

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

BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT
AND SHRI B R BASKARAN, ACCOUNTANT MEMBER

IT(TP)A No.1619/Bang/2017
Assessment year: 2013-14

M/s. Tivo Tech Private Limited [Formerly Veveo (India) Pvt. Ltd.], 10 th Floor, Primrose 7B, Embassy Tech Village, Outer Ring Road, Devarabisanahalli Village, Bangalore – 560 103. PAN: AABCV 9504G	Vs.	The Deputy Commissioner of Income Tax, Circle 7(1)(2), Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	Smt. Tanmayee Rajkumar, Advocate
Respondent by	:	Shri Pradeep Kumar, CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	10.06.2020
Date of Pronouncement	:	12.06.2020

ORDER

Per N.V. Vasudevan, Vice President

This is an appeal by the assessee against the final assessment order dated 07.06.2017 passed by the Assessing Officer u/s. 143(3)

r.w.s. 144C(13) of the Income-tax Act, 1961 [the Act] relating to assessment year 2013-14.

2. The only issue that arises for consideration in this appeal is as to whether the Transfer pricing adjustment ("TP adjustment") of Rs. 56,84,277/- made by Transfer Pricing Officer ("TPO") towards the international transaction of provision of Software Development services("SWD") to the Assessee's Associate Enterprise ("AE") which was subsequently enhanced to Rs. 78,69,258/- by the AO on giving effect to the directions of the Dispute Resolution Panel ("DRP") is valid and sustainable.

3. The Assessee is a company incorporated under the provisions of the Companies Act, 1956 and is a wholly owned subsidiary of Veveo Inc., USA and provides software development services to Veveo Inc.

4. During the previous year relevant to the assessment year 2013-14, the Assessee provided SWD services to Veveo Inc., its Associated Enterprise ("AE") for which it received a consideration of Rs. 14,61,26,880/-. Since the transaction between the Assessee and its AE was an international transaction, the income from the said international transaction has to be determined having regard to Arm's Length Price (ALP) as laid down in Sec.92 of the Act.

5. In support of its claim that the price received in the international transaction was at Arm's Length, the Assessee filed a Transfer Pricing analysis. The Details of the Assessee's international transaction were as follows:-

Particulars	Amount in Rs.	TP adjustment pursuant to the DRP Directions
Software Development Services	14,61,26,880	Adjustment of Rs. 78,69,259/-

6. There is no dispute that in terms of Rule 10B of the Income Tax Rules, 1962 (Rules), the Transaction Net Margin Method (TNMM) was the Most Appropriate Method (MAM) for the purpose of determining the ALP. The profit level indicator chosen for the purpose of comparing Assessee's profit margin with that of the comparable companies was Operating Profit/Operating Cost (OP/OC). The OP/OC of the Assessee was as follows:-

Operating Income	Rs. 15,07,95,023/-
Operating Cost	Rs.12,50,30,954/-
Operating Profit (Op. Income — Op. Cost)	Rs. 25,764,069/-
Operating/NCP mark-up (OP/TC)	20.61%

7. The Assessee in its TP study chose the following 11 comparable companies and the arithmetic mean profit margin of those companies was 12.45%. Since the profit margin of the Assessee was much more than the comparable companies, the Assessee claimed that the transaction was at Arm's Length:-

SI. No.	Name of the company	Average NPI (in %)
1	Akshay Software Technologies Ltd.	5.66
2	RS Software (India) Ltd.	16.45
3	Spry Resources India Pvt. Ltd.	21.01
4	Cigniti Technologies Ltd	8.35
5	Persistent Systems and Solutions Ltd	16.55
6	KALS Information Systems Limited	9.95
7	Helios & Matheson Information Technology Ltd.	15.16
8	Evoke Technologies Pvt Ltd	10.45
9	Acropetal Technologies Ltd	11.03
10	Sasken Communications Technologies Ltd	5.56

11	Mindtree Ltd	16.79
Arithmetical Mean		12.45

8. Out of the 11 comparables selected by the Assessee, the Transfer Pricing Officer (TPO) to whom the AO made a reference for determination of ALP u/s.92CA of the Act, accepted 2 comparables viz., RS Software (India) Ltd. and Mindtree Ltd. The TPO chose 5 more comparable companies and arrived at average arithmetic mean margin of 25.15%.

Comparables selected by the TPO and their arithmetic mean

Sl. No.	Name of the Company	Mark-up on Total Costs (WC—unadj) (in %)	Mark-up on Total Costs (WC—adj) (in %)
1	CG-VAK Software Exports Ltd.	20.54	25.26
2	ICRA Techno Analytics Ltd.	17.10	18.20
3	Larsen and Toubro Infotech Ltd.	26.06	30.85
4	Mindtree Ltd. (seg.)	18.19	22.60
5	Persistent Systems Ltd.	28.27	32.20
6	RS Software (India) Pvt. Ltd.	17.41	23.61
7	Tech Mahindra Ltd. (seg.)	18.72	23.33
AVERAGE MARK-UP		20.90	25.15

9. The TPO accordingly computed arm's length price and adjustment/addition to be made to total income as follows:-

Arm's Length Mean Mark-up	20.90%
Less: Working Capital Adjustment	- 4.25%
Adjusted mean mark-up of the comparables	25.15%
Operating Cost	Rs. 12,50,30,954/-
Arm's Length Price – 125.15% of Operating Cost	Rs. 15,64,79,300/-
Price Received	Rs. 15,07,95,023/-
Shortfall being adjustment u/s. 92CA	Rs. 56,84,277/-

10. The addition suggested above was incorporated by the AO in the draft order of assessment. The Assessee preferred objections to the draft order of assessment before the Dispute Resolution Panel (DRP u/s.144C of the Act. Apart from challenging the correctness of comparable companies chosen by the TPO and correctness of the action of the TPO in rejecting comparable companies chosen by the Assessee in its TP Study, the Assessee also submitted that negative Working Capital Adjustment (WCA) ought not to have been made by the TPO and thereby the average arithmetic mean margin of comparable companies were increased by 4.25%. It was submitted that working capital adjustment is made for the time value of money lost when credit time is given to the customers. The Assessee however is not an entrepreneur but a captive service provider which is entirely funded by the AEs. This being so, the assessee does not stand to lose anything as it is compensated on a total cost plus basis. The assessee is running the business without any working capital risk as compared to the comparables. Therefore, requirement for adjustment of negative working capital does not arise. It was submitted that in the Assessee's own case for assessment year 2012-13, the CIT(A) has reversed the order of the TPO making negative working capital adjustments. Detailed submissions in this regard were made before DRP which are placed at pages 154-155 and 333-337 of the paperbook.

11. The DRP issued the following directions:-

- The DRP directed the exclusion of Tech Mahindra Ltd. and ICRA Techno Analytics Ltd as being incomparable to the Assessee.

- The DRP did not agree with the contention of the Assessee that negative working capital adjustment should not be made.

List of comparables post DRP directions

Sl. No.	Name of the Company
1	CG-VAK Software Exports Ltd.
2	Larsen & Toubro Infotech Limited
3	Mindtree Ltd. (seg.)
4	Persistent Systems Ltd.
5	RS Software (India) Pvt. Ltd.

12. Pursuant to the DRP's directions, the Respondent passed the final assessment order wherein the TP adjustment stood enhanced.

13. Before the Tribunal, the Assessee has raised various grounds of appeal. The gist of the grounds of appeal is prayer for the following reliefs:-

- That Persistent Systems Limited, Larsen & Toubro Infotech Limited and CG-VAK Software Exports Limited ought to be excluded from the final list of comparables as being functionally not comparable to the SWD services of the Assessee. (Ground Nos. 2.2 and 2.3)
- That Akshay Software Technologies Limited and Cigniti Technologies ought to be included in the final list of comparables. (Ground No. 2.5)
- That an adjustment on account of negative working capital ought not to have made since the Assessee is a risk insulated captive

software development service provider and does not carry any working capital risk. (Ground 2.6)

14. We are of the view that if Ground No.2.6 is adjudicated then there would be no necessity to adjudicate other grounds because the average arithmetic profit margin of comparable chosen by the TPO without WCA will be within the 3% (+) or (-) range to the profit margin of the Assessee which is permitted under proviso to Sec.92CA(2) of the Act and therefore there would be no necessity to make any working capital adjustment.

15. As far as Gr.No.2.6 is concerned, the Assessee has contended that the TPO and the DRP erred in adding to the average arithmetic profit margin of the comparable companies chosen by the TPO, negative working capital adjustment. It was submitted that Working capital adjustment is made for the time value of money lost when credit time is given to the customers. The Assessee however is not an entrepreneur but a captive service provider which is entirely funded by the AEs. This being so, the assessee does not stand to lose anything as it is compensated on a total cost plus basis. The assessee is running the business without any working capital risk as compared to the comparables. Therefore, requirement for adjustment of negative working capital does not arise. It was submitted that in the Assessee's own case for assessment year 2012-13, the CIT(A) has reversed the order of the TPO making negative working capital adjustments. Detailed submissions in this regard are placed at pages 154-155 and 333-337 of the paperbook.

16. The Assessee also places reliance on *Digital Juice Animation Private Limited v. ACIT* (order dated 06.02.2020 in IT(TP) No. 215/Bang/2017), *Lam Research India Pvt Ltd*, ITA No. 1473 & 1385/2014 (order dated 30.04.2015) and *Software AG Bangalore*

Technologies Pvt Ltd in ITA No. 1628/2014 (order dated 31.03.2016) passed by this Hon'ble Tribunal, where it has been held that negative working capital adjustment shall not be made in case of a captive service provider as there is no risk and it is compensated on a total cost plus basis. The Tribunal in the aforesaid decisions have followed decision of ITAT Hyderabad Bench in the case of *Adaptec (India) Pvt. Ltd. (infra)*. The learned DR relied on the order of the TPO/DRP on the issue.

17. On the above ground, it is undisputed that the Hyderabad Bench of the ITAT in *ITA. No. 206/Hyd/2014 for Assessment Year 2009-2010* in the case of *Adaptec (India) P. Ltd. Vs. The ACIT, Circle 1(1)*, order dated 25.3.2015 held that no such addition can be made for the following reasons:-

“Ground No.8 pertains to the issue of negative working capital. As briefly stated above, after arriving at the arithmetic mean of all comparables at 22.03%, the A.O. worked out negative working capital adjustment of 3.22% thereby, making arms length price at 25.25%. Even though, DRP refused to interfere with the objections of the assessee in its order, we were informed that DRP has directed the TPO/A.O. not to make any negative working capital adjustment in some of the cases in the next assessment year, in the cases of Market Tools Research P. Ltd., and Mega Systems Worldwide India P. Ltd., assessee placed on record copies of orders of DRP. In that DRP considered the issue and directed the TPO as under :

"14. Ground No.11 : Negative Working Capital adjustment - Making a negative working capital adjustment without appreciating the fact that the company does not bear any working capital risks. On this issue, the assessee submitted as under :

"The learned TPO determined the ALP for the international transactions with A.Es by making a negative working capital adjustment for the

differences in working capital between the assessee and the companies considered as comparables. The assessee does not agree with the learned TPO as the company does not bear any working capital risk since it is been fully funded by it's A.E. from its inception and has no working capital contingencies. The company has never taken any loans till date from the date of incorporation nor has incurred any expense for meeting the working capital requirement."

We have gone through the submissions and the order of the TPO. The assessee pleaded that the DRP has acceded such a plea in some other case. On examination, we find that the DRP, Hyderabad in the case of Cordys Software India P. Ltd., for A.Y. 2008-09 in its directions dated 03.08.2012 has given a finding as under :

"7.7. 4 Thus, working capital adjustment is made for the time value of money lost when credit time is provided to the customers. The applicant is not an entrepreneur but a captive service provider. Its entire funding needs are provided by the A.E. This being so, the applicant does not stand to lose anything as it is compensated on a total cost plus basis. The TPO probably was carried away by the large amount of receivables appearing in the books of the applicant. But the applicant is running its business without any working capital risk while comparable companies have such a risk for them. If at all any working capital adjustment is to be made to this situation, only a positive adjustment has to be made to the comparables so that they are brought on par with the applicant. In view of the same, the Panel directs that negative working capital adjustment to the arithmetic mean margin of the comparables shall not be made."

In view of the above, the Panel directs that negative working capital adjustment to the arithmetic mean margin of the comparables shall not be made."

18. In view of the above, we are of the opinion that assessee's case being similar, there is no need for making any negative working capital adjustment when assessee does not carry any working capital risk. In fact, TPO should have done necessary working capital adjustment to the profits of the selected comparables so as to make them comparable to the assessee. In view of this, we direct the TPO not to make negative working capital adjustment.

19. It is undisputed that the Assessee is also a captive service provider such as the Assessee in the case decided by the ITAT Hyderabad Bench and therefore making a negative working capital adjustment without appreciating the fact that the company does not bear any working capital risks, was not correct. No other contrary decision was brought to our notice. Following the aforesaid decisions, we allow Gr.No.2.6 raised by the Assessee.

20. The TPO is directed to compute the ALP in accordance with the decision on Gr.No.2.6 after affording Assessee opportunity of being heard. In view of the decision on Gr.No.2.6, we are of the view that the grievance of the Assessee in other grounds relating to exclusion and inclusion of comparable companies raised in Gr.No.2.2, 2.3 & 2.5 does not require any adjudication and those grounds are left open without any adjudication.

21. The other grounds raised in its appeal in relation to its international transaction of provision of SWD services were not pressed at this stage. However, if necessary, the Assessee is allowed liberty to urge the said grounds in any future proceeding, appellate or otherwise, and in these proceedings at a future point in time.

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

Pronounced in the open court on this 12th day of June, 2020.

Sd/-

(B R BASKARAN)
ACCOUNTANT MEMBER

Sd/-

(N V VASUDEVAN)
VICE PRESIDENT

Bangalore,
Dated, the 12th June, 2020.

/Desai S Murthy/

Copy to:

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

By order

Assistant Registrar
ITAT, Bangalore.