltd.
- Wipro Ltd.
- Megasoft Ltd.
- Flextronics Software Systems Ltd.
- KALS Information Ltd.
- Ishir Infotech Ltd.
- Avani Cimcon Technologies Ltd.
- Lucid Software Ltd.
- E-Zest Solutions Ltd.
- Persistent Systems Ltd.
- R Systems International Ltd.
- Celestial Labs Ltd.
- Helios & Matheson Information Technology Ltd.

11. The Hon'ble CIT(A) has erred disallowing the working capital adjustment allowed by the Id. TPO.”

4. It will be appropriate to deal with ground Nos.4 to 6 raised by the revenue in its appeal also together with ground No. 9 raised by the revenue as the same is interlinked with ground No.9 raised by the assessee.

5. The assessee is a company engaged in the business of software development. It rendered software development services to its Associated Enterprise (AE). The issues that arise for consideration in grounds of

appeal set out above are with regard to determination of arm's length price [ALP] in respect of international transaction of rendering software development services by the assessee to its AE as is required under the provisions of section 92 of the Income-tax Act, 1961 [the Act].

6. The assessee in respect of its claim that the price received in the international transaction is at arm's length filed a transfer pricing analysis. The Most Appropriate Method chosen for the purpose of comparison of the assessee's profit margin with that of the comparable companies was Transactional Net Margin Method (TNMM). The Profit Level Indicator (PLI) chosen for the purpose of comparison was Operating Profit to Operating Cost (OP/OC). The OP/OC of the assessee was as follows:-

| Particulars | IT (INR) |
|---------------------------------|-----------------|
| Operating Revenue | 27,03,85,879 |
| Less: Operating Expenses | 24,45,93,369 |
| Operating Profit | 2,57,92,510 |
| Return on Operating Cost | 10.54% |

7. The assessee had chosen certain comparable companies whose average arithmetic profit margin was comparable with that of the assessee and hence the assessee claimed that the price received in the international transaction was at arm's length.

8. The Transfer Pricing Officer (TPO) to whom the question of determination of ALP was referred by the AO, did not accept the claim of assessee and he on his own identified 26 comparable companies and adopting the average arithmetic mean of those companies determined the ALP as follows:-

| S.No. | Company Name | Unadjusted Margins FY 2006-07 |
|-------|--|-------------------------------|
| 1 | Accel Transmatics Ltd | 21.11% |
| 2 | Avani Cimcon Technologies Ltd | 52.59% |
| 3 | Celestial Labs Ltd | 58.35% |
| 4 | E Zest Solutions Ltd | 36.12% |
| 5 | Flextronics Software Systems Ltd | 25.31% |
| 6 | Helios & Matheson Information Technology Ltd | 36.63% |
| 7 | igate Global Solutions Ltd | 7.49% |
| 8 | Infosys Technologies Ltd | 40.30% |
| 9 | Ishir Infotech Ltd | 30.12% |
| 10 | KALS Information Systems Ltd | 30.55% |
| 11 | Lucid Software Ltd | 19.37% |
| 12 | Megasoft Ltd | 60.23% |
| 13 | Mindtree Ltd | 16.90% |
| 14 | Persistent Systems Ltd | 24.52% |
| 15 | R Systems International Ltd | 15.07% |
| 16 | Tata Elxsi Ltd | 26.51% |
| 17 | Thirdware Solutions Ltd | 25.12% |
| 18 | Wipro Ltd. | 33.65% |
| 19 | Datamatics Ltd | 1.38% |
| 20 | Geometric Limited (Seg) | 10.71% |
| 21 | LGS Global Ltd | 15.75% |
| 22 | Mediasoft Solutions Ltd | 3.66% |
| 23 | Quintegra Solutions Ltd | 12.56% |
| 24 | R S Software (India) Ltd | 13.47% |
| 25 | Sasken Communications Technologies Ltd | 22.17% |
| 26 | SIP Technologies & Exports Ltd | 13.90% |
| | Arithmetic mean | 25.14% |

Computation of Arm's Length Price

| Particulars | Amount INR |
|-------------------------------------|-------------------|
| Arithmetic mean PLI | 25.14% |
| Less: Working Capital Adjustment | 0.50% |
| Adjusted Arithmetic mean PLI | 24.64% |

Arm's Length Price

| Particulars | Amount INR |
|--|------------------------------|
| Operating cost | 24,45,93,369 |
| Arm's Length Margin | 24.64% of the operating cost |
| Arm's Length Price (ALP) @ 124.64% of operating cost | 30,48,61,175 |

Price Received vis-a-vis the Arm's Length Price

| Particulars | Amount INR |
|--|--------------------|
| Arm's Length Price @ 124.64% of operating cost | 30,48,61,175 |
| Price received | 27 03 85 879 |
| Shortfall being adjustment u/s 92CA | 3,44,75,296 |

9. The addition suggested by the TPO was incorporated in the draft assessment order of the AO. The assessee did not file any objections before the Dispute Resolution Panel (DRP) against the draft assessment order and therefore the final assessment order was passed by the AO. The assessee preferred appeal before the CIT(Appeals) against the final assessment order. The CIT(Appeals) excluded Tata Elxsi Ltd. from the list of comparable companies and also directed that only segmental margin pertaining to software development segment of comparable company, Megasoftware Ltd., should be considered. The CIT(A) also disallowed the claim of assessee for allowing working capital adjustment.

10. Aggrieved by the relief allowed by the CIT(A), the revenue has preferred grounds 4 to 6 and aggrieved by the order of CIT(A) in not excluding certain comparable companies and not allowing working capital adjustment, the assessee has raised ground Nos. 9 to 11 before the Tribunal.

11. As far as the grounds raised by the assessee in its appeal, the assessee seeks exclusion of 13 comparable companies out of 25 comparable companies that remain after the order of CIT(A). The Id. counsel for the assessee brought to our notice a decision of the ITAT Bangalore Bench in the case of *Sonus Networks India Pvt. Ltd. V. DCIT, IT(TP)A No.1365/Bang/2001*, order dated 28.6.2019 for AY 2007-08. This was also a case of a company rendering software development services such as the assessee. The TPO in the aforesaid case had also selected

the very same 26 comparable companies as was chosen by the TPO in the case of assessee in this appeal. The very same 13 comparable companies which the assessee seeks to exclude was considered by the Tribunal in the aforesaid decision and the Tribunal excluded 10 out of 13 comparable companies from the list of comparable companies with the following findings:-

(i) Avani Cimcon Technologies Ltd.

As far as this company is concerned, the Mumbai Bench of the Tribunal in the case of Telcordia Technologies Pvt. Ltd. v. ACIT - ITA No.7821/Mum/2011 accepted the assessee's contention that this company has revenue from software product and observed that in the absence of segmental details, Avani Cincom cannot be considered as comparable to the assessee who was rendering software development services only. In view of the aforesaid decision, The Tribunal accepted the plea of the Assessee to reject this company as a comparable.

(ii) Celestial Labs Ltd.

As far as this company is concerned, the stand of the assessee is that it is absolutely a research & development company. It was submitted that the acceptance of this company as a comparable for the reason that it is into pure software development activities and is not engaged in R&D activities is bad in law. Further reference was also made to the decision of the Mumbai Bench of the Tribunal in the case of Teva Pharma Private Ltd. v. Addl. CIT - ITA No. 6623/Mum/2011 (for AY 2007-08) in which the comparability of this company for clinical trial research segment was considered. It was therefore submitted that this company is not a pure software service provider such as the Assessee. The Tribunal accepted the plea of the Assessee and held that

this company ought not to have been considered as comparable to a SWD service provider such as the Assessee.

(iii) E-Zest Solutions Ltd.

The Tribunal held in the decision cited that the TPO has included this company in the list of comparables only on the basis of the statement made by the company in its reply to the notice under section 133(6) of the Act without examining whether the services rendered by the company to give a finding whether the services performed by this company are similar to the software development services performed by the assessee. From the details on record, the tribunal found that while the assessee is into software development services, this company i.e. e-Zest Solutions Ltd., was rendering product development services and high end technical services which come under the category of KPO services. The Tribunal followed co-ordinate bench order of Tribunal in the case of Capital I-Q Information Systems (India) (P.) Ltd. (supra) wherein it was held that KPO services are not comparable to software development services and are therefore not comparable. Following the aforesaid decision of the co-ordinate bench of the Hyderabad Tribunal in the aforesaid case, the tribunal held that this company, i.e. e-Zest Solutions Ltd. be omitted from the set of comparables.

(iv) Helios & Matheson Information Technology Ltd :

As far as this company is concerned, the Tribunal held that this company was engaged in sale of software products, which was quite distinct from the activity undertaken by the assessee in the IT Services segment.

(v) Infosys Technologies Ltd.

As far as this company is concerned, the Tribunal excluded this company from the list of comparable companies since it owns significant intangible and has huge revenues from software products. It was also held that the break-up of revenue from software services and software products is not available.

(vi) KALS Information Systems Ltd.

As far as this company is concerned, the contention of the assessee is that the aforesaid company has revenues from both software development and software products. Besides the above, it was also pointed out that this company is engaged in providing training. It was also submitted that as per the annual report, the salary cost debited under the software development expenditure was Rs. 45,93,351. The same was less than 25% of the software services revenue and therefore the salary cost filter test fails in this case. Reference was made to the Pune Bench Tribunal's decision of the ITAT in the case of *Bindview India Private Limited v. DCI*, ITA No. ITA No 1386/PN/10 wherein KALS as comparable was rejected for AY 2006-07 on account of it being functionally different from software companies. Accepting the aforesaid contentions, the Tribunal held that this company was developing software products and not purely or mainly software development service provider and accepted the plea of the Assessee that this company is not comparable.

(vii) Persistent Systems Ltd.

The assessee objected to the inclusion of this company as a comparable for the reasons that this company being engaged in software product designing

and analytic services, it is functionally different and further that segmental results are not available. The Tribunal found that from the details on record that this company i.e. Persistent Systems Ltd., is engaged in product development and product design services while the assessee is a software development services provider and that the segmental details are not given separately. Therefore, following the principle enunciated in the decision of the Mumbai Tribunal in the case of *Telecordia Technologies India Pvt. Ltd. (supra)* that in the absence of segmental details/information a company cannot be taken into account for comparability analysis, the Tribunal held that this company i.e. Persistent Systems Ltd. ought to be omitted from the set of comparables for the year under consideration.

(viii) Wipro Limited

As far as this company is concerned, the Tribunal held that this company is engaged both in software development and product development services. There is no information on the segmental bifurcation of revenue from sale of product and software services. The Tribunal followed the order of the Tribunal in the case of 24/7 Customer.Com Pvt. Ltd. (ITA No. 227/Bang/2010) wherein it was held that this company was owning intangibles cannot be compared to a low risk captive service provider who does not own any such intangible and hence does not have an additional advantage in the market.

(ix) Flextronics Software Systems Ltd. (Seg), was excluded for the reason that credible information was not available about the company. The TPO; obtained information from this company u/s 133(6) of the Act but there was a complete contradiction between the information obtained u/s 133(6) and

annual report and therefore the said information cannot be substituted for the information contained in annual report.

(x) Ishir Infotech Ltd., was excluded as a comparable company on the ground that this company does not satisfy the 25% employee cost to the total cost filter to be regarded as a service industry by following the decision of the Tribunal in the case of *First Advantage Offshore Services Pvt. Ltd. Vs. DCIT IT(TP) A.No.1086/Bang/2011 for AY 07-08*.

12. The aforesaid decision takes care of 10 comparable companies out of 13 comparable companies that are sought to be excluded in ground No.9. The other companies which assessee seeks to exclude are Megasoftware Ltd. which has been directed to be excluded by the Tribunal in *Sonus Networks India Pvt. Ltd. (supra)*. Also the Tribunal directed segmental results of this company to be taken and hence the grievance of assessee in this regard is not accepted.

13. The next company the assessee seeks exclusion is Flextronics Systems Ltd. which has been directed to be excluded in the case of *Sonus Networks India Pvt. Ltd. (supra)* on the ground that there was a variation in the financial results as available in the public domain and as obtained by the TPO by issue of notice u/s. 133(6) of the Act. Hence we direct the exclusion of this company.

14. The other company which remains to be excluded is R Systems International Ltd. As far as this company is concerned, in the very same decision in the case of *Sonus Networks India Pvt. Ltd. (supra)*, the comparability of this company was remanded to the TPO with a direction to cull out the financial results of this company in the relevant previous year relevant to AY 2007-08 and thereafter compare the segmental profit margin of this company from SWD services segment.

15. The TPO is directed to compute the ALP as per the directions contained in this order regarding exclusion of comparable companies.

16. As far as grounds 4 & 5 raised by the revenue is concerned, the grievance is that the CIT(A) ought not to have directed computation of margins of this company on a segmental basis. As far as this objection is concerned, we find that the CIT(A) while giving the aforesaid direction has taken note of the fact that the financials in public domain did not reflect the segmental details. The AO obtained segmental details by issue of notice u/s. 133(6) of the Act. The CIT(A) directed that only segmental profit margins relatable to software development services segment should be taken for the purpose of comparison. The plea of revenue is that the profit margin at the entity level should be taken, which in our view, cannot be accepted. In the TNMM, what is to be compared is only the transaction and margin from the transaction. The transaction for which the ALP is sought to be determined is rendering of software development services and therefore the plea of revenue to take the enterprise level profit margin is devoid of any merit.

17. As far as ground No.6 raised by the revenue is concerned, it is the plea of assessee that Tata Elxsi Ltd. which was excluded from the list of comparable companies satisfies all the filters and therefore should be retained as a comparable. On this aspect, we find that the CIT(A) has given a finding that Tata Elxsi Ltd. performs different functions and is predominantly engaged in product design services and not a fully SWD services provider and therefore in our view, this company is rightly excluded from the list of comparable companies. The decision cited by the Id. AR in respect of ground No.9 of the assessee's appeal considers Tata Elxsi Ltd. as a comparable and has also rejected the same as not comparable. In view of the above, we find no merit in ground 6 raised by the revenue.

18. As far as ground No.11 raised by the assessee is concerned, the issue is with regard to the question whether working capital adjustment should be given or not. In this regard, we find that the reasons given by the CIT(A) for not allowing working capital adjustment are not 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;

(iii) the net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction [or the specified domestic transaction] and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;

(iv) the net profit margin realised by the enterprise and referred to in sub-clause (i) is established to be the same as the net profit margin referred to in sub-clause (iii);

(v) the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction [or the specified domestic transaction];

(f) ** ** *

(2) For the purposes of sub-rule (1), the comparability of an international transaction [or a specified domestic transaction] with an uncontrolled transaction shall be judged with reference to the following, namely:—

- (a) the specific characteristics of the property transferred or services provided in either transaction;
- (b) the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;
- (c) the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;

- (d) conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

(3) An uncontrolled transaction shall be comparable to an international transaction [or a specified domestic 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 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(1)(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."

19. 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 Ground No.11 of the assessee.

20. The other issue that remains for consideration in the revenue's appeal is grounds 2 & 3 of the revenue's appeal which reads as follows:-

"2. The ld. CIT(A) erred in holding the ratio laid down by the Hon'ble High Court in the case of M/s. Tata Elxsi Ltd. (ITA No.70/2009).

3. The ld. CIT(A) erred in holding that the expenses reduced from the Export Turnover must also be reduced from the Total Turnover since there is no provision under Sec. 10A for exclusion of such expenses from Total Turnover."

21. We have considered the rival submissions. Taking into consideration the decision rendered by the Hon'ble High Court of Karnataka in the case of *CIT v. Tata Elxsi Ltd [2012] 349 ITR 98 (Karn)*,

we are of the view that communication charges should be excluded both from export turnover and total turnover. We are of the view that as of today, law declared by the Hon'ble High Court of Karnataka which is the jurisdictional High Court is binding on us. Moreover, the order of the Hon'ble Karnataka High Court has been upheld by the Hon'ble Supreme Court in the case of *CIT v. HCL Technologies Ltd. in Civil Appeal No.8489-98490 of 2013 & Ors. dated 24.04.2018*. Hence these grounds are rejected.

22. In the result, the appeal by the revenue is dismissed, while the appeal by the assessee is partly allowed.

Pronounced in the open court on this 4th day of January, 2021.

Sd/-

Sd/-

(CHANDRA POOJARI)
ACCOUNTANT MEMBER

(N V VASUDEVAN)
VICE PRESIDENT

Bangalore,

Dated, the 4th January, 2021.

/Desai S Murthy /

Copy to:

- | | | | |
|-------------------------|------------|--------|-----------|
| 1. Assessee | 2. Revenue | 3. CIT | 4. CIT(A) |
| 5. DR, ITAT, Bangalore. | | | |

By order

Assistant Registrar
ITAT, Bangalore.