

**IN THE INCOME TAX APPELLATE TRIBUNAL
'C' BENCH : BANGALORE**

**BEFORE SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER
AND
SMT. BEENA PILLAI, JUDICIAL MEMBER**

IT(TP)A No. 235/Bang/2021
Assessment Year : 2016-17

M/s. Arm Embedded Technologies Pvt. Ltd., Bagmane World Technology Center, SEZ Citrine Block, 5 th Floor, Marathahalli Outer Ring Road, Doddanekkundi Village, Mahadevapura, Bengaluru – 560 048. PAN: AAECA1582E	Vs.	The Deputy Commissioner of Income Tax, Circle 1 (1)(1), Bengaluru.
APPELLANT		RESPONDENT

Assessee by	:	Shri T. Suryanarayana, Advocate
Revenue by	:	Shri Praveen Karanth, CIT-DR

Date of Hearing	:	27-07-2022
Date of Pronouncement	:	30-08-2022

ORDER

PER BEENA PILLAI, JUDICIAL MEMBER

Present appeal is filed by the assessee against order dated 07/04/2021 by the National e-Assessment Centre, Delhi for A.Y. 2016-17 on following grounds of appeal:

“The grounds mentioned herein by the Appellant are without prejudice to one another.

1. That the order of the Deputy Commissioner of Income-tax, National e-Assessment Centre, Delhi / Deputy Commissioner of Income-tax, Circle 1(1)(1), Bengaluru (learned AO) dated 07 April 2021, passed under Section 143(3) read with section 144C(13) of the Act, pursuant to

the directions of the learned Dispute Resolution Panel ('learned Panel') to the extent prejudicial to the Appellant, is bad in law and liable to be quashed.

2. That on the facts and in the circumstances of the case, the learned Panel and the learned AO erred in upholding the learned TPO's approach of determining the arm's length price for the provision of software development

MOW ('SWD') services and provision of marketing and sales support services (MSS') segments of the Appellant by:

2.1 Rejecting the value of international transaction of provision of SWD and provision of MSS, as recorded in the books of account. as the arm's length price.

2.2 Rejecting the TP documentation maintained by the Appellant under Section 92D of the Act, in good faith and with due diligence.

2.3 Applying the provisions of Rule 10B(5) read with Rule 10CA(2) and Rule 10CA(4) of the Income-tax Rules, 1962 ('the Rules') while undertaking the fresh benchmarking analysis.

2.4 Rejecting the Company's contentions against that the use of information under section 133(6) of the Act, which tantamounts to choosing secret comparable companies whose information were not available in public domain while undertaking the TP study for the respective financial year and without prejudice. not sharing the responses received under section 133(6) with the Appellant.

2.5 Conducting a fresh comparability analysis by rejecting certain filters applied by the Appellant in the TP documentation as below:

- Research and development (R&D) > 3% of sales*
- Net fixed assets > 200% of sales*

2.6 Applying additional / modified filters in the fresh comparability analysis undertaken as below:

- Companies with export service income > 75% of sales were selected*
- Companies whose income from core service > 75% of sales were selected (the Appellant had also applied this filter with a lower threshold of 50%)*
- Companies with employee cost > 25% of operating cost were selected*
- Companies with different financial year ending were rejected*

2.7. Using data, which was not contemporaneous, and which was not available in the public domain at the time of preparing the TP documentation.

2.8 Application of related party transaction ('RPT') filter by applying an inappropriate interpretation of computing the filter and thereby accepting Persistent Systems Ltd., Aspire Systems (India) Pvt. Ltd. and Thirdware Solution Ltd. as comparable companies to the SWD services segment of the Appellant, though they fail the RPT filter.

2.9 Holding that decisions of this Hon'ble Tribunal cannot be relied upon while adjudicating the comparability of certain companies and that companies cannot be rejected for non-availability of segment information.

SWD services segment

2.10 Including the following companies even though such companies are functionally different (such as engaged in R&D activities, presence of intangibles, significant onsite revenue, etc.) from the Appellant.

- R S Software (India) Ltd.
- Larsen & Toubro Infotech Ltd.
- Nihilent Ltd.
- Inteq Software Pvt. Ltd.
- Persistent Systems Ltd.
- Infobeans Technologies Ltd.
- Thirdware Solution Ltd.
- Infosys Ltd.
- Aspire Systems (India) Pvt. Ltd.
- Cybage Software Pvt. Ltd.

2.11 Excluding the following companies even though the same are functionally comparable to the Appellant.

- Akshay Software Technologies Ltd.
- Sasken Communication Technologies Ltd.
- Evoke Technologies Pvt. Ltd.
- Yudiz Solutions Private Ltd.
- Smartcloud Infoservices Pvt. Ltd.

MSS segment

2.12. Including the following companies even though such companies are functionally different (such as engaged in commission activities, intermediary and outsourcing functions, technology and litigation support, etc.) from the Appellant.

- Killick Agencies & Marketing Ltd.
- Scarecrow Communications Ltd.
- iRunaway India Pvt. Ltd.

2.13 Excluding the following companies even though the same are functionally comparable to the Appellant and data is available in the public domain.

- *Cheers Interactive India Pvt. Ltd.*
- *MCI Management India Pvt. Ltd.*
- *Showhouse Event Management Pvt. Ltd.*
- *Competent Automobiles Co. Ltd.*
- *Empire Industries Ltd. (Trading and Indenting)*

2.14 Not considering certain expenses such as provision for doubtful debts, provision for warranties, provision for doubtful deposits, miscellaneous expenditure written off as operating, on the premise that these are not the C routine operating cosfs to be for determining the mark-up of the comparable companies

3. That on the facts and in the circumstances of the case, the learned Panel and the learned AO erred in making an adjustment of INR 1,954,655 in respect of notional interest on outstanding receivables from associated enterprises ('AEs') to the income of the Appellant by considering overdue receivables from AEs as a separate international transaction under the provisions of section 92B of the Act.

3.1 That without prejudice, the learned AO / Panel ought to have considered the weighted average realization period of receivables for the Appellant, which is only 28 days in respect of the SWD services segment and 29 days in respect of the MSS segment.

3.2 That without prejudice, the learned AO / Panel erred in ignoring that, if at all a TP adjustment has to be sustained with respect to notional interest on overdue receivables. interest should be computed using LIBOR as against SBI short term deposit rate.

4. That on the facts and in the circumstances of the case, the learned Panel and the learned AO erred in not providing working capital adjustment for determining the arm's length price while relying on the judicial precedents based on a fact pattern, which is not applicable to the Appellant

5. Not providing suitable adjustment to account for differences in the risk profile of the Appellant vis-a-vis the comparable companies.

6. That on the facts and in the circumstances of the case, the learned AO and the learned TPO erred in not conforming with the directions of the learned Panel while computing the mark-up on operating cost of certain comparable companies.

7. That on the facts and in the circumstances of the case, the learned AO erred in not granting consequential relief in the computation of interest of INR 1,206,532 u/s 234A, INR 36,799,226 u/s 234B and INR 4,086 u/s 234C of the Act while computing the tax payable.

8. That on the facts and in the circumstances of the case, the learned AO has erred in serving notice under section 271(1)(c) of the Act and initiating penalty proceedings for concealment of income and for furnishing inaccurate particulars of such income.

That the Appellant craves leave to add to and/or to alter, amend, rescind, modify the grounds herein below or produce further documents before or at the time of hearing of this appeal."

Brief facts of the case are as under :

2.1 The assessee is a subsidiary of Arm Limited, UK. The Appellant is engaged in providing contract SWD and MSS services to its AEs. It filed its return of income for the A.Y. 2016-17 on 11/11/2016 declaring total income of Rs.32,01,14,040/-. Subsequently, the case was selected for scrutiny. Statutory notice u/s 143(2) of the Act along with notice u/s 142(1) were issued and served on the assessee.

2.2 The Ld.AO noted that, during the F.Y. 2015-16, the assessee company had international transactions as per Section 92 of the Income-tax Act, 1961. According to Section 92CA of the Income-tax Act, 1961, the case was referred to the Transfer Pricing Officer in order to determine the Arm's Length Price after obtaining necessary approval.

2.3 The Ld.TPO observed that the assessee had following international transaction with its AE for the year under consideration:

Particulars	Amount in Rs.
Receipts from provision of contract SWD services	254,51,50,802/-
Receipts from provision of contract MSS services	3,56,17,182/-
Receipts from provision of resource augmentation services	8,29,521/-
Reimbursement of travel expenses	20,38,151/-
Reimbursement of expenses received Resource augmentation services	74,61,814/-
Reimbursement of expenses received – others	52,63,595/-
Remittance made on behalf of employees towards RSU	12,74,20,517/-
Reimbursement of expenses paid towards ESPP	Rs.5,90,21,834/-

2.4 The Ld.TPO noted that the assessee used TNMM as the most appropriate method and OP/OC as PLI to compute its margin under SWD and ITES segment. The assessee computed its margin at 11.4% for SWD segment and 7.99% for MSS segment. The assessee used following comparables under both the segments having

SWD Segment:

Sl.No.	Name of the company	Weighted average
1.	CG-VAK Software & Exports Ltd.	9.83
2.	Cigniti Technologies Ltd.	10.97
3.	Kals Information Systems Ltd.	10.76
4.	Melstar Information Technologies Ltd.	-3.43
5.	Mindtree Ltd.	20.84
6.	Persistent Systems Ltd.	31.06

7.	RS Software (India) Ltd.	28.85
8.	TVS Infotech Ltd.	3.58
9.	Tata Elxsi Ltd.	18.46
10.	Tera Software Ltd.	13.14
11.	Akshay Software Technologies Ltd.	0.04
12.	Evoke Technologies Pvt. Ltd.	5.47
13.	R Systems International Ltd.	24.36
14.	Sasken Communication Technologies Ltd.	27.83
35th Percentile		9.83
Median		12.06
65th Percentile		20.84

MSS segment:

Sl. No.	Name of the company	Weighted average
	Majestic Research Services & Solutions Ltd.	19.01
1.	Mig Media Neurons Ltd.	11.76
2.	Cheers Interactive India Pvt. Ltd.	1.77
3.	MCI Management India Pvt. Ltd.	6.40
4.	Showhouse Event Management Pvt. Ltd.	4.48
5.	Competent Automobiles Co. Ltd.	8.22
6.	Empire Industries Ltd.	3.98
7.	Priya International Ltd.	17.68
35th Percentile		4.48
Median		7.31
65th Percentile		11.76

2.5 As the 35th percentile of the comparables under both the segment was within +/- 5% range, the assessee concluded its transaction under SWD and MSS segment to be at arms length.

Dissatisfied with the approach by the assessee the Ld.TPO applied following filters:

SWD segment:

	Filters applied by the Ld.TPO
1.	Companies for which financial information for 1 out of 3 years was not available – rejected.
2.	Companies having different financial year ending (i.e. not March 31,2016 or data of the company which does not fall within 12-month period i.e. 01-04-2015 to 31-03-2016 – rejected.
3.	Companies whose SWD service income is less than 75% of its total operating revenues – excluded.
4.	Companies having more than 25% related party transactions of the sales – excluded.
5.	Companies who have export service income less than 75% of the sales – excluded.
6.	Companies with employee cost less than 25% of turnover – excluded.
7.	Companies having positive net worth- selected.
8.	Companies making persistent losses (loss for any 2 years out of last 3 years)- excluded.
9.	Companies with turnover > 1 crore- selected

MSS segment:

	Filters applied by the Ld.TPO
1.	Companies having different financial year ending (i.e. not March 31,2016 or data of the company which does not fall within 12-month period i.e. 01-04-2015 to 31-03-2016-rejected

2.	Companies whose income was less than Rs. 1Crore – excluded
3.	Companies whose MSS service income is less than 75% of its total operating revenues – excluded
4.	Companies who have more than 25% related party transactions – excluded
5.	Companies who have negative net worth – excluded.
6.	Companies making persistent losses (i.e. for any 2 years out of the last 3 years) – excluded

2.6 The Id.TPO after considering the submissions, shortlisted following comparables under both the segment:

SWD Segment:

Sl. No.	Name of the Company	Weighted average (in %)
1.	Kals Information Systems Ltd.	8.60
2.	E-Zest Solutions Ltd.	10.87
3.	Rheal Software Pvt. Ltd.	14.50
4.	CG-VAK Software & Exports Ltd.	18.50
5.	R S Software (India) Ltd.	20.87
6.	Larsen & Toubro Infotech Ltd.	24.83
7.	Nihilent Technologies Ltd.	26.36
8.	Cigniti Technologies Ltd.	27.34
9.	Inteq Software Pvt. Ltd.	28.20
10.	Persistent Systems Ltd.	30.89
11.	Infobeans Technologies Ltd.	32.42
12.	Thirdware Solution Ltd.	36.90
13.	Infosys Ltd.	38.61

14.	Aspire Systems (India) Pvt. Ltd.	39.28
15.	Cybage Software Pvt. Ltd.	66.45
35th Percentile		24.83
Median		27.34
65th Percentile		30.89

MSS Segment:

Sl. No.	Name of the Company	Mark-up on Total Costs (WC-unadj) (in %)
1.	Quadrant Communications Ltd.	-0.34
2.	Esha Media Research Ltd.	-1.60
3.	Goldmine Advertising Ltd.	5.94
4.	Pressmine Advertising Ltd.	12.99
5.	Ugam Solutions Pvt. Ltd.	17.75
6.	Majestic Research Services & Solutions Ltd.	20.94
7.	Killick Agencies & Marketing Ltd.	20.99
8.	Scarecrow Communications Ltd.	23.12
9.	Irunway India Pvt. Ltd.	25.09
35th Percentile		14.14
Median		17.75
65th Percentile		20.94

2.7 The Ld.TPO thus proposed the adjustment under both the segments being the shortfall as under:

SWD segment:

Taxpayers operating revenue	Rs. 254,51,50,802/-
Taxpayer operating cost	Rs. 220,75,75,550/-
Taxpayers operating profit	Rs. 33,75,75,252/-
Taxpayers PLI	15.29%

35 th Percentile Margin of comparables set	24.83%
Adjustment required (if PLI<35 th Percentile)	Yes
Median margin of comparable set	27.34%
Arm's length price	Rs. 281,11,26,705/-
Price received	Rs. 254,51,50,802/-
Shortfall being adjustment u/s. 92CA	Rs. 26,59,75,903/-

MSS segment:

Taxpayers operating revenue	Rs. 3,56,17,182/-
Taxpayer operating cost	Rs. 3,29,82,027/-
Taxpayers operating profit	Rs. 26,35,155/-
Taxpayers PLI	7.99%
35 th Percentile Margin of comparables set	14.14%
Adjustment required (if PLI<35 th Percentile)	Yes
Median margin of comparable set	17.75%
Arm's length price	Rs. 3,88,36,337/-
Price received	Rs. 3,56,17,182/-
Shortfall being adjustment u/s. 92CA	Rs. 32,19,155/-

2.8 On receipt of the order passed under section 92CA by the Ld.AO, the proposed transfer pricing adjustment is the addition proposed in the draft assessment order.

2.9 Aggrieved by the Draft assessment order, the assessee raised objection before the DRP. The directions by the DRP are as follows:

- (i) The DRP directed recomputation of margin of CG-VAK Software & Exports Ltd., Aspire Systems (India) Pvt. Ltd., Cybage Software Pvt. Ltd., Nihilent Ltd. and Cigniti Technologies Ltd under SWD segment. In MSS segment, Quadrant Communications Ltd., Goldmine Advertising Ltd., Pressman Advertising Ltd., Ugam Solutions Pvt. Ltd., Killick

Agencies & Marketing Ltd. and Scarecrow Communications Ltd. Were directed by the DRP for recomputation of margin.

(ii) Further, the DRP directed the inclusion of Benchmark IT Solutions India Pvt. Ltd., while the other objections of the Appellant on inclusion and exclusion of comparables came to be rejected.

(iii) All other objections of the assessee on inclusion and exclusion of comparables came to be rejected.

2.10 The Ld.AO passed the final assessment order in line with the directions of the DRP, by recomputing the TP adjustment at Rs.16,79,59,549/- for SWD segment and TP adjustment originally proposed was incorporated.

2.11 Aggrieved by the impugned order, the assessee preferred the appeal before this *Tribunal*.

3. The Ld.AR submitted that the assessee wish to argue on following grounds wherein comparable mentioned herein are only pressed:

4. Ground No.2.10: That RS Software (India) Ltd., Larsen & Toubro Infotech Ltd., Nihilent Ltd., Inteq Software Pvt. Ltd., Persistent Systems Ltd., Infobeans Technologies Ltd., Thirdware Solution Ltd., Infosys Ltd., Aspire Systems (India) Pvt. Ltd. and Cybage Software Pvt. Ltd. ought to be excluded on account of the companies being functionally dissimilar to the assessee.

5. Ground No. 2.11: That the Ld.TPO erred in excluding Akshay Software Technologies Ltd, Sasken Communication Technologies Ltd. and Evoke Technologies Pvt. Ltd., even though the same are functionally comparable to the assessee.

6. Ground No. 2.12: That Killick Agencies & Marketing Ltd., Scarecrow Communications Ltd. and iRunway India Pvt. Ltd. ought to be excluded from the final list of comparables as the companies are functional dissimilar to the assessee.

7. Ground No. 2.13: That Cheers Interactive India Pvt. Ltd., MCI Management India Pvt. Ltd. and Showhouse Event Management India Pvt. Ltd., ought to be included in the final list of comparables as the companies are functionally comparable to the assessee.

8. Ground No. 3: Notional interest on delayed receivables computed by the Ld.TPO.

9. Ground No.4: Non-grant of working capital adjustment:

10. Before we undertake the comparability analysis, it is sine qua non to understand the functions performed, assets owned and risks assumed.

Functions:

ARM India is a contract service provider providing contract software development services and marketing and sales support services. Apart from these primary operations, ARM India also provides resource augmentation services to ARM UK and ARM USA.

ARM India has its principal office in Bangalore and Noida, India and its business activities include:

a) Contract software development services: ARM India has entered into a Services Agreement whereby it is required to provide contract software development services predominantly to ARM UK and a small portion of the software development services to ARM US. The services provided by ARM India under the

agreement are contractual in nature and includes, validation, coding and verification of products developed by ARM UK and ARM US. For the projects sourced to ARM India, ARM UK provides the overall specifications and scope. Based on the specification document, ARM India team executes the specifications.

The services provided by ARM India are in the nature of projects / assignments identified by ARM UK and sub-contracted to ARM India from time to time.

There has not been any change in the operating model followed by ARM India in the provision of contract software development services to ARM UK and ARM US in the prior three years. ARM India is compensated with a cost plus arm's length mark-up of 15% for the provision of contract software development services.

b) Contract marketing and sales support services: ARM India also provides marketing and sales support services for ARM UK products in India. These services are provided under the marketing and sales support services agreement entered into with ARM UK.

The marketing and sales support services include conducting market research and forecasts, distribution of promotional materials and the use of advertising materials provided by ARM UK, participation in trade shows, technical symposium and addressing inquiries and information requests from customers.

There has not been any change in the operating model followed by ARM India in the provision of marketing and sales support services to ARM UK in the prior three years. ARM India, in terms of the intercompany agreement is compensated with a cost plus

arm's length mark-up of 8% for the provision of the above services.

Assets owned:

4.7. Assets employed

Any business requires assets (tangible or intangible) without which it cannot carry out its activities. Intangibles play a significant role in the functioning of a business and are accordingly more important. An understanding of the assets employed and owned by ARM India provides an insight into the resources deployed by ARM India and their contribution to the business processes/economic activities of ARM India.

4.7.1. Tangibles owned by ARM India

ARM India owns routine tangible assets like furniture, fixtures, computers, hardware and software tools etc. required for carrying out its operations. All assets of ARM India are either directly or indirectly used for the purpose of carrying out its design and development activity and marketing and sales support services activity.

Table 3: Assets owned by ARM India as on March 31, 2016

S. No.	Particulars of assets	Amount (In INR)
1	Leasehold Improvements	229,722,727
2	Computers Equipment	822,932,437
3	Office Equipment	48,661,108
4	Furniture and Fixtures	71,029,391
5	Computer Software	29,247,982
6	Vehicles	4,126,582
7	Plant and Equipment	93,992,143
	Total	1,299,712,370

4.7.2. Intangibles

ARM India does not own any intangibles and does not undertake any R&D on its own account that leads to the development of non-routine intangibles. ARM India uses the process, know-how, technical data software, operating/ quality standards etc. developed/ owned by ARM UK for its provision of services.

Risk Assumed:

4.8. Risks assumed

The risk profile of ARM India vis-à-vis its AEs is provided in Table 4 below:

Table 4: Risk Profile- Contract software development services

Risk Category and Description	Exposure of ARM India	Exposure to ARM UK and ARM US
Market Risk - Market risk arises for a business due to increased competition and relative pricing pressures, change in demand patterns and needs of customers, inability to develop / penetrate in a market, etc.	With respect to the rendering of contract software development services, ARM India will not have any exposure to market risk as it will render all services on a contract basis exclusively for ARM UK and ARM US on a	The market risks will be borne entirely by the ARM Group since the products are owned by ARM Group.

Risk Category and Description	Exposure of ARM India	Exposure to ARM UK and ARM US
	cost plus mark-up revenue model.	
Product/ Service liability risk - Product development / R&D risk represents risk associated with product/ service failures including non-performance to generally accepted or regulatory standards. This could result in product recalls and possible injuries to end-users.	With respect to the rendering of software development services, ARM India will not bear any product/ service liability risk as the services are rendered directly to ARM UK and ARM US consistent with level of services as agreed in terms of the inter-company arrangement.	All business and market risks with respect to the final product including risk of warranty and product liabilities are borne by ARM UK and ARM US. ARM UK and ARM US is responsible for any claims on the products and claims or product liability insurance expenses accrue to them.
Technology Risk: This risk arises if the market in which the company operates in is sensitive to introduction of new products and technologies. Hence, in that case, business units may face loss of potential revenues due to inefficiencies arising from obsolete infrastructure and tools as well as obsolescence of manufacturing processes.	ARM India does not bear technology risk because it renders contract software service on a cost plus mark-up basis.	ARM UK being the owner of the technology bears the risk of technological obsolescence.
R&D risk: Represents risk that R&D activities performed by an enterprise may not be successful.	ARM India does not perform any R&D activity. ARM India performs software development activities on contractual basis under the review and supervision of ARM UK and ARM US; such development activities are a part of ARM Group's function. Thus, the risk that development activities performed may not be successful, lies with ARM Group.	Since ARM UK is the owner of the development activities, any success or failure of such activities also lies with ARM UK. Thus, the risk of R&D activities is borne solely by ARM UK.
Credit Risk - This is the risk arising from non-payment of dues by customers.	ARM India is not exposed to this risk as it deals with ARM UK and ARM US i.e., ARM Group entities, which assures of payment.	ARM UK and ARM US is exposed to credit risk as it deals with multiple third party customers. The credit facility provided by ARM UK and ARM US to its customer's results in the former bearing the risk of non-payment etc.
Foreign Exchange Risk - This risk relates to the potential impact on profits that may arise because of changes in foreign exchange rates.	ARM India does not carry out any hedging activities. However, since the contract between ARM India and ARM	ARM Group has business dealings with a number of companies in different parts of the world.

Risk Category and Description	Exposure of ARM India	Exposure to ARM UK and ARM US
	is a cost plus arrangement, the foreign exchange risk is passed on to ARM UK and ARM US. In other words, ARM India does not bear any risk on this count.	Therefore, ARM UK and ARM US is exposed to foreign exchange risks.

Table 5: Risk Profile- Marketing and sales support services

Risk Category and Description	Exposure to ARM India	Exposure to ARM UK
Market Risk: Market risk arises for a business due to increased competition and relative pricing pressures, change in demand patterns and needs of customers, inability to develop / penetrate in a market, etc.	With respect to the rendering of marketing and sales support services, ARM India does not have any exposure to market risk as it renders all services on a contract basis exclusively for ARM UK on a cost plus mark-up basis.	The market risks are borne entirely by ARM UK since the products are owned by it. Also, ARM UK holds the responsibility of marketing the products and maintaining the customer relationship.
Product / Service liability risk: Product development / R&D risk represents risk associated with product/ service failures including non-performance to generally accepted or regulatory standards. This could result in product recalls and possible injuries to end-users.	With respect to the rendering of marketing and sales support services, ARM India does not bear any product/service liability risk as it does not have ultimate customer interface.	All business and market risks with respect to the final product including risk of warranty and product liabilities are borne by ARM UK.
Technology risk: Technology risk arises if the market in which the company operates in is sensitive to introduction of new products and technologies. Hence, in that case, business units may face loss of potential revenues due to inefficiencies arising from obsolete infrastructure and tools as well as obsolescence of manufacturing processes.	ARM India does not bear any risk in this count because it operates as a contract service provider, on a cost plus mark-up basis to undertake various services.	ARM India being the provider of the technology bears the risk of technological obsolescence.
Credit Risk: This is the risk arising from non-payment of dues by customers.	ARM India receives all its revenue from ARM, hence does not bear any credit risk.	ARM UK sells its products to a number of customers worldwide, which might result in non-payments and bad debts.

Risk Category and Description	Exposure to ARM India	Exposure to ARM UK
		Hence ARM UK bears the credit risk
Foreign Exchange Risk: This risk relates to the potential impact on profits that may arise because of changes in foreign exchange rates.	ARM India does not carry out any hedging activities. However, since the contract between ARM India and ARM is a cost plus arrangement, the foreign exchange risk is passed on to ARM UK. In other words, ARM India does not bear any risk on this count.	ARM UK has business dealings with a number of companies in different parts of the world. Therefore, ARM UK is exposed to foreign exchange risks

Characterisation:

Based on the facts as presented in the above analysis of functions performed, assets employed and risks assumed by ARM India, it is possible to characterize ARM India as a contract service provider engaged in the provision of contract software development services predominantly to ARM UK and a small portion of the software development services to ARM US.

Based on the facts as presented in the functional analysis, ARM India can be characterized as a service provider engaged in rendering marketing and sales support services to ARM UK. ARM India bears limited risks associated with undertaking such activities. The functions performed by ARM India, risks assumed and assets used, do not lead to development or creation of any non-routine intangibles by ARM India.

11. Ground No.2.10: is raised by the assessee seeking exclusion of following comparables for functional dissimilarities:

- RS Software (India) Ltd.,

- Larsen & Toubro Infotech Ltd.,
- Nihilent Ltd.,
- Inteq Software Pvt. Ltd.,
- Persistent Systems Ltd.,
- Infobeans Technologies Ltd.,
- Thirdware Solution Ltd.,
- Infosys Ltd.,
- Aspire Systems (India) Pvt. Ltd. and
- Cybage Software Pvt. Ltd.

12. Inteq Software Pvt. Ltd.:

It is submitted that this company is functionally dissimilar to the assessee on various counts and therefore deserves to be rejected. The Ld.AR submitted that, this comparable is functionally not similar with that of assessee, and that, the segmental data is not available in respect of diverse activities carried on by it. He relied on pages 1334, 1341 of the annual report paper book. He thus preyed for this comparable to be excluded from the final list due to lack of segmental data.

13. Larsen and Toubro Infotech Ltd.:

It is submitted that this company is functionally dissimilar to the assessee on various counts and therefore deserves to be rejected. The Ld.AR submitted that, this comparable is functionally not similar with that of assessee, as it renders application development maintenance, enterprise solutions, testing and validation, digital solutions, infrastructure management services, platform-based service which cannot be equated to the routine software service provider like the assessee. The Ld.AR submitted that this company is also engaged in activities such as cloud

computing, infrastructure management, analytics & information management, etc., and that No segmental details are available. The LdAR submitted that this company is also engaged in trading IT related products has cost of brought out items and has won awards and recognitions for innovative products. He relied on pages 969, 979, 922, 986 of the annual report paper book in support.

The Ld.AR submitted that this company is a market leader and enjoys significant benefits on account of ownership of marketing intangibles, intellectual property rights and business rights and brand value. As a result of this high brand value, the company enjoys a high bargaining power in the market. He relied on pages 943, 946, 920, 1011 of the annual report paper book in support. Referring to page 1023, 1015 the Ld.AR submitted that this company has significant onsite activities. Further, he submitted that during the year under consideration, this company has extraordinary event, whereby Information Systems Resources Centre Private Limited amalgamated with the Company. He thus prayed for exclusion of this company from the final list.

14. Infobeans Technologies Ltd.:

It is submitted that this company is functionally dissimilar to the assessee on various counts and therefore deserves to be rejected. The Ld.AR submitted that, this comparable is functionally not similar with that of assessee, as it is specialised in business applications development for web and mobile. This company provides software engineering services primarily in Custom Application Development, Content Management Systems,

Enterprise Mobility, Big Data Analytics. He placed reliance on page 1668 of annual report paper book. The services rendered by this company are different from the routine low end software development services rendered by the assessee as a captive service provider to its AE. The Ld.AR further submitted that, segmental details of such diverse activities carried on by this company are not available. He thus prayed for exclusion of this company from the final list.

15. Thirdware Solutions Limited

It is submitted that this company is functionally dissimilar to the assessee on various counts and therefore deserves to be rejected. The Ld.AR submitted that, this comparable is functionally not similar with that of assessee, as it is engaged software and consultancy. The Ld.AR submitted that this company has significant competencies in transaction systems, Analytics and Cloud applications. Further, the company has earned revenue from software development, implementation services, application management services, and other related services and from sale the sale of license and subscription for software application, which are not akin to the captive services rendered by the assessee. He placed reliance on page 1825, 1834, 1857 of annual report paper book. The Ld.AR submitted that this company deals in product also and segmental details of diverse services are not available. He relied on page 2508 of annual report paper book. He thus prayed for exclusion of this company from the final list.

It is submitted by the Ld.AR that, Inteq Software Pvt.Ltd, L&T Infotech Ltd., Infobean Technologies Ltd., Thirdware Solutions Ltd. excluded by *Hon'ble Delhi Tribunal* in case of *Global Logic*

India Ltd., reported in (2022) 134 *taxmann.com* 35 for functional dissimilarities.

On the contrary, the Ld.DR relied on the orders passed by the authorities below.

We have perused the submissions advanced by both sides in light of records placed before us.

16. We note that the decision of *Hon'ble Delhi Tribunal* in case of *Global Logic India Ltd.*, (supra) considered these comparables for assessment year 2016-17 and has held them to be functionally not similar with a captive service provider like that of the assessee before us. Further The assessee in *Global Logic India Ltd.*, (supra) is also as captive service provider as observed by *Hon'ble Delhi Tribunal* therein. *Hon'ble Tribunal* observed as under:

**COMPARABLE COMPANIES SOUGHT TO BE EXCLUDED BY THE TAXPAYER
LARSEN & TOUBRO INFOTECH LTD. (L&T)**

14. The taxpayer sought to exclude L&T from the final set of comparables chosen by the ld. TPO for the purpose of benchmarking its international transactions qua SDS on the grounds inter alia that it is functionally dissimilar; that its segmental data is not available; that L&T is a huge brand with ownership of intangibles and on account of extra ordinary event; and on the ground that this company was rejected in taxpayer's own case in *Global Logic India Ltd. v. Dy. CIT [2020] 117 taxmann.com 39 (Delhi - Trib.)*.

15. However, on the other hand, ld. DR for the Revenue opposed the contentions raised by the taxpayer to exclude L&T as a comparable on the grounds inter alia that this comparable was chosen by the taxpayer itself and in case of TNMM applied for benchmarking the international transactions minor dissimilarities are not to be taken into account; that the taxpayer cannot be taken as a captive entity as its spectrum is much more and it is also a global brand having presence in many countries and relied upon the order passed by the ld. TPO/ld. DRP.

16. When we examine profile of L&T from its financials, available at pages 6, 7 & 11 of the paper book, it is into providing application development and maintenance services providing digital solutions such as big data analytics, enterprise computing, cognitive computing, infrastructure management services and enterprise solutions. It has also been awarded and recognized by various forums for providing such niche services in the field of innovation in information technology category, analytics solutions/services etc., explained at page 11 of the paper book.

17. When we examine Notes forming Parts of Accounts at page 116 of the paper book, it is evident that L&T is having two segment accounts, namely, (i) Services Cluster Segment which includes Banking and Financial Services, Insurance, Media & Entertainment, Travel & Logistics and Healthcare, and (ii) Industrial Cluster Segments which consists of Hi Tech and Consumer Electronics, Consumer Retail & Pharma, Energy & Process, Automobile & Aerospace, Plant Equipment & Industrial Machinery, Utilities and E&C. But aforesaid various segments do not indicate profit earned from provisions of SDS. Apart from it, L&T is a huge brand having ownership of significant intangibles to the tune of Rs. 7.42 millions, as is evident from its financials at pages 8 and 103 of the paper book.

18. Coordinate Bench of the Tribunal rejected L&T in taxpayer's own case for AY 2014-15 (*supra*), available at pages 61 to 63 of the case law paper book, by returning following findings :—

"6.6 The next objection of the assessee is regarding multiple segments. From segment reporting on page S-1258 of the Annual Report (page 129 of PB-2), we find that the assessee has reported three business segments. The first segment is service cluster which includes banking, financial services, insurance, media and entertainment, travel and logistics and healthcare. The second segment industry cluster which includes Hi Tech and consumer electronics, consumer, retail and Pharma, energy and process, auto Mobile and aerospace, plant equipment and industrial machinery, utilities and E &C. The third segment, is telecom segment which refers to product engineering services (PES) which has been discontinued in this year. Regarding the PES, in Director's report, (available on page S-1225 of the Annual Report or page 96 of PB-2), it is reported as under :

"TRANSFER OF PRODUCT ENGINEERING SERVICES (PES) BUSINESS TO L&T TECHNOLOGY SERVICES LIMITED (LTTSL) AND WINDING UP OF GDA TECHNOLOGIES INC. (GDA INC.) As part of business restructuring undertaken within L&T Group, it was decided to consolidate the engineering services business under a separate subsidiary of L&T, L&T Technology Services Ltd. (LTTSL). Pursuant to this, the Company initiated and completed transfer of its Product Engineering Services (PES) Business Unit to LTTSL effective January 1, 2014, PES Business Unit was transferred by way of slump sale for total sales consideration of Rs. 489.53 crs based on ITA No. 4740/Del./2018 fair valuation, GDA Technologies Inc., USA (GDA Inc.), a wholly owned subsidiary of the Company was part of PES business with synergy in terms of the end customers they serve, primarily the semiconductor companies. Over last few years, the performance of GDA Inc. was adversely affected resulting in falling revenues and operational losses. Consequent to the transfer of PES business, certain IPs (Intellectual Properties) owned by GDA Inc. were transferred to LTTSL, the Company was wound up during the year."

6.7 In view of the above reporting, it is clear that under the telecom segment, the assessee was engaged in providing engineering services, which is distinct from the services of the software development. Thus,

at entity level, the company cannot be considered functionally similar to the assessee. The company cannot be considered comparable at the segment level also because of there are expenses of Rs. 205,80,17,445/- (page 129 of PB-2) , which has not been allocated into three segments, and thus the segmental result are distorted.

6.8 During the year, the extraordinary event of demerger of product engineering service business (PES) has occurred with effect from 01/01/2014, which has also impacted the profit of the company at the entity level. In the decision of the Tribunal in case of Xchanging Technology Service India Private Limited (ITA No. 1897/Del./2004), which has been approved the Hon'ble High Court in ITA No. 813/2015 , the company is held to be not valid comparable on account of extraordinary events. Thus, In view of the extraordinary event in the year under consideration also, this company is liable to be excluded from the set of the comparable."

19. In taxpayer's own case in Global Logic India (P.) Ltd. v. DCIT [IT Appeal No. 8726 (Delhi) of 2019, dated 29-6-2020] L&T was excluded by the coordinate Bench of the Tribunal by returning following findings :—

"20. The Tribunal in assessee's own case in ITA No. 4740/Del/2018 relating to Assessment Year 2014-15 vide order dated 1-5-2020 has directed the exclusion of the said concern from the final list of comparables while benchmarking the ALP of the international transaction by the assessee with its AE. Before parting, we may also refer to an extraordinary event under which Larsen & Toubro Infotech Ltd. initiated and completed transfer of its Product Engineering Services Business (PES) Unit to L&T Technology Services Ltd. w.e.f. January 1, 2014 as part of the business restructuring undertaken within the Larsen & Toubro group. Though the initiation started from 1-1-2014 but the whole effect of the transaction was during the year under consideration. Further, Larsen & Toubro Infotech Ltd. during the year under consideration acquired Information Systems Resource Centre Private limited ("ISRC") thereby making it wholly owned subsidiary and because of such extraordinary event of acquisition, the said concern cannot be held to be a valid comparable and thus has to be excluded from the final set of comparable. Accordingly, we hold so."

20. In view of the facts inter alia that L&T is into various segments having no segmental financials, having huge brand value and intangibles is not a suitable comparable vis-à-vis taxpayer which was working as a captive entity and that contention raised by the ld. DR that under TNMM minor dissimilarities do not affect the overall comparability is not sustainable because though it is a taxpayer's own comparable but there being no estoppel against statute and that taxpayer can rectify its mistake at any stage of the proceedings. Secondly, it is not a case of minor dissimilarities rather it is a case of functional dissimilarity and non-availability of segmental financials to provide the clear picture qua profit earned by the company from provisions of SDS. L&T is a big brand having ownership of huge

intangibles which ought to provide competitive advantage to the taxpayer in the form of premium pricing and huge volume of business ultimately leading to the higher profitability. So, we are of the considered view that L&T is not a suitable comparable vis-à-vis the taxpayer, hence ordered to be excluded.

THIRDWARE SOLUTION LTD. (THIRDWARE)

40. The taxpayer sought exclusion of Thirdware on the ground that it is functionally dissimilar vis-à-vis the taxpayer. However, on the other hand, ld. DR for the Revenue relied upon the orders passed by the ld. TPO/ld. DRP to retain this comparable.

41. Perusal of Notes - Additional Information and Profit & Loss account, available at page 570 of the annual reports paper book, shows that it has income earned from sale of licence and provision of training services also under the head 'software services from local unit', 'export of software services', 'revenue from subscription & training' and 'sale of licence' to the tune of Rs. 2809.62 lakhs, Rs. 19285.11 lakhs, Rs. 32.59 lakhs & Rs. 8.77 lakhs respectively. The taxpayer has also brought on record website of the company, available at pages 71 to 73 of the appeal memo, which shows that Thirdware is having competency in providing services in most advanced and niche area of technologies such as Robotic Process Automation, Big Data Analytics & Cloud Computing.

42. From the profile of Thirdware it has come on record that Thirdware is functionally dissimilar vis-à-vis the taxpayer as it has been deriving income from sale of licence and software services export from SEZ unit and revenue from subscription and training etc. and it is also into sale of licence and its segmental financials are not available.

43. Thirdware has been ordered to be excluded by the coordinate Bench of the Tribunal in case of *Fiserve India (P.) Ltd. v. ITO* [2015] 60 taxmann.com 48 (Delhi - Trib.) on ground of dissimilarity to routine software development service provider which has been affirmed by Hon'ble Delhi High Court in ITA 17/2016 order dated 6-1-2016. So, we order to exclude Thirdware from the final set of comparables.

INFOBEANS TECHNOLOGIES LTD. (INFOBEANS)

44. The taxpayer sought exclusion of Infobeans as a comparable again on ground of functional dissimilarity, it also being into providing services viz. software engineering services primarily in Custom Application Development (CAD), Content Management Systems, Enterprise Mobility, Big Data Analytics, UX & UI, Automation Engineering Services, as is evident from its financials, available on page 123 of the annual report paper book.

45. The taxpayer also brought on record profile of the Infobeans at pages 58 to 60 of the appeal memo wherein it is claimed by the Infobeans that it is providing wide range of services under four verticals i.e. services, automation, enterprise and industries and under the automation services verticals, the company is providing advanced robotic process automation services. Since Infobeans is into diversified activities it cannot be a suitable comparable vis-à-vis the taxpayer which is a routine software development services provider. Infobeans has been excluded as a comparable on account of functional dissimilarity vis-à-vis routine software development service provider by the coordinate Bench of the Tribunal in case of *Pub Matic India (P.) Ltd.* (supra).

So, in view of the matter, we order to exclude Infobeans from the final set of comparables.

INTEQ SOFTWARE LTD. (INTEQ)

46. *The taxpayer sought exclusion of Inteq again on account of functional dissimilarity being into providing outsourced product development services and Healthcare BPO services to its customers as per website extracted at pages 83 to 85 of the appeal memo set. It being a private limited company its financials are not available in the public domain. Its annual report made available at pages 848 to 909 of the annual reports paper book does not provide segmental profitability earned from software development services, outsourced product development services and Healthcare BPO services.*

47. *When we examine profit & loss account at page 873 of the annual report paper book, software development and service charges are shown in composite manner with no segmental profitability. In these circumstances, we are of the considered view that Inteq is not a suitable comparable vis-à-vis the taxpayer which is a routine software development service provider working on cost-plus mark up model, hence ordered to be excluded from the final set of comparables.*

17. We note that the assessee in *Global Logic India Ltd. (supra)* was a captive service provider to its AE for assessment year 2016-17. Nothing has been placed by the Revenue to deviate from the above view taken by the coordinate bench of this *Tribunal* in *Global Logic India Ltd. (supra)*.

18. Respectfully following the view taken by the coordinate bench of this *Tribunal* in *Global Logic India Ltd. (supra)*, we direct Ld. AO/TPO to exclude **Inteq Software Pvt.Ltd, L&T Infotech Ltd., Infobean Technologies Ltd., Thirdware Solutions Ltd.** from the final list of comparable for SWD segment.

19. Persistent Systems Ltd. :

It is submitted that this company is functionally dissimilar to the assessee on various counts and therefore deserves to be rejected. The Ld.AR submitted that, this comparable is functionally not similar with that of assessee, as it is engaged in, rendering Enterprise Digital Transformation, product engineering and solutioning for Internet of Things (IoT), product engineering and professional services to ISVs and enterprises, IP products, IT

services, development of software products and offers complete product life cycle services without there being separate segmental information disclosed in its Annual Report for such activities . He placed reliance on page 1421, 1592, 1608, 1641 of the annual report paper book. It is submitted that Persistent Systems made significant investments towards research and development activities in the relevant previous year. Persistent has collaborated with researchers from IGIB, JNU, IISER-Pune and NCL to develop SanGeniX - an DNA sequencing using Next Generation Sequencing (NGS) technology), eSkIN-will help discovery of new pharmaceutical and cosmetic products to empower pharmaceuticals and cosmetic companies to predict the effects of their products on human skin). He placed reliance on page 1421 of the annual report paper book. Persistent has established “persistent labs” which focuses on latest technologies viz., gesture computing, machine learning etc. Using the innovations of Persistent labs. The Ld.AR further submitted that this company partnered with IBM and have added an engineering team that is building products and tools for continuous lifecycle management and for digital transformation and has partnerships with various leading platform providers in Analytics, Big Data, Cloud, Mobile, Machine Learning, and IoT. He placed reliance on page 1420, 1421, 1422, 1391 of the annual report paper book. The Ld.AR submitted that as a part of Aepona acquisition, this company acquired development centers in Belfast, UK and in Colombo, Sri Lanka during the year under consideration. He placed reliance on page 1420, 1421 of the

annual report paper book. He thus prayed for exclusion of this company from the final list.

The Ld.AR submitted thus submitted that Persistent Systems Ltd, is not functionally similar with that of assessee who is a captive service provider to its AE.

20. Infosys Ltd.:

It is submitted that this company is functionally dissimilar to the assessee on various counts, and therefore, it ought to be rejected from the final list of comparables. It is submitted that the Ld.TPO erred rejected contentions of the assessee and upheld the inclusion of the company in the final list of comparables.

It is submitted that this company renders services like business IT services comprising of application development and maintenance, independent validation, infrastructure management, engineering services comprising product engineering and life cycle solutions and business process management; Consulting and systems integration services comprising consulting, enterprise solutions, systems integration and advanced technologies; Products, business platforms and solutions to accelerate intellectual property-led innovation including Financial, and banking solution; and offerings in the areas of Analytics, Cloud, and Digital Transformation He placed reliance on page 1901, 1903, 1949, 2013 of annual report paper book. It is submitted that this company is a full-fledged risk bearing entrepreneur who cannot be compared to the assessee that renders routine software services. It is submitted that the company owns seven Edge products/platforms and six other product based solutions.

The Ld.AR submitted that, this company does not have segmental data in respect of rendering software services and development of products. It is submitted that this company has significant intangibles as a part of its fixed assets in the nature of intellectual property. He placed reliance on 1904, 1944, 1984 of annual report paper book. The company owns significant brand value and focuses immensely on brand building. The Ld.AR submitted that, this company heavily focuses on research and development activity and incurs significant expenditure for this account and for the financial year relevant to assessment year under consideration, the company incurred research and development expenses of Rs. 415 crores. He placed reliance on page 1942 of annual report paper book. The Ld.AR submitted that, this company for the year under consideration has earned abnormally high profit with margin of 38.61%, which makes it incomparable with the assessee.

The Ld.AR submitted thus submitted that this company is not functionally similar with that of assessee who is a captive service provider to its AE.

It is also submitted that these comparables are not functionally similar with that of the assessee as has been observed by *Coordinate Bench of this Tribunal* in following cases:

1. *Decision of Hon'ble Mumbai Tribunal in case of Red Hat India Pvt. Ltd. vs. Addl. CIT reported in (2022) 136 taxmann.com 52.*
2. *Decision of coordinate bench of this Tribunal in case of OLF India Software Pvt.Ltd. vs. ACIT in IT(TP)A No.182/2021 by order dated 28/09/2022 for A.Y. 2016-17.*
3. *Decision of Hon'ble Hyderabad Tribunal in case of Infor (India) Pvt. Ltd. vs. DCIT in ITA-TP.No. 198/Hyd/2021 by order dated 06.10.2021 for A.Y. 2016-17.*

On the contrary, the Ld.CIT.DR placed reliance on orders passed by authorities below.

We have perused the submissions advanced by both sides in the light of records placed before us.

21. Before us, the Ld.DR has not been able to place anything on record contrary to the above submissions by the Ld.AR. We of the view that with such varied functions, these companies cannot be compared with assessee before us, which is a captive service provider. We accordingly direct the Ld.AO/TPO **to exclude Persistent Systems Ltd., and Infosys Ltd. from the final list.**

22. Aspire Systems (India) Pvt.

It is submitted that, this company is functionally not comparable with the assessee as it earns income from power generation. The Ld.AR placed reliance on page 127 of Annual Report. The Ld.AR submitted that, the company owns significant intangibles in form of goodwill, customer contracts. He placed reliance on page 2077 & 2087 of annual report paper book in support. It is submitted that Applied Development Software (India) Pvt.Ltd., and Pure Apps Consulting Services Pvt. Ltd., amalgamated with the company that lead to acquisition of assets. He placed reliance on page 2056 of annual report paper book. The Ld.AR placed reliance on following decisions in support:

Decision of Hon'ble Mumbai Tribunal in case of Red Hat India Pvt. Ltd. vs. Addl. CIT reported in (2022) 136 taxmann.com 52

Decision of Hon'ble Hyderabad Tribunal in case of Infor India Pvt. Ltd. in IT(TP)A No. 198/Hyd/2021 by order dated 06.10.2021 for A.Y. 2016-17.

Decision of Hon'ble Punjab & Haryana in Equant Solutions India (P.) Ltd. reported in (2020) 113 taxmann.com 517

Coordinate bench of this Tribunal in case of ARM Embedded Technologies (P.) Ltd. reported in (2021) 129 taxmann.com 263

Coordinate bench of this Tribunal in case of Yahoo Software Development India Pvt. Ltd. reported in TS-191-ITAT-2020(Bang)

On the contrary, the Ld.DR relied on the orders passed by the authorities below.

We have perused the submissions of both sides in light of records placed before us. We note that this company earns its revenue from power generation and it has nothing to do with the rendering of software development service. In fact, we note that this company is a full fledged entrepreneur in the business of power generation and therefore is not comparable functionally with a captive software service provider like assessee.

Nothing is been placed by the Revenue contrary to the above observation. We therefore respectfully following the above view, direct the Ld.AO/TPO **to exclude Aspire System India Pvt. Ltd. from the final list.**

23. Nihilent Technologies Limited

It is submitted that, this company is functionally dissimilar to the assessee and therefore ought to be rejected from the final list of comparables. It is submitted that, services rendered by this company are wide in range and diversified. The Ld.AR submitted that, the company is engaged in diversified activities. It is submitted that, it renders services in the nature of consulting, software development and product development, provision of business consulting in the area of the enterprise transformation, change and performance management, digital transformation, business intelligence and data science services and also providing related IT services. The Ld.AR submitted that, software-consulting services include end-to-end solutions, onsite management and IT functions,

and planning & system designing, which are in no way comparable to the captive software development activities as provided by the assessee.

The Ld.AR further submitted that, this company has incurred significant expenses in foreign currency of 37.68%, 33.27% and 37.47% of its total expenditure during the FYs 2015-16, 2014-15 and 2013-14, respectively, which suggests that is engaged in provision of onsite services. And that, during the FY relevant to assessment year under consideration, this company acquired GNet Group LLC, a business intelligence and analytical company, and Intellect Bizware Services Pvt. Ltd., specialising in ERP and enterprise innovation. The Ld.AR submitted that, these acquisitions are bound to have a significant impact on the financials of the company. The Ld.AR thus submitted that, for all the above reasons this company cannot be considered to be comparable with. He relied on the decision of *Hon'ble Mumbai Tribunal* in case of *Red Hat India Pvt. Ltd. v. ACIT (supra)*

On the contrary, the Ld.DR relied on the orders passed by the authorities below.

We have perused the submissions of both sides in light of records placed before us.

The assessee sought exclusion of Nihilent on ground of its functional dissimilarity vis-à-vis assessee. We have examined the website information of Nihilent, made available by the assessee at page No. 405 of the paper book, wherein it is mentioned that it is engaged in providing advanced analytics, artificial intelligence, blockchain, business intelligence, data science, cloud services etc.

45. *Perusal of the disclosure of enterprise's reportable segment explanatory available at page No. A406 of the paper book shows that Nihilent is engaged in software development and consultancy, engineering services, web development and hosting and subsequently diversified itself into the domain of business analytics and business process outsourcing and financials of Nihilent available at page No. A304, A405-A406 of the paper book shows that*

Nihilent has only one business segment and in the absence of segmental financials, as it is into diversified business, this company cannot be a valid comparable vis-à-vis assessee, who is a low risk entity working on cost + markup model. Hence, Nihilent is ordered to be excluded as a comparable. Nihilent Ltd.

46. *The assessee sought exclusion of Nihilent Ltd. as a comparable on the ground that it is functionally dissimilar vis-à-vis assessee. This objection was also raised before the Ld. DRP but rejected. The assessee relied upon website of the company which is made available at page A 412 of the paper book wherein Nihilent Ltd. is shown to be engaged in providing advanced analytics, artificial intelligence, blockchain, business intelligence, data signs, cloud services etc. The annual financials of this company available at page A412 & A413 of the paper book shows that it is rendering Enterprise transformation and change management, Digital transformation services and Enterprise IT services but segmental financials are not available as is apparent from its financials available at page A305, A412 & A413 of the paper book. When this company is into various segments but segmental financials are not available it cannot be a valid comparable vis-à-vis assessee which is a routine software development service provider working on cost + markup model, hence ordered to be excluded.*

We note that the assessee in *Red Hat India Pvt. Ltd. v. ACIT (supra)* was a captive service provider to its AE for assessment year 2016-17. Nothing has been placed by the Revenue to deviate from the above view taken by the coordinate bench of this *Tribunal* in *Red Hat India Pvt. Ltd. v. ACIT (supra)*. We are of the view that, based on the functions performed by this company as submitted by the Ld.AR and the observations of *Hon'ble Mumbai Tribunal*, this comparable deserves to be excluded from the final list.

We therefore respectfully following the above view, direct the Ld.AO/TPO to exclude Nihilent Technologies Ltd from the final list.

24. Cybage Software Pvt.Ltd.

It is submitted that this company is engaged in the provision of diversified services which include product engineering, testing & quality assurance services, specialized services, support services, etc. It is submitted that this company is engaged in product development and has developed a product called 'excelshore' apart from providing spectrum of services including ITeS and BPO services

and that segmental information of the diverse business functions undertaken by the company is not available.

The Ld.AR submitted that this company is making super normal profits and that it is not reflective of the performance of the industry in which it operates.

Particulars	FY 2013-14	FY 2014-15	FY 2015-16
OP/OC	68.82%	67.75%	62.04%

Reliance in this regard is placed on the decision of the *Hon'ble Hyderabad Tribunal in Infor (India) Pvt. Ltd. v. DCIT* (supra).

On the contrary, the Ld.DR relied on the orders passed by the authorities below.

We have perused the submissions of both sides in light of records placed before us.

Primarily we note that this company is a product company and has diversified business segments. We note that this company is a full fledged entrepreneur and assumes all the risks attributable to the various business segments for which details are not available. In our view, under such circumstances, this company cannot be held to be functionally comparable with that of assessee which is a captive service provider that caters only to its AE.

Respectfully following the above view, we direct the Ld.AO/TPO to exclude Cybage Software Pvt.Ltd., from the final list.

25. R.S Software (I) Pvt.Ltd:

It is submitted that, this company is engaged in diversified activities, which are not similar to the services rendered by the assessee. The company is into custom application development, quality assurance and testing, application maintenance and support, strategic consulting, in respect of which, segmental details are unavailable.

The company is engaged in development of platform services and is rendering data analytics services, which are different from the routine SWD services rendered by the assessee. The data analytics services rendered by the company will fall within the definition of KPO services, which are incomparable to the services rendered by the assessee.

It is submitted that this company conducts research and development work in the areas of real time analytics, MDM, proximity, payments, digital commerce, mobile payments, testing, automation, personalised loyalty in payments and merchant management in payments laboratory.

On the contrary, the Ld.DR relied on the orders passed by the authorities below.

We have perused the submissions of both sides in light of records placed before us.

We note that this company is a full fledged entrepreneur and assumes all the risks attributable to the various business segments for which details are not available. In our view, under such circumstances, this company cannot be held to be functionally comparable with that of assessee which is a captive service provider that caters only to its AE.

We therefore direct the Ld.AO/TPO to exclude R.S Software (I) Pvt.Ltd, from the final list.

Accordingly this ground raised by the assessee stands allowed.

26. Ground No. 2.11: That the Ld.TPO erred in excluding Akshay Software Technologies Ltd, Sasken Communication

Technologies Ltd. and Evoke Technologies Pvt. Ltd., even though the same are functionally comparable to the assessee.

It is submitted that this company is engaged in providing software development services. It is submitted that these comparables were not considered by the Ld.TPO as they did not appear in the search matrix carried out by him, which has been upheld by the DRP. He placed reliance on the decisions of coordinate bench of this *Hon'ble Tribunal* in the case of *Prism Networks Pvt. Ltd. reported in (2022) 141 taxmann.com 163*.

On the contrary, the Ld.DR relied on the orders passed by the authorities below.

We have perused the submissions of both sides in light of records placed before us.

We note that this Tribunal in case of *Prism Networks Pvt. Ltd.(supra)* observed and held as under:

18. We heard the rival submissions. It is clear from the order of the DRP that the DRP has not considered the plea of the Assessee in proper perspective. The fact that the TPO rejected the TP study of the Assessee cannot be the basis not to consider the claim of the Assessee for inclusion of comparable companies. The TPO excluded these companies only on the ground that information related to these companies was not available in the public domain and this fact was shown to be an incorrect assumption by the Assessee in the submissions before the DRP. In such circumstances, it was incumbent on the part of the DRP to have adjudicated the question of inclusion of these companies as comparable companies. The fact that these companies do not figure in the search matrix of the TPO is not and cannot be a ground not to consider inclusion of these companies as comparable companies. Since the DRP has failed to do so, we are of the view that the issue regarding inclusion of the aforesaid companies as comparable companies should be set aside to AO/TPO for fresh consideration in the light of the information available in public domain. Thus ground No. 7 is treated as allowed for statistical purposes.

Respectfully following the above view, we remit the comparables back o the Ld.AO/TPO for fresh consideration in the light of information available in public domain.

Accordingly this ground stands allowed for statistical purposes.

27. Ground No. 2.12: That Killick Agencies & Marketing Ltd., Scarecrow Communications Ltd., and iRunway India Pvt. Ltd., ought to be excluded from the final list of comparables under the IteS segment, as these companies are functional dissimilar to the assessee.

28. Killick Agencies & Marketing Ltd.

It is submitted that this company is engaged in sale of dredging equipment, which used for excavation purposes under the water, which are not comparable to the services rendered by the assessee. It is also submitted that this company earns major portion of its revenue from commission and service income, whereas, the assessee earns its revenue by providing marketing and sales support services to its AEs.

It is submitted that this company has been excluded by this *Tribunal* in the assessee's own case for the assessment year 2010-11. And that it has been consistently excluded from the final list of comparables in the cases of similarly placed assessees. Reliance is placed on the decision of this *Tribunal* in the case of *DCIT v. Electronics for Imaging India (P.) Ltd.* reported in (2016) 70 *taxmann.com* 299

The Ld.DR relied on the order passed by authorities below.

We have perused the submissions of both sides in light of records placed before us.

We note that this *Tribunal* in the case of *DCIT v. Electronics for Imaging India (P.) Ltd.* (*supra*) observed and held as under:

Further, we note that this company is entirely in a different activity with that of the assessee. Undisputedly, this company is acting as agent for various foreign principals for sale of dredgers, dredging equipment, steerable rudder propulsions and other equipments and machineries.

As observed by coordinate bench in case of this *Tribunal* in the case of *DCIT v. Electronics for Imaging India (P.) Ltd.(supra)* this company is functionally not similar with that of the assessee.

We therefore direct exclusion of this company from the final list.

29. Scarecrow Communications Ltd.

It is submitted that this company has operated without having a single employee during the financial year 2015-16. The company acts as an intermediary in providing its services which is contrary to the activity undertaken by the assessee as a marketing support service provider. The company having operated without a single employee shows that the company is not rendering any services on its own and is therefore not comparable to the assessee.

Further the revenue earned is in respect of different types of services which are not comparable to the assessee. Further, there are no segmental details available as regards the services. It is submitted that this company was directed to be excluded by the DRP in the assessee's own case for the assessment years 2013-14 and 2014-15 on the ground that it is not functionally comparable to the assessee. The relevant extracts of the DRP's directions are produced on page 188 of the appeal set.

We have perused the submissions of both sides in light of records placed before us. This comparable has been excluded by the revenue itself in the preceding assessment years for being functionally different.

We therefore direct exclusion of this company from the final list.

30. iRunway India Pvt. Ltd.

The company is involved in providing services in nature of patent licensing, patent valuation and portfolio analysis, product testing, end-to-end litigation support, source code analysis, among other technology and litigation support services, which is functionally different as compared to the assessee. The company also generates intangibles internally.

We therefore direct exclusion of this company from the final list.

Accordingly this ground raised by the assessee stands partly allowed.

31. Ground No. 2.13 is in respect of following comparables that the assessee is seeking to include under the MSS segment:

- Cheers Interactive India Pvt.Ltd.,
- MCI Management India Pvt.Ltd. and
- Showhouse Event Management India Pvt. Ltd.,

It is submitted that these companies are engaged in providing MSS services. It is submitted that these comparables were not considered by the Ld.TPO, as they did not appear in the search matrix carried out by him, which has been upheld by the DRP.

The both sides relied on the submission made in respect of comparables sought for inclusion under SWD segment.

On similar situation, we have remanded the comparable to the Ld.AO/TPO for fresh consideration herein above following the decision of coordinate bench of this *Hon'ble Tribunal* in the case of *Prism Networks Pvt. Ltd. reported in (2022) 141 taxmann.com 163*.

Respectfully following the above view *mutatis mutandis*, we remit the comparables back to the Ld.AO/TPO for fresh consideration in the light of information available in public domain.

Accordingly this ground stands allowed for statistical purposes.

32. Ground No. 3 is in respect of notional interest on delayed receivables computed by the Ld.TPO.

32.1 The Ld.AR submitted that the amounts outstanding have been settled by the AE on an on-going basis in the normal course of business having regard to economic and commercial factors. Since the outstanding receivables related to the SWD and the MSS services rendered by the assessee, the assessee submits that, the determination of ALP of the outstanding receivables is not warranted as the same is subsumed in the ALP of the principal transaction. The assessee also submits that the outstanding receivables cannot be made subject matter of TP adjustment as the same is not covered under the provisions of Section 92B of the Act. She placed reliance on decision of coordinate bench of this *Tribunal* in case of *Avnet India (P.) Ltd. v. DCIT* reported in (2016) 65 *taxmann.com* 187, wherein it was observed as under:

“8. 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 Goldstar Jewellery Ltd. (supra), wherein it was observed as under:.....

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.”

32.2 The Ld.AR placed reliance on decision of *Delhi Tribunal* in [Kusum Healthcare Pvt.Ltd vs. ACIT](#) reported in (2015) 62 *Taxmann.com* 79, deleted addition by considering the above principle, and subsequently *Hon'ble Delhi High Court* in [Pr. CIT vs. Kusum Health Care Pvt. Ltd.](#), reported in (2017) 398 *ITR* 66 (Del), held that no interest could have been charged as it cannot be considered as international transaction. He also placed reliance upon decision of *Delhi Tribunal* in case of [Bechtel India vs DCIT](#) reported in (2016) 66 *taxman.com* 6 which subsequently upheld by *Hon'able Delhi High Court* vide order dated 21/07/16 in *ITA No. 379/2016*, also upheld by *Hon'ble Supreme Court* vide order dated 21/07/17, in *CC No. 4956/2017*.

32.3 It has been submitted by Ld.AR that outstanding receivables are closely linked to main transaction and so the same cannot be considered as separate international transaction. He also submitted that into company agreements provides for extending credit period with mutual consent and it does not provide any interest clause in case of delay. She argued that, the working capital adjustment takes into account the factors related to delayed receivables and therefore no separate adjustment is required in such circumstances.

32.4 On the contrary Ld.CIT.DR submitted that interest on receivables is an international transaction and Ld.TPO rightly determined its ALP. In support of her contentions, she placed reliance on decision of *Hon'ble Delhi Tribunal* order in [Ameriprise India Pvt. Ltd. vs. ACIT](#) in 2015- TII-347-ITAT-DEL-TP, wherein it is held that, interest on receivables is an international transaction and the transfer pricing adjustment is warranted. He

stated that [Finance Act](#), 2012 inserted Explanation to [Section 92B](#), with retrospective effect from 1.4.2002 and sub-clause (c) of clause (i) of this Explanation provides that:

*(i) the expression "international transaction" shall include--
..... (c) capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business;....'.*

32.5 Ld.CIT.DR submitted that expression 'debt arising during the course of business' refers to trading debt arising from sale of goods or services rendered in course of carrying on business. Once any debt arising during course of business is an international transaction, he submitted that any delay in realization of same needs to be considered within transfer pricing adjustment, on account of interest income short charged or uncharged. It was argued that insertion of Explanation with retrospective effect covers assessment year under consideration and hence under/non- payment of interest by AEs on debt arising during course of business becomes international transactions, calling for computing its ALP. He referred to decision of *Delhi Tribunal in Ameriprise (supra)*, in which this issue has been discussed at length and eventually interest on trade receivables has been held to be an international transaction. Referring to discussion in said order, it was stated that *Hon'ble Delhi Bench* in this case noted a decision of the *Hon'ble Bombay High Court* in the case of [CIT vs. Patni Computer Systems Ltd.](#), (2013) 215 Taxmann 108 (Bom.), dealt with question of law:

(c) *'Whether on the facts and circumstances of the case and in law, the Tribunal did not err in holding that the loss suffered by the assessee by allowing excess period of credit to the associated enterprises without charging an interest during such credit period would not amount to international transaction whereas [section 92B\(1\)](#) of the Income-tax Act, 1961 refers to any other transaction having a bearing on the profits, income, losses or assets of such enterprises?'*

32.6 The Ld.AR submitted that, while answering above question, Hon'ble Bombay High Court referred to amendment to [section 92B](#) by [Finance Act](#), 2012 with retrospective effect from 1.4.2002. Setting aside view taken by Tribunal, Hon'ble Bombay High Court restored the issue to file of Tribunal for fresh decision in light of legislative amendment. It was thus argued that non/under-charging of interest on excess period of credit allowed to AEs for realization of invoices, amounts to an international transaction and ALP of such international transaction has to be determined by Ld.TPO. In so far as charging of rate of interest is concerned, he relied on decision of the Hon'ble Delhi High Court in [CIT vs. Cotton Naturals \(I\) Pvt. Ltd](#) (2015) 276 CTR 445 (Del) holding that currency in which such amount is to be re-paid, determines rate of interest. He, therefore, concluded by summing up that interest on outstanding trade receivables is an international transaction and its ALP has been correctly determined.

We have perused the submissions advanced by both the sides in the light of the records placed before us.

32.7 Ld.TPO computed interest on outstanding receivables at the rate equal to 4.985% on the receivables that exceeded 6 months. It has been argued by Ld.AR that authorities below disregarded business/commercial arrangement between the assessee and its

AE's, by holding outstanding receivables to be an independent international transaction.

32.8 This Bench referred to decision of *Special Bench* of *Kolkotta Tribunal* in case of *Instrumentation Corpn. Ltd. v. Asstt. DIT in ITA No. 1548 and 1549 (Kol.) of 2009, dated 15- 7-2016*, held that outstanding sum of invoices is akin to loan advanced by assessee to foreign AE., hence it is an international transaction as per explanation to section 92 B of the Act. We also perused decision relied upon by Ld.AR. In our considered opinion, these are factually distinguishable and thus, we reject argument advanced by Ld.AR.

32.9 Alternatively, it has been argued that working capital adjustment subsumes sundry creditors. In such situation computing interest on outstanding receivables and loan and advances to international transaction would amount to double taxation. *Hon'ble Delhi Tribunal* in case of *Orange Business Services India Solutions Pvt. Ltd. vs. DCIT in ITA No. 6570/Del/2016 vide its order dated 15.2.2018* has observed that:

*"There may be a delay in collection of monies for supplies made, even beyond the agreed limit, due to a variety of factors which would have to be investigated on a case to case basis. Importantly, the impact this would have on the working capital of the assessee would have to be studied. It went on to hold that, there has to be a proper inquiry by the TPO by analysing the statistics over a period of time to discern a pattern which would indicate that vis-à-vis the receivables for the supplies made to an AE, the arrangement reflected an international transaction intended to benefit the AE in some way. Similar matter once again came up for consideration before the Hon'ble Delhi High Court in *Avenue Asia Advisors Pvt. Ltd. vs. DCIT* (2017) 398 ITR 120 (Del). Following the earlier decision in *Kusum Healthcare* (supra), it was observed that there are several factors which need to be considered before holding that every receivable is an international transaction and it requires an assessment on the working capital of the assessee. Applying the decision in *Kusum Health Care* (supra), the Hon'ble High Court directed the TPO to study the impact of the receivables appearing*

in the accounts of the assessee; looking into the various factors as to the reasons why the same are shown as receivables and also as to whether the said transactions can be characterized as international transactions."

In view of the above, we deem it appropriate to set aside the impugned order on this issue and remit the matter to the file of the Ld.AO/TPO for deciding it in conformity with the above referred judgment. Needless to say, the assessee will be allowed a reasonable opportunity of being heard in such fresh proceedings.

Accordingly these ground raised by assessee stands allowed for statistical purposes.

33. Ground No.4 is raised as the Ld.AO/TPO did not grant the working capital adjustment for computing the margin of the comparables.

33.1 The contention of Ld.AR is that, the Ld.AO/TPO/DRP erred in not providing appropriate adjustments towards the difference in the working capital between the assessee and the companies selected as comparables. He submitted that in view of the following judgements, the assessee is entitled for working capital adjustment and prayed that the same may be granted:-

1. *Huawei Technologies India Pvt. Ltd. (AY 2012-13) IT(TP) No.1939/Bang/2017*
2. *IKA India (P) Ltd. vs. Deputy Commissioner of Income-tax (AY 12-13) IT(TP)A No.2192/Bang/2017.*
3. *Deputy Commissioner of Income-tax V. Apotex Pharmachem India (P) Ltd. in IT(TP)A No.156/Bang/2014 & 2200/Bang/2016 (AY 09-10 & 11-12).*

33.2 We have heard the submissions of both sides on this issue based on the records placed before us.

33.3 We note that, this issue has been considered by this coordinate bench of this *Tribunal* in the case of *Huawei*

Technologies India P. Ltd. in IT(TP)A No.1939/Bang/2017 dated 31.10.2018, wherein, it was held as under:

"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 (d).....

(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.*
- 1. 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.*
 - 2. 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."*
 - 3. In Paragraph 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 s 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.*
- (vi) 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.*
- (vii) 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 ITA No.2112/Mds/2011 (2013) 38 taxmann.com. 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 Vs. E Value Serve.com (2016) 75 taxmann.com 195(Del-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 Anal is 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 page 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 1ule 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."

33.4 In view of the above, we remit the issue to the file of AO/TPO to compute the working capital adjustment after necessary examination in the light of the above observation and after allowing an opportunity of hearing to the assessee.

Accordingly this ground stands partly allowed for statistical purpose.

In the result, appeal of the assessee stands partly allowed.

Order pronounced in the open court on 30th August, 2022.

Sd/-
(CHANDRA POOJARI)
Accountant Member

Sd/-
(BEENA PILLAI)
Judicial Member

Bangalore,
Dated, the 30th August, 2022.
/MS /

Copy to:

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

By order

Assistant Registrar,
ITAT, Bangalore