IN THE INCOME TAX APPELLATE TRIBUNAL
BANGALORE BENCHES "A", BANGALORE

Before Shri George George K, JM and Shri B.R.Baskaran, AM

IT(TP)A No.3358/Bang/2018 : Asst.Year 2014-2015

M/s.Xchanging Solutions Limited Plot No.13, 14, 15 SJR i-Park EPIP Industrial Area, Phase I Whitefield, Bangalore – 560066. **PAN : AAFCS9303L.**	v.	The Dy.Commissioner of Income-tax, Circle 7(1)(2) Bangalore.
(Appellant)		(Respondent)

Appellant by : Sri.Chavali Narayanan, CA
Respondent by : Sri.Sumer Singh Meena, CIT(OSD)-DR

Date of Hearing : 28.10.2021		**Date of Pronouncement : 01.11.2021**

O R D E R

Per George George K, JM

This appeal at the instance of the assessee is directed against final assessment order dated 22.10.2018 passed u/s 143(3) r.w.s. 144C of the I.T.Act. The relevant assessment year is 2014-2015.

2. The assessee has raised various grounds and sub-grounds. However, during the course of hearing, the learned AR limited his submission to grounds No.4.6(d), 4.11 to 4.14, 5.1 and 5.2. The surviving grounds read as follows:-

"Transfer Pricing Issue :

4.6 (d) applying only the lower turnover filter of less than INR 1 crore as a comparability criterion and not applying a higher threshold limit for turnover filter.

4.11 The learned DRP/AO/TPO have erred in law and facts by determining a transfer pricing adjustment on account of

interest on outstanding receivables amounting to INR 1,20,83,994.

4.12 Without prejudice to our ground of objection 4.11 above, the learned DRP/AO/TPO have erred in law and in facts by not appreciating that the outstanding trade receivables from its AE's is arising from the provision of software development services transaction which is to be considered as closely linked to such transaction and should not be tested separately from arm's length perspective.

4.13 Without prejudice to our ground of objection 4.11 above, the learned DRP/AO/TPO have erred in law and in facts by re-characterizing the outstanding receivables as on 31 March 2014 as a separate international transaction.

4.14 Without prejudice to our ground of objection 4.11 above, the learned DRP/AO/TPO have erred in law and in facts, by not considering that once the working capital adjustment is granted, if appropriately takes into account the delayed / outstanding receivable and separate TP adjustment is unwarranted.

Corporate Tax Issue :
5.1 The learned DRP/AO has erred in law and on facts in disallowing advances written off aggregating to INR 74,70,129 by holding that the advances were not for the purpose of the business, without having regard to the submission made by the Appellant during the assessment proceedings that the underlying advances were made in the regular course of the business, on revenue account and thus, the write off of such advances is allowable under Section 37(1) read with Section 28 of the Act is business / trading loss.

5.2 The learned DRP/AO has erred in law and on facts, in making an ad-hoc disallowance of 10% of the per diem allowance granted to the employees computed at INR 7,97,471 due to non-collation of bills, without having regard to the jurisdictional High Court decision in the case of CIT v. Symphony Marketing Solutions India (P) Ltd (388 ITR 457) and the fact of actual incurrence of expenditure by the Appellant through reimbursement to employees."

3. The brief facts of the case are as follows:

The assessee is a private limited company having its registered office in Bangalore. The assessee has operating

subsidiaries in USA, UK, Germany, France, Japan, Australia, Singapore and Malaysia. For the relevant assessment year 2014-2015, the assessee had entered into an international transaction for provision for software services to its Associate Enterprises (AEs) as well as non-AEs. During the course of assessment proceedings, the case was referred to Transfer Pricing Officer (TPO) to determine Arm's Length Price (ALP) of Software Development (SWD). The Transfer Pricing Officer (TPO) passed order dated 30.10.2017 u/s 92CA of the I.T.Act determining transfer pricing adjustment of Rs.7,75,64,059 in respect of SWD services and Rs.1,20,83,994 in respect of interest on delayed receipts of trade receivables from its AEs. Pursuant to the TPO's order, draft assessment order dated 22.12.2017 was issued by the Assessing Officer (AO) incorporating the aforesaid transfer pricing adjustment.

4. Aggrieved, the assessee filed objections before the Dispute Resolution Panel (DRP). The DRP vide its directions dated 05.09.2018 partly allowed the objections raised by the assessee. Pursuant to the DRP's directions, final assessment order dated 22.10.2018 was passed incorporating the TP adjustment, which was re-worked out to Rs.6,76,49,378. The adjustment pertaining to corporate tax remained unchanged at Rs.74,70,129 and Rs.7,97,471.

5. Aggrieved by the final assessment order, the assessee has filed this appeal before the Tribunal.

We shall first adjudicate the transfer pricing issue.

Software Development Services to AE [Ground No.4.6(d)]

6. The net margin on cost earned by the assessee and the comparison of the TP analysis undertaken by the assessee and the TPO are as follows:-

Net margin on cost earned by the assessee as computed by the TPO in the TP order:

Particulars	Amount (INR)
Operating income	59,69,92,471
Operating cost	52,12,95,618
Operating profit (op. income – op. cost)	7,56,96,853
Operating / Net margin (OP/OC)	14.52

Comparison of the TP analysis undertaken by the assessee and the TPO:

Particulars	Assessee	TPO
Methodology adopted	TNMM	TNMM
Profit level indicator (PLI)	OP/OC	OP/OC
Database used	PROWESS, CAPITALINE AND ACE-TP	PROWESS & Ace-TP
Comparables selected	22	8

6.1 In the TP study, the assessee applied various filters and based on the above search process, the assessee arrived at 22 comparables with arithmetical mean of 10.72%. Since the assessee's margin was 14.2% and the comparable was at 10.52%, the assessee sought to justify the ALP of SWD segment with its AEs. The TPO, however, rejected the TP study of the assessee and conducted fresh TP analysis. The TPO applied various filters and selected 8 comparable companies at arithmetical mean of 29.04% and made an adjustment of Rs.7,75,64,059. The filters applied by the TPO,

the comparables selected by the TPO, their arithmetical mean, computation of ALP and adjustment made by the TPO are as follows:-

Filters applied by the TPO:

Sl. No.	Description
1	Use of current year data
2	Companies having different financial year ending (i.e. not March 31, 2013) or data of company which does not fall within 12 month period i.e. 01.04.2012 to 31.03.2013, were rejected.
3	Companies whose income was less than 1 Crore were excluded.
4	Companies whose software development service income is less than 75% of its total operating revenue were excluded.
5	Companies who have more than 25 percent related party transaction of sales were rejected.
6	Companies who have export service income less than 75% of sales were rejected.
7	Companies with employee cost less than 25 percent of turnover were rejected.

Comparables selected by TPO and their arithmetic mean:

Sl No.	Particulars	Margin (%)
1	Infosys Limited	36.13%
2	Larsen & Toubro Infotech Limited	24.61%
3	Mindtree Limited	20.43%
4	Persistent Systems Limited	35.10%
5	RS Software (India) Limited	24.25%
6	Cigniti Technologies Limited	27.62%
7	SQS India BFSI Limited	22.37%
8	Thirdware Solutions Limited	44.68%
	Arithmetic Mean	29.40%

Computation of arm's length price by the TPO and the adjustment made:

Particulars	Amount (INR)
Arm's Length Mean Margin	29.40%
Operating cost (OC)	52,12,95,618
Arm's Length Price (ALP) = 129.40% of OC	67,45,56,530
Price Received	59,69,92,471
Short fall being adjustment u/s 92CA	7,75,64,059

6.2 On objections of the assessee, the DRP accepted the contentions of the assessee that SQS India BFSI Limited is not comparable to the assessee and directed its exclusion. Further, the DRP accepted the contention of the assessee that CG-VAK Softwsare & Exports Limited and Sagarsoft India Limited are to be included in the comparable list. On giving effect to the DRP's direction, the list of companies selected as comparables and their arithmetical mean are as follows:-

Sl No.	Particulars	Margin (%)
1	Infosys Limited	36.13%
2	Larsen & Toubro Infotech Limited	24.61%
3	Mindtree Limited	20.43%
4	Persistent Systems Limited	35.10%
5	RS Software (India) Limited	24.25%
6	Cigniti Technologies Limited	27.62%
7	Thirdware Solutions Limited	44.68%
8	CG-VAK Software & Exports Limited	12.33%
9	Sagarsoft India Limited	1.44%
	Arithmetical Mean	25.18%

6.3 Aggrieved by the TP adjustment made under the SWD segment, assessee has raised the issue before the ITAT. The learned AR limited the contention to ground No.4.6(d) mentioned above. It was submitted that the AO / TPO had excluded companies having turnover less than Rs.1 crore, however, the TPO has not put an upper limit to the turnover for exclusion of companies having higher turnover. The learned AR relied on the following judicial pronouncements, in which the companies having high turnover (more than Rs.200 crore) were rejected :-

(i) Arista Networks India Private Limited [IT(TPA) No.2440/Bang/2019 (order dated 05.10.2021)]

(ii) Zynga Game Network India Pvt. Ltd. [IT(TPA) No.36/Bang/2019

6.4 The learned AR submitted that if the above proposition is accepted, the following six companies has to be excluded from the list of comparables, namely, (i) Larsen & Toubro Infotech Limited, (ii) Mindtree Limited, (iii) Persistent Systems Limited, (iv) R S Software (India) Limited, (v) Infosys Systems Limited, and (vi) Thirdware Solutions Limited.

6.5 The learned Departmental Representative supported the orders of the Income Tax Authorities.

6.6 We have heard rival submissions and perused the material on record. The AO / TPO had excluded companies having turnover of less than Rs.1 crore, however, the AO / TPO has not put upper limit to turnover for exclusion of companies having high turnover. The company having very high turnover cannot be compared to the company like the assessee, whose turnover is only Rs.56.11 crore. This proposition has been accepted by the Hon'ble Bombay High Court in the case of CIT v. Pentair Water Private Limited in ITA No.18/2018 (judgment dated 16.09.2015). The recent orders of the Bangalore Bench of the Tribunal in the case of M/s.Zynga Game Network India Private Limited v. DCIT in ITA No.2573/Bang/2018 (order dated 23.03.2021) and Pearson India Support Services Private Limited v. DCIT in ITA No.3171/Bang/2018 (order dated 28.06.2019) had followed the judgement of the Hon'ble Bombay High Court in the case

of CIT v. Pentair Water Private Limited (supra) and directed the AO / TPO to exclude from the list of comparables, the companies having turnover of more than Rs.200 crore. The relevant finding of the ITAT in the case of Zynga Game Network India Private Limited v. DCIT (supra), reads as follows:-

> *"38. We note that Ld.AO/TPO has applied filter of more than Rs.1 crore, but did not put an upper limit to the filter. This Tribunal in case of Genesis Integrating Systems India Pvt Ltd vs DCIT reported in (2012) 53 SOT 159 and various other decisions have held that, companies having turnover in excess of Rs.200 crores cannot be compared with companies having turnover less than Rs.200 crore. This preposition has been accepted by Hon'ble Bombay High Court in case of CIT vs Pentair Water Pvt.Ltd., by order dated 16/09/2015 in ITA No. 18/2015. Hon'ble Court upheld rejection of companies having turnover holding that turnover is a relevant factor in considering comparability of companies.*
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> *39. Objection raised by Ld.CIT.DR has been dealt with by this Tribunal in case of Autodesk India Pvt.Ltd. vs DCIT in (2018) 96 taxmann.com 263 for assessment year 2005-06. This Tribunal reviewed gamut of case laws to consider, whether companies having turnover more than Rs.200 crores should be regarded as comparable with a company having turnover less than 200 crore. This Tribunal held as under:*
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> > "17.7 We have considered the rival submissions. The substantial question of law (Question No.1 to 3) which was framed by the Hon'ble Delhi High Court in the case of Chryscapital Investment Advisors (India) Pvt. Ltd., (supra) was as to whether comparable can be rejected on the ground that they have exceptionally high profit margins or fluctuation profit margins, as compared to the Assessee in transfer pricing analysis. Therefore as rightly submitted by the learned counsel for the Assessee the observations of the Hon'ble High Court, in so far as it refers to turnover, were in the nature of obiter dictum. Judicial discipline requires that the Tribunal should follow the decision of a non-jurisdiction High Court, even though the said decision is of a nonjurisdictional High Court. We however find that the Hon'ble Bombay High Court in the case of Pentair Water India (P.) Ltd. (supra) has taken the view that turnover is a relevant criterion for choosing companies as comparable companies in determination of ALP in transfer pricing cases. There is no decision of the jurisdictional High Court on this issue. In the circumstances, following the principle that where two views are available on an issue, the view favourable to the Assessee has to be adopted, we respectfully follow the view of the Hon'ble Bombay High Court on the issue. Respectfully following the aforesaid decision, we uphold the order of the DRP excluding 5

companies from the list of comparable companies chosen by the TPO on the basis that the 5 companies turnover was much higher compared to that the Assessee.

17.8 In view of the above conclusion, there may not be any necessity to examine as to whether the decision rendered in the case of Genisys Integrating Systems (I) (P.) Ltd. (supra) by the ITAT Bangalore Bench should continue to be followed. Since arguments were advanced on the correctness of the decisions rendered by the ITAT Mumbai and Bangalore Benches taking a view contrary to that taken in the case of Genisys Integrating Systems (I) (P.) Ltd. (supra), we proceed to examine the said issue also. On this issue, the first aspect which we notice is that the decision rendered in the case of Genisys Integrating Systems (I) (P.) Ltd. (supra) was the earliest decision rendered on the issue of comparability of companies on the basis of turnover in Transfer Pricing cases. The decision was rendered as early as 5.8.2011. The decisions rendered by the ITAT Mumbai Benches cited by the learned DR before us in the case of Willis Processing Services (supra) and Capegemini India (P.) Ltd. (supra) are to be regarded as per incurium as these decisions ignore a binding co-ordinate bench decision. In this regard the decisions referred to by the learned counsel for the Assessee supports the plea of the learned counsel for the Assessee. The decisions rendered in the case of NTT Data (supra), Societe Generale Global Solutions (supra) and LSI Technologies (supra) were rendered later in point of time. Those decisions follow the ratio laid down in Willis Processing Services (supra) and have to be regarded as per incurium. These three decisions also place reliance on the decision of the Hon'ble Delhi High Court in the case of Chriscapital Investment (supra). We have already held that the decision rendered in the case of Chriscapital Investment (supra) is obiter dicta and that the ratio decidendi laid down by the Hon'ble Bombay High Court in the case of Pentair (supra) which is favourable to the Assessee has to be followed. Therefore, the decisions cited by the learned DR before us cannot be the basis to hold that high turnover is not relevant criteria for deciding on comparability of companies in determination of ALP under the Transfer Pricing regulations under the Act. For the reasons given above, we uphold the order of the CIT(A) on the issue of application of turnover filter and his action in excluding companies by following the ratio laid down in the case of Genisys Integrating (supra)."

40. Ld.AR submitted that though this decision was rendered with reference to AY 2005-06 and 2006-07, same reasoning would apply to AY 2015-16 also and in this regard. Based upon above discussions and the decision relied by Ld.AR herein above. We are of opinion that objection raised by revenue cannot withstand the test of law.

Accordingly we direct Ld. AO/TPO to exclude Tata Elxi Ltd (Seg.), Mindtree Ltd., Larsen and Toubro Infotech Ltd., RS Software (India) Ltd.,

Persistent Systems Ltd., Nihilent Technologies Ltd., Infosys Ltd., Cybage software Pvt.Ltd. for having high turnover as compared to a captive service provider like assessee."

6.7 As mentioned earlier, the assessee's turnover is Rs.56.11 crore. The turnover of the six companies for the relevant assessment year, which the assessee is seeking to exclude are as follows:-

Sl No.	Name of the company	Turnover (Rs. In crore)
1	Larsen & Toubro Infotech Limited	4,643.94
2	Mindtree Limited	3,031.60
3	Persistent Systems Limited	1,184.12
4	R S Software (India) Limited	351.88
5	Infosys Systems Limited	44,341.00
6	Thirdware Solutions Limited	206.76

6.8 In view of the judicial pronouncements cited supra, we direct the AO / TPO to exclude the above mentioned six companies, since it is having turnover exceeding Rs.200 crore. It is ordered accordingly.

6.9 In the result, ground No.4.6(d) is allowed.

Interest on outstanding receivables from AE (Grounds No.4.11 to 4.14)

7. The TPO did not consider the assessee's submission that the trade receivables are not separate international transaction and impact if any, gets subsumed by way of working capital adjustment. In this regard, the TPO has proceeded to re-characterize the trade receivable from AEs as loan to AEs and imputed interest on average trade receivables

during the year for a period of 335 days (i.e. allowing a credit period of 30 days) at 6 month LIBOR plus 400bps (resulting in 4.3836%). The same has resulted in an adjustment amounting to INR 1,20,83,994.

7.1 The DRP rejected the assessee's objection regarding interest on delayed receivables. Consequently, the adjustment in this segment remained unchanged at Rs.1,20,83,994.

7.2 Aggrieved, the assessee has raised this issue before the Tribunal. The learned Counsel for the assessee submitted that the assessee had undertaken working capital adjustment to consider the impact of extended credit period. It was stated that the working capital adjustment were made to analyse the operational performance of the company. Therefore, receivable amounts get adjusted in the working capital adjustments, hence, another separate addition is not required under the TP provision. In this context, the learned AR relied on the ITAT order in assessee's own case for assessment year 2008-2009 in ITA No.1294/Bang/2012 (order dated 31.10.2016).

7.3 The learned Departmental Representative was duly heard.

7.4 We have heard rival submissions and perused the material on record. The Tribunal in assessee's own case for assessment year 2008-2009 (supra) had directed AO / TPO to determine afresh the ALP in respect of providing SWD services

by considering the proper working capital adjustment in comparable prices. It was held by the Tribunal that in case after giving necessary adjustment, the international transaction of the assessee is found to be at arm's length, then there is no question of separate adjustment on account of allowing credit period from receivables from AE. The relevant finding of the Tribunal in assessee's own case for assessment year 2008-2009 reads as follows:-

> *"23. We have heard the learned Counsel for the assessee as well as learned Departmental Representative and considered the relevant material on record. At the outset we note that this issue has been considered and decided by this Tribunal in a series of decisions including the decision in the case of M/s. Dell International Services India Pvt. Ltd. Vs. JCIT in ITA No.308/Bang/2015 Dt.17.6.2016 wherein the Tribunal has considered this issue in para 7 as under :*
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> > *" 7. We have considered the rival submissions and relevant material on record. At the outset, we note that allowing a credit period on receivable from AE is not an independent international transaction however, it is part of the main international transaction of providing software development services by the assessee to its AEs. There are series of decisions wherein the Tribunal has considered this transaction as part of the main international transaction between the assessee and its AE and therefore the treatment of the same at the time of determining the arm's length of the international transaction has to be given in the shape of allowing the necessary adjustment in the comparable prices on account of working capital adjustment. We find that the Mumbai Bench of the Tribunal in the case of Goldstar Jewellery Ltd. in ITA No.6570/Mum/2012 vide order dt.14.1.2015 as well as the Delhi Bench of the Tribunal in the case of Kusum Healthcare Pvt. Ltd. Vs. ACIT in ITA No.6814/Del/2014 vide order dt.31.3.2015 has taken this view that allowing the credit period over and above normal credit period prevailing in the industry is certainly relevant and part of the main international transaction of sale or purchase between the assessee and the AE. However, it was held that it cannot be treated as an independent international transaction de horse the main international transaction between the parties. We further note that an identical issue was considered and decided by the Mumbai Bench of this Tribunal in the case of Information Systems Resource Centre Pvt. Ltd. Vs. ACIT in ITA No.7757/Mum/2012 and C.O. 282/Mum/2013 vide order dt.29.5.2015 in paras 11 to 13 as under :*

" 11. We have considered the rival submissions as well as the relevant material on record. In the present case, the sale transaction of the assessee with its A.E. have been accepted by the Transfer Pricing Officer / Assessing Officer at arm's length and no adjustment has been made in respect of the sale transaction. However, the Transfer Pricing Officer has made the adjustment on account of credit period provided by the assessee to the A.E. on realisation of sale proceeds. At the outset, we note that an identical issue has been considered by the co– ordinate bench of the Tribunal, Mumbai Benches, in Goldstar Jewellery Ltd. (supra), vide Para–8, held as under:–

"8. We have considered the rival submissions and relevant material on record. The assessee has reported international transaction in its TP report regarding sale to its AE from manufacture of jewellery units and diamond trading unit. The TPO accepted the price charged by the assessee from AE at arm's length. However, the TPO has made the adjustment on account of notional interest for the excess period allowed by the assessee to AE for realization of dues. The TPO applied 18.816% per annum as arm's length on the over due amounts of AE and proposed adjustment of Rs. 2,49,95,139/-. The DRP though concurred with the view of the Assessing Officer/TPO on the issue of international transaction, however, the adjustment was reduced by applying the interest rate of 7% instead of 18.816% applied by the TPO. The first issue raised by the assessee is whether the aggregate period extended by the assessee to the AE which is more than the average credit period extended to the nonAE would constitute international transaction. We are of the view that after the insertion of explanation to section 92B(1), the payment or deferred payment or receivable or any debt arising during the course of business fall under the expression international transaction as per explanation. Therefore, in view of the expanded meaning of the international transaction as contemplated under clause (i) (e) of explanation to section 92B(1), the delay in realization of dues from the AE in comparison to non-AE would certainly falls in the ambit of international transaction. However, this transaction of allowing the credit period to AE on realization of sale proceeds is not an independent international transaction but it is a closely linked or continuous transaction along with sale transaction to the AE. The credit period allowed to the party 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 OECD 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 transactions then those transactions can safely be regarded as closely linked 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 nonAE 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 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 Assessing Officer/TPO to re-do the exercise of determination of ALP in terms of above observation." 12. Thus, it is clear that the Tribunal has taken a view that the transaction of allowing the credit period to the A.E. on realisation of sale proceeds has to be considered along with the main international transaction in respect of sale to A.E. A similar view has been taken by the Tribunal, Delhi Bench, in Kusum Healthcare Pvt. Ltd. (supra), wherein the Tribunal, vide Para–7 to 10, held as under:–

" 7. We have heard rival submissions and perused the material on record. An uncontrolled entity will expect to earn a market rate of return on its working capital investment independent of the functions it performs or products it provides. However, the amount of capital required to support these functions varies greatly, because the level of inventories, debtors and creditors varies. High levels of working capital create costs either in the form of incurred interest or in the form of opportunity costs. Working capital yields a return resulting from a) higher sales price or b) lower cost of goods sold which would have a positive impact on the operational result. Higher sales prices acts as a return for the longer credit period granted to customers. Similarly in return for longer credit period granted, a firm should be willing to pay higher purchase price which adds to the cost of goods sold. Therefore, high levels accounts receivable and inventory tend to overstate the operating results while high levels of accounts payable tend to understate them thereby necessitating appropriate adjustment. The appropriate adjustments need to be considered to bring parity in the working capital investment of the assessee and the comparables rather than looking at the receivable independently. Such working capital adjustment takes into account the impact of outstanding receivables on the profitability. In this regard, the reliance is placed on the following rulings wherein the need to undertake working capital adjustment has been appreciated by the Hon'ble Tribunals :

- *Mercer Consulting India Pvt. Ltd. [TS-170-ITAT-2014(DEL)]*
- *Mentor Graphics (Noida) Private Limited [109 ITD 101]*
- *Egain communication (P) Ltd. [ITA No. 1685/PN/2007]*
- *Sony India (Pvt.) ltd. [2011-TII-43-ITAT-DEL-TP]*
- *Capgemini India Private Limited [TS-45-ITAT-2013(Mum)-TP]*

8. In view of the above, a working adjustment appropriately takes into account the outstanding receivable. Therefore, the assessee has undertaken a working capital adjustment to reflect these differences by adjusting for differences in working capital and thereby, profitability of each comparable company. Accordingly, while calculating the working capital adjusted, operating margin on costs of the comparable companies, the impact of outstanding receivables on the profitability has been taken into account. If the pricing/ profitability of the assessee are more than the working

capital adjusted margin of the comparables, then additional imputation of interest on the outstanding receivables is not warranted.

9. The assessee had undertaken a working capital adjustment for the comparable companies selected in its transfer pricing report which was also submitted with the Ld. TPO. A snapshot of the result is provided below: Segment Name Appellant's Margin (OP/TC) Working capital adjusted margins of comparables (OP/TC) Manufacturing Activity 46.33% 11.84% Trading Activity 17.44% 8.36% 10. The above analysis empirically demonstrates that the differential impact of working capital of the vis-a-vis its comparables has already been factored in the pricing/profitability of the assessee which is more than that working capital adjusted margin of the comparables. Hence, any further adjustment to the margins of the assessee on the pretext of outstanding receivables is unwarranted and wholly unjustified."

Following the orders of the Tribunal, we set aside this issue to the record of the Assessing Officer / Transfer Pricing Officer and direct to re–do the exercise of determination of arm's length price in the light of the above decisions of the Tribunal. The grounds raised in this cross objection are allowed for statistical purposes." Following the earlier orders of this Tribunal, we set aside this issue to the record of the A.O./TPO with the direction to redo the exercise of determination of ALP by considering the proper working capital adjustment in the comparable prices in respect of transaction of software development services provider to the AE. We make it clear that if after giving the necessary adjustment the international transaction of the assessee is found at arm's length then there is no question of any separate adjustment on account of allowing the credit period on the receivable from AE. We further clarify that the normal credit period allowed for the receivable from the AE shall be the credit period prevailing in the industry and therefore we are of the view that two months credit period should be taken as a normal business practice in the industry. The TPO/A.O shall also consider the benchmark interest rate as LIBOR/PLR in the light of various precedents on this issue."

A similar view has been taken by this Tribunal in a series of other decisions as referred in the earlier decisions as well as relied upon by the ld. AR of the assessee. Accordingly, taking a consistent view we set aside this issue to the record of the A.O./TPO with the direction to redo the determination of ALP in respect of providing software development services by considering the proper working capital adjustment in comparable price. In case after giving the necessary adjustment the international transaction of the assessee is found at arm's length then there is no question of separate adjustment on account of allowing credit period on receivable from the AE."

7.5 Taking a consistent stand, we direct the AO / TPO to redo the transfer pricing analysis in respect of interest on outstanding receivables by taking into account the directions of the Tribunal in assessee's own case for assessment year 2008-2009 (supra). It is ordered accordingly.

7.6 In the result, Grounds No.4.11 to 4.14 are allowed for statistical purposes.

Corporate Tax Issues (Ground No.5.1)

8. The assessee had given advances to the employees against their salary for meeting expenses on food and travel while working on clients deliverables / projects. Further, some advances were also given to various vendors / service providers for carrying out various services in connection with the operations of the assessee. Certain advances could not be recovered from the employees who had left the services of the assessee and also from the vendors due to various reasons. The advances which could not be recovered has been written of to the profit and loss account of the assessee for the relevant assessment year and claimed as allowable expenses / business loss in terms of section 37(1) r.w.s. 28 of the I.T.Act.

8.1 However, the claim of the assessee was rejected by the Assessing Officer. According to the A.O., the assessee had claimed advances as bad debts. It was held by the A.O., as per the provisions of section 36 of the I.T.Act, bad debts can be allowed only if it is trade receivables, which has been

already offered to income in the previous year and the same has not been received subsequently. It was further held by the A.O. that the advances paid and written of as bad debt will not fall under the provisions of the Income-tax Act as lending or advancing amount is not the business of the assessee. Therefore, the advances given by the assessee was disallowed for the reason that it is not for the purpose of business and the claim of bad debt is not permissible as the same has not been offered as income in the previous year. The view taken by the Assessing Officer was affirmed by the DRP in his directions dated 05.09.2018.

8.2 Aggrieved, the assessee has raised this issue before the Tribunal. The learned AR reiterated the submissions made before the Income Tax Authorities.

8.3 The learned Departmental Representative relied on the finding of the AO / DRP.

8.4 We have heard rival submissions and perused the material on record. The claim made by the assessee is not towards bad debt u/s 36(1)(vii) of the I.T.Act, but under the provisions of section 28 of the I.T.Act as business or trade loss. Giving advance to the employees as well as vendors were essential and wholly and exclusively linked to the business of the assessee. The loss if any is an incidental business loss. In this context, we rely on the judgment of the Hon'ble Delhi High Court in the case of Triveni Engineering & Industries Limited (ITA No.56 of 2009). Further, the advances given to

the vendors, which is non-recoverable, is also allowable as business loss. This proposition has also been upheld by the Hon'ble Apex Court in the case of Mysore Sugar Co. Ltd. (1962) 46 ITR 649. Since the A.O. has not examined the claim of deduction u/s 37(1) r.w.s. 28 of the I.T.Act, we deem it appropriate to restore the issue to the files of the A.O. for *de novo* consideration. The assessee is directed to furnish necessary evidences before the A.O. The A.O. is directed to dispose of the matter expeditiously after affording a reasonable opportunity of hearing to the assessee.

8.5 Hence, ground No.5.1 is allowed for statistical purposes.

Ground No.5.2

9. The company paid aggregate amount of Rs.79,74,715 as per diem to the employees travelling for business / official purposes outside India to cover actual expenses of meals, travel, laundry and miscellaneous expenses etc. The Assessing Officer disallowed on an adhoc basis 10% of the per diem allowance granted to the employees, thereby making a disallowance of Rs.7,97,471. The relevant observation of the A.O. in the draft assessment order in making adhoc disallowance of 10% of the per diem reads as follows:-

> *"7. The assessee has granted per diem allowance to its directors and employees to meet out official expenses. But the assessee has not sought any proof of the expenditure from its employees. It has merely furnished the basis of arriving at the expenditure. The question of whether the expenditure has actually been incurred or the extend to which it was actually incurred or whether it was incurred for business purposes could not be verified. Considering the above scenario, I am of the opinion that the expenditure has been incurred wholly and*

> *exclusively for the purposes of business. Therefore, the undersigned is proposed to disallow the 10% of Rs.79,74,715 of a diem allowances for non production of any supporting evidences to establish that the same has been utilized for the purpose of business and added back to total income under section 36(1)(iii) of the Income-tax Act, 1961, of the assessee-company."*

9.1 The view taken by the A.O in the draft assessment order was confirmed by the DRP. The DRP held that the assessee was required to prove that the expenditure was incurred, which the assessee has failed to prove.

9.2 Aggrieved, the assessee has raised this issue before the Tribunal. The learned AR reiterated the submissions made before the Income Tax Authorities.

9.3 The learned Departmental Representative was duly heard.

9.4 We have heard rival submissions and perused the material on record. The per diem is given to the employees to meet daily expenses for foreign travels. The expenses are reimbursed on the basis of self-declaration of the employees. Since, these amounts are small amounts, reimbursement are given based on the self-declaration given by the employees. Per diem allowance is very minimal amount to meet the daily need and is not disproportionate or unreasonable. In this context, we rely on the judgment of the Hon'ble jurisdictional High Court in the case of *CIT v. Symphony Marketing Solutions India (P.) Ltd. reported in (2016) 388 ITR 457 (Karn.)*, wherein it was held that *"..... per diem allowance of $50 to*

$75 paid by the assessee to its employees on official trips to the USA and Europe to be reasonable….."

9.5 In view of the aforesaid reasoning and judicial pronouncement cited above, we are of the view that adhoc disallowance of 10% of per diem by AO and confirmed by the DRP is uncalled for. Therefore, we delete the disallowance. It is ordered accordingly.

9.6 Hence, ground No.5.2 is allowed.

10. In the result, the appeal filed by the assessee is partly allowed for statistical purposes.

Order pronounced on this 01st day of November, 2021.

Sd/-	**Sd/-**
(B.R.Baskaran)	**(George George K)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

Bangalore; Dated : 01st November, 2021.
Devadas G*

Copy to :
1. The Appellant.
2. The Respondent.
3. The DRP-2, Bengaluru.
4. The Pr.CIT-7, Bengaluru.
5. The DR, ITAT, Bengaluru.
6. Guard File.

Asst.Registrar/ITAT, Bangalore