

आयकर अपीलीय अधिकरण, मुंबई न्यायपीठ 'के' मुंबई

IN THE INCOME TAX APPELLATE TRIBUNAL

"K" BENCH, MUMBAI

श्री बी. रामकोटय्य, लेखा सदस्य, एवं श्री अमित शुक्ला, न्यायिक सदस्य के समक्ष

BEFORE SHRI B. RAMAKOTIAH, ACCOUNTANT MEMBER AND

SHRI AMIT SHUKLA, JUDICIAL MEMBER

आयकर अपील सं. / ITA no. 7653/Mum./2011

(निर्धारण वर्ष / Assessment Year : 2007-08)

Evonik Degussa India P. Ltd.
Krislon House, Sakivihar Road
Sakinaka, Andheri (E), Mumbai 400 072

..... अपीलार्थी /
Appellant

बनाम v/s

Asstt. Commissioner of Income Tax-OSD
Circle-3(1), Aayakar Bhavan
101, M.K. Road, Mumbai 400 020

..... प्रत्यर्थी /
Respondent

स्थायी लेखा सं./ Permanent Account Number – AAACH3690Q

निर्धारिती की ओर से / Assessee by : Mr. Kanchan Kaushal a/w
Mr. Prasad Pardiwala and
Mr. Dipesh Gada
राजस्व की ओर से / Revenue by : Mr. Ajeet Kumar Jain

सुनवाई की तारीख /
Date of Hearing – 22.10.2012

आदेश घोषणा की तारीख /
Date of Order – 21.11.2012

आदेश / ORDER

प्रत्येक पीठ
PER BENCH

The present appeal preferred by the assessee, is directed against the final impugned assessment order dated 13th September 2011, which has been passed in pursuance of the directions given by the Dispute Resolution

Panel-I (for short "DRP"), Mumbai, under Section 144C of the Income Tax Act, 1961 for the quantum of assessment for the assessment year 2007-08. Following grounds have been raised by the assessee:-

"1. On the facts and circumstances of the case, and in law, the learned Assessing Officer (AO)/ Dispute Resolution Panel (DRP)/ Transfer Pricing Officer (TPO) erred in making an upward adjustment of Rs.68,47,532/- to the income of the Appellant in respect of provision of research and development support services by -

a. rejecting comparables from the set provided by the Appellant;

b. including companies which are not functionally comparable;

c. denying risk adjustment to the Appellant to account for differences between the risk profile of comparables and the Appellant;

d. using current year's financial data (i.e. Financial Year 2006-07) as against average margin of 3 years of comparable companies; and

e. denying (+/-) 5% range benefit available under proviso to Section 920(2) of the Income-tax Act, 1961 (the Act).

The Appellant prays that the AO be directed to delete the aforementioned adjustment.

2. On the facts and circumstances of the case, and in law, the learned AO/ DRP/ TPO erred in making a notional addition of Rs. 9,83,383/- towards interest on perceived delay in collection of receivables from the associates enterprises.

The Appellant prays that the aforementioned notional addition be deleted.

3. On the facts and circumstances of the case, and in law, the learned AO / DRP erred in treating network accesses charges (grouped under the head software expenses) as capital expenditure and thereby not allowing the same as deduction under section 37(1) of the Act.

The Appellant prays that the AO be directed to delete the aforementioned disallowance.

Without prejudice to Ground no.3 above, the learned A.O. / DRP erred in not granting depreciation at the rate of 60% as per entry III(5) of Table of Rates of Depreciation read with section 32(1)(ii) of the Act r/w Rule 5 of the I.T. Rules, 1962.

The appellant prays that the A.O. be directed to allow depreciation at the rate of 60% on network access charges."

2. The relevant facts, apropos ground no.1, are that the assessee, Evonik Degussa India (P) Ltd., is a fully owned subsidiary of 'Evonik Degussa GmbH', a specialty chemical company headquartered at Germany. The assessee's main business is providing support services for the various division of Evonik Group of companies which are bifurcated into two parts - firstly, marketing, promotion and coordinate support services and secondly, testing and analytical support services. During the year, the assessee had following international transactions with its Associate Enterprise (in short "A.E").

<i>S.No.</i>	<i>Nature of Transaction</i>	<i>Amount for A.Y. 2007-08(Rs.)</i>
1.	<i>Provision of support services</i>	<i>8,99,77,540</i>
2.	<i>Provision of support services in connection with research and development</i>	<i>6,32,42,198</i>
3.	<i>Payment for network access</i>	<i>12,60,835</i>
4.	<i>Payment of seminar / training fees</i>	<i>3,05,007</i>
5.	<i>Recovery of expenses</i>	<i>4,10,904</i>
	<i>Total:-</i>	<i>15,51,96,484</i>

3. The assessee had prepared separate segment for the transaction of rendering R&D support services and marketing support services. For its R&D support services, the assessee had shown profit margin on operating cost at 20.75%, as per its segmental account. It has benchmarked its international transaction under 'Transactional Net Marginal Method' (in short "TNMM") as most appropriate method. In its Transfer Pricing Study report for comparability analysis, the assessee has initially identified 16 comparable companies wherein the arithmetic mean of the operating profit to the total cost worked out to 11.87% based on three years average. As against this, the assessee's operating profit to the total cost in the relevant

segment was at 20.75%. Thus, it was claimed that the assessee's margin were at arm's length. During the course of the transfer pricing proceedings, the Transfer Pricing Officer (for short "TPO") directed the assessee to submit the margin of comparable companies using only the relevant year data (i.e., F.Y. 2006-07). In response to this, the assessee submitted 12 comparables out of which seven were claimed to be directly comparable and five companies having segmental data comparable to the assessee. The arithmetic mean of the operating profit / total cost (OP/TC) worked out at 14.13%.

4. The TPO observed that comparables selected by the assessee has not resulted into appropriate set of comparables as it has excluded many companies considered to be comparable for R&D and support services. The TPO in his search for comparables, identified new comparables, one of which was common to the assessee's set of comparables. The assessee in response to the show cause notice issued by the TPO as to why the eight new companies should not be selected, filed detail objections before the TPO with regard to the data and functional analysis, turnover, etc. The TPO rejected the assessee's contentions and finally included 19 comparable companies some of them which were adopted by the assessee also. The arithmetic mean margin of these 19 comparables was worked out at 27.30% as against 20.75% earned by the assessee. Accordingly, an upward adjustment of Rs. 34,81,318 in the Arms Length Price (in short ALP) was made to the income of the assessee.

5. The assessee, against the adjustment so made by the TPO in ALP, filed detail objections before the "DRP", that the comparables identified by the TPO were not appropriate considering the nature of activity undertaken by the assessee i.e., testing and analytical services. The DRP directed the assessee to undertake fresh comparability analysis. In response, the assessee submitted its results whereby nine comparable companies were identified and the arithmetic mean of the operating margin of such nine

comparable companies worked out at 9.94%. List of such companies provided before the DRP were as follows: –

<i>S.no.</i>	<i>Name of the Company</i>	<i>Profit Level Indicator (%)</i>
1.	<i>Choksi Laboratories Ltd.</i>	<i>33.78%</i>
2.	<i>Vimta Labs Ltd.</i>	<i>25.26%</i>
3.	<i>Dolphin Medical Services Ltd.</i>	<i>8.31%</i>
4.	<i>N.G. Industries Ltd.</i>	<i>18.10%</i>
5.	<i>Transgene Biotek Ltd. Diagnostic</i>	<i>22.68%</i>
6.	<i>GVK Biosciences P. Ltd.</i>	<i>26.68%</i>
7.	<i>Tog Lifesciences Ltd.</i>	<i>26.06%</i>
8.	<i>A D S Diagnostic Ltd. – Diagnostic</i>	<i>-24.96%</i>
9.	<i>Max Neeman Medical International (Asia) Ltd.</i>	<i>-46.73%</i>
	<i>Arithmetic mean (Arm's length mark-up)</i>	<i>9.94%</i>
	<i>Assessee's margin</i>	<i>20.75%</i>

6. The DRP, however, after calling for the remand report from the TPO, arrived at final set of six companies wherein the arithmetic mean was arrived at 33.63%. The list of such six companies were as under: –

<i>S.no.</i>	<i>Name of the Company</i>	<i>Profit Level Indicator (%) / OP-TC</i>
1.	<i>Choksi Laboratories Ltd.</i>	<i>33.78%</i>
2.	<i>Vimta Labs Ltd.</i>	<i>25.26%</i>
3.	<i>TCG Lifescience</i>	<i>26.06%</i>
4.	<i>Celestial Labs Ltd.</i>	<i>58.35%</i>
5.	<i>GVK Bioscience</i>	<i>26.68%</i>

6.	<i>Biocon Ltd. (seg.)</i>	31.63%
	<i>Arithmetic Mean :</i>	33.63%

7. These six comparables were arrived after rejecting diagnostic companies and loss making companies which were selected by the assessee and two new comparable companies were added viz. Celestial Labs Ltd. and Biocon Ltd. (segmental). Thus, after the direction of the DRP, the adjustment in ALP was enhanced to Rs. 68,47,532, as against adjustment made by the TPO at Rs. 34,81,318.

8. Before us, the learned Counsel, Mr. Kanchan Kaushal, representing the assessee, after referring to the facts and contentions raised before the TPO as well as the DRP, submitted that the inclusion of the two comparable companies viz. Celestial Labs Ltd. and Biocon Ltd., is wholly erroneous as they were functionally not comparable and rejection of other companies on the ground that they were diagnostic companies, were also not tenable as they were also involved in similar type of business activity i.e., testing and analytical services. Insofar as the two loss making companies i.e., ADS Diagnostic Ltd. and Max Neeman Medical International (Asia) Ltd. are concerned, it was submitted that these being loss making companies, therefore, the same are not being pressed by the assessee in this particular case. Regarding inclusion of 'Celestial Labs Ltd.', he submitted that company is engaged in the business of supporting pharmaceutical and biotechnology companies with customized I.T. solutions. The company is also involved in commercial production and marketing of enzymes and neutraceuticals. The main services rendered by the said company were mostly software development, bio informatic services and data ware-housing and mining. In support of his contentions, he drew our attention to Page-125, which is part of the director's report of Celestial Labs Ltd. wherein it has been mentioned that the company has developed a drug design tool, cellsuite for structure base drug design. Further, this company is also involved in software developed and products for its customer like Sap services and Cell sanjivani products. He further

drew our attention to pages-141 and 144, wherein it has been mentioned that assessee's main turnover is from bio-informatic service data warehousing and mining software development products and services. Thus, the functional profile of the said company is entirely different from the assessee and the same is not comparable. In support of his contention that Celestial Labs Ltd. functionally comparable to testing and analytical services, he relied upon the decision of a co-ordinate bench of the Tribunal rendered in *Tevapharma P. Ltd.*, ITA no.6623/Mum./2011, vide order dated 23rd December 2011.

9. Regarding inclusion of 'Biocon Ltd.', wherein segmental data of contract research segment was taken by the TPO, he submitted that Biocon Ltd. is doing contract research work for Biocon Group and subsidiary and is functionally not comparable to the business of the assessee. After referring to the Pages-428 and 453 of the paper book, which are the part of the annual report of Biocon Ltd., he pointed out that the company is engaged in the manufacture of biotechnology products and further it is organized into two business segments i.e., enzymes and active pharmaceutical ingredients. Regarding segmental selection by the TPO, he submitted that contract research segment is not available in annual report of Biocon Ltd., on stand alone but the same has been identified in the consolidated annual report of Biocon Ltd. In the said consolidated annual report, the contract research segment of Biocon Ltd. relates to two subsidiaries i.e., 'Clinigene International Ltd.' and 'Syngene International Ltd.' and it is a joint venture of Biocon Biopharmaceutical P. Ltd. After referring to Page-595 of the paper book which is consolidated annual report of Biocon Ltd., he pointed out that Biocon Ltd. shows following segment under the segmental information i.e., enzyme, pharma, contract research segment and joint venture segment. Insofar as enzyme & pharma segment is concerned, the same relates to Biocon Ltd. and joint venture segment is also separately identified segment of joint venture of Biocon Pharmaceuticals. The revenue of contract research segment is close to Clinigene International Ltd. and Syngene International Ltd. Regarding

Clinigene International Ltd., he submitted that the company is wholly owned subsidiary of Biocon Ltd. and is engaged in discovering new bio markers and is discovering new diseases subsets and novel data based on pharma co-genomics. Thus, the functional performance and the nature of activity by Clinigene International Ltd. is different from assessee's business of testing and analytical services. He further highlighted that the related party transaction in the said case was approximately 38% of sales and the net worth of the company has been eroded in the past two years and turned negative. Based on this analysis, specifically having substantial related party transaction, he submitted that this company cannot be taken as comparable. Regarding another subsidiary Syngene International Ltd., he submitted that it is engaged in the customized research service provider with product set of services in drug development process from discover to supply of development compounds. It has two sets of income i.e., contract research fees and sales of compounds. He referred to the business operation and profile of the said company from its website to show that its function is entirely different from the functional profile of the company. Thus, he concluded that Biocon Ltd., even as per its segmental profile, cannot be taken as comparable.

10. Regarding rejection of 3 diagnostic companies, he submitted that these companies are not only providing diagnostic services, but are also doing testing and analytical services which include lab research and analytical facilities for certain products. Thus, functions of these companies are akin to that of the assessee. He proceeded to referred to the entire business profile and activities carried out by these diagnostic company. Thus, he submitted that three diagnostic companies should be included while taking list of comparables and two company viz. Celestial Labs Ltd. and Biocon Ltd. should be excluded. Once this exercise is taken and their arithmetic mean of the finally selected companies is worked out then the arithmetic mean will come to 22.98% which is quite near assessee's margin of 20.75% and if benefit of safe harbour of +/- 5% is given, then no adjustment is called for. Besides raising the aforesaid contentions, the

learned Counsel for the assessee submitted that both the authorities i.e., DRP and the TPP has denied the risk adjustment to the assessee on account of difference between risk profile of the comparables and the assessee. He submitted that there is a difference in this profile with the companies dealing with principal to principal basis to its customers and the companies which are captive service provider, set up by its parent company. He pointed out that there are various risk profile like market risk, credit risk services, liability risk, R&D risk, etc., which makes huge differences in the profit margin and most of these risks are not undertaken by the assessee. The companies, who are taking more risk will have more profits, therefore, the same cannot be compared with the assessee. In support of this contentions, he relied upon the following case laws:-

- *E-Gain Communications P. Ltd. (Pune Tribunal – 23 SOT 385)*
- *Skoda Auto India P. Ltd., (Pune Tribunal – 30 SOT 319)*
- *Mentor Graphics (Noida) P. Ltd. (Delhi – 18 SOT 78)*
- *Phillips Software Centre P. Ltd. (Bangalore – 119 TTJ 721)*
- *Aztec Software and Technology Services Ltd. (Bangalore – ITA no.584/Bang./2006)*

11. *Per Contra*, the learned Departmental Representative regarding exclusion of three diagnostic companies by the TPO, referred to the business profile of the said companies from the records available in the assessee's paper book and submitted that the assessee is not at all a diagnostic company but conducts only lab research and analytical services. For e.g., in the case of Dolphin Medical Services, he submitted that the company is undertaking CT Scan, MRI, Colour Doppler, etc. From the Profit & Loss account of the said company, as appearing at Page-209 of the paper book, he submitted that no segmental details have been provided to bifurcate the revenues generated out of activities carried out by it and also the turnover of the said company is only Rs. 2.96 crores. Regarding Transgene Biotek Ltd., which is also a diagnostic company, he submitted that the said company has undertaken development of new vaccine and is

holding patent rights. Therefore, the said company cannot be comparable at all with that of the assessee. He referred to the Director's report appearing at Pages-151-153, to demonstrate that the activities of the said company are entirely different with the business profile and function of the assessee company. Regarding other diagnostic company also, he referred to the business profile and the sales revenue to show that the function of these companies nature of revenue and business operations were entirely different from that of the assessee company.

12. Regarding inclusion of 'Celestial Labs Ltd.', he drew our attention to the Profit & Loss account of the said company as appearing at Page-135 and submitted that the Revenue from sale of services constituted 96% whereas revenue from sale of products is less than 4%. Therefore, the said company has rightly been included. Moreover, he submitted that there is no segmental report of this company as the turnover is less than Rs. 50 crores. Regarding inclusion of 'Biocon Ltd.', he submitted that in T.P. report, the assessee has itself taken this company as a comparable company, therefore, why the assessee is now objecting to inclusion of such company. He, thus, strongly relied upon the directions of the DRP and the order of the Assessing Officer.

13. On the issue of risk adjustment, he submitted that this issue has neither been raised before the TPO nor has been decided by the DRP. Therefore, this is a plea taken before the Tribunal for the first time. Even otherwise also, he submitted that in the T.P. report, the assessee has not made any kind of risk adjustment. Therefore, the plea of risk adjustment cannot be given now after the DRP's direction. He submitted that in the case of captive service provider, which are mostly dealing with single customer, there is always a very high risk because once such a customer is lost, the entire business gets affected. The credit risk is also very much in the case of captive service provider. He highlighted that there can be hundreds of risk but the same has to be established and to be quantified

by the assessee. Once there could not be any quantification, risk adjustment cannot be allowed.

14. In the rejoinder, regarding Biocon Ltd., the learned Counsel submitted that the said company was initially included because it was taken on the basis of three year data and was rejected by the assessee in the fresh research conducted after TPO's direction. The DRP has resorted to cherry picking to take the companies having very high profitability margin from the set of the comparables given either by the assessee or by the TPO. Regarding objection of the risk adjustment by the learned Departmental Representative, he submitted that the risk profile of the captive service provider and independent enterprise cannot be the same as the risk undertaken by the former is far less and, therefore, the profit also is not as high as that of those enterprise which take higher risk.

15. Regarding rejection of other diagnostic companies, he reiterated his submission that one of the major functions was research and analytical services, therefore, the same can be said to be comparable companies.

16. We have carefully considered the rival contentions of the parties, perused the material placed on record, as have been referred to at the time of hearing and also the orders of the TPO as well as the DRP. The only issue before us is whether two comparable companies namely Celestial Labs Ltd. and Biocon Ltd. (segmental) can be said to be includable in the set of comparable taken by the TPO after directions of the DRP and also the rejection of three diagnostic companies by the TPO. The summary of the list of comparables accepted by the assessee as well as by the TPO and rejection by the TPO and included but objected by assessee are as under:-

<i>Sl.no.</i>	<i>Name of the Comparables</i>	<i>Profit Level Indicator(PLI)</i>	<i>Disposition</i>	<i>Summary – Reasons for acceptance</i>
1.	<i>Choksi Laboratories Ltd.</i>	<i>33.78%</i>	<i>Accepted</i>	<i>Both by the assessee as well as by the TPO</i>
2.	<i>GVK Bioscience P. Ltd.</i>	<i>26.68%</i>	<i>Accepted</i>	<i>Both by the assessee as well as by the TPO</i>

3.	<i>TCG Lifescience Ltd.</i>	26.06%	<i>Accepted</i>	<i>Both by the assessee as well as by the TPO</i>
4.	<i>Vimta Labs Ltd.</i>	25.26%	<i>Accepted</i>	<i>Both by the assessee as well as by the TPO</i>
5.	<i>Dolphin Medical Services Ltd.</i>	8.31%	<i>Rejected</i>	<i>By the TPO on the ground that the company is engaged in diagnostic services to which assessee has objected to.</i>
6.	<i>Max Neeman Medical International Ltd.</i>	(-)46.73%	<i>Rejected</i>	<i>By the TPO on the ground that the company is engaged in diagnostic services to which assessee has objected to.</i>
7.	<i>ADS Diagnostic Ltd. – Diagnostic</i>	(-)24.96%	<i>Rejected</i>	<i>By the TPO on the ground that the company is engaged in diagnostic services to which assessee has objected to.</i>
8.	<i>Transgene Biotek Ltd. – Diagnostic segment</i>	22.68%	<i>Rejected</i>	<i>By the TPO on the ground that the company is engaged in diagnostic services to which assessee has objected to.</i>
9.	<i>N.G. Industries Ltd.</i>	18.10%	<i>Rejected</i>	<i>By the TPO on the ground that the company is engaged in diagnostic services to which assessee has objected to.</i>
10.	<i>Celestial Labs Ltd.</i>	58.35%	<i>Accepted</i>	<i>New comparable introduced by the TPO on the ground that it is engaged in the research services. This has been objected by the assessee.</i>
11.	<i>Biocon Ltd. – segment</i>	31.65%	<i>Accepted</i>	<i>New comparable introduced by the TPO on the ground that it is engaged in the research services. This has been objected by the assessee.</i>

Insofar as the companies listed at serial number 6 and 7 i.e., ADS diagnostic Ltd. and Max Neeman Medical International (Asia) Ltd. are concerned, the assessee has not pressed for the exclusion of the said companies being very heavy loss making companies.

17. The assessee is a fully owned subsidiary of Evonik Degussa GmbH and is providing support services viz. marketing promotion co-ordination and testing and analytical support services for Evonik Group of companies. Thus, the assessee is a kind of captive service provider to its AE. Insofar as the segmental data of the support services in connection with research and development, the assessee had shown the profit margin of 20.75% on the operating cost in relation to its international transactions. It was this profit margin, the TPO has rejected the assessee's comparables shown by the assessee in its T.P. report.

18. Since, the issue involved before us is inclusion and exclusion of certain companies, therefore, we proceed to analyze such comparables very briefly. Coming to the inclusion of Celestial Labs Ltd., it is seen that the said company is engaged in the business of supporting pharmaceutical and biotechnology companies with customised information technology solution. It is mainly engaged in the software development in drug designing tool, bio informatic service and data warehousing. More than 96% of its revenue is from this service which are mostly in the nature of drug designing tools and Sap services. The profile of the company, as highlighted by the learned Counsel for the assessee (which are illustrated in para 8 above), shows that its functions are entirely different from that of the assessee company which is mainly into testing and analytical service in R&D. While carrying out comparability analysis, one has to examine the functional profile of the company and the attributes of the products and services provided. If the products and services are different, then it becomes very difficult to compare the PLI with the tested party. The functional analysis shows that this company is mainly engaged in development of specific type software services and products. Thus, Celestial Labs Ltd. which is mainly a software development company and engaged in bio informatic services cannot be said to be functionally comparable with that of the assessee and, therefore, it cannot be included for comparability analysis in the set of comparables taken by the TPO.

Accordingly, we uphold the contentions of the assessee that the said company cannot be included.

19. Regarding inclusion of Biocon Ltd., insofar as contract research segment taken by the TPO is concerned, we find merits in the contentions of the learned Counsel that its contract research segment relates to two subsidiary of Biocon Ltd. i.e., Clinigene International Ltd. and Syngene International Ltd. The former company cannot be included at all for the preliminary reason that its related party transaction is approximately 38% of its sales, therefore, it cannot be held to be a fit case for comparison of a controlled transaction with an uncontrolled transaction. On this ground alone, the data of the said company cannot be included for comparability analysis. Insofar as Syngene International Ltd., this company is again 99% subsidiary of Biocon Ltd. and is engaged as a custom research service provider in the drug development process from discovery to supply of development compounds. From annual report, it is seen that the company has two sets of income – one from contract research fees and sale of compounds. However, in the absence of segmental information regarding contract research and manufacturing activities, it is difficult to analyse its main revenue and profit margin from the contract research work. Even otherwise also, apparently it is seen that its functional profile is different with that of the assessee company. Thus, going by the segmental data of Biocon Ltd. with regard to contract research segment, we do not find any merit in the inclusion of the said company by the TPO in the set of comparables for determining the ALP in the case of the assessee. Hence, this company is directed to be excluded from the set of comparables.

20. Now, coming to the various diagnostic companies excluded by the TPO viz. Dolphin Medical Services Ltd., Transgene Biotek Ltd. and N.G. Industries Ltd., we find from the perusal of record produced before us, that not only the functional profile of these companies are different but the characteristic of the services rendered are also different. For e.g., Dolphin Medical Services Ltd., as pointed out by the learned Departmental

Representative, is engaged in diagnostic services like CT scan, MRI, colour Doppler, etc., which is entirely different from R&D, testing and analytical services performed by the assessee. These services cannot be compared with the business activity carried on by the assessee. In the case of Transgene Biotech, it is seen that it is engaged in the business of pre-clinical and clinical research service for biopharma and as pointed out by the learned Departmental Representative, this company is involved in developing human vaccines and has patent rights of various products and vaccines developed by it. Thus, this company cannot be compared with the activities of the assessee company which is in R&D and analytical services. Similar is the case of N.G. Industries Ltd. which is also purely a diagnostic and medical company and its services are entirely different from that of assessee. Thus, these three companies has rightly been rejected by the TPO from the set of comparables and the contentions of the learned Counsel for the assessee to include these three companies for the purpose of comparability analysis is hereby rejected.

21. In view of our aforesaid findings, only four set of companies which has been accepted by both the TPO as well as the assessee viz. Choksi Labs Ltd., Vimta Lab Ltd., G.V.K. Biosciences P. Ltd. and TCG Lifescience Ltd., should be included for the purposes of comparability analysis and the arithmetic mean of the PLI of these final set of companies by taking operating profit of the total cost should be taken for the purpose of determining the ALP.

22. Regarding the plea of risk adjustment on account of difference between the risk profile of the comparables and the assessee, we find that neither the TPO nor the DRP has dealt with the assessee's contentions / objections. Therefore, in the interest of justice, we are of the considered opinion that the matter needs to be restored back to the file of the TPO, who will examine the assessee's contentions on this score and decide the issue afresh in accordance with the law after providing due and effective

opportunity of representing the case to the assessee. We order accordingly. Ground no.1, is thus, partly allowed.

23. In ground no.2, the assessee has challenged the addition of Rs. 9,83,383, on account of notional addition towards interest on the amount receivable from the A.E.

24. The TPO observed that the assessee has given credit of thirty days in the invoices raised against the A.E. However, there has been delay in making the payment by the A.E. beyond the stipulated credit period and on such delayed payment, the assessee has not charged any interest. Accordingly, he computed the interest @ one percent per month for the period of delay beyond thirty days and accordingly he worked out the notional interest to be received by the assessee at Rs. 9,83,383.

25. Objection before the DRP by the assessee was rejected.

26. Learned Counsel Shri Kanchan Kaushal submitted that the assessee is a zero debt company and it does not have any borrowings from external sources, therefore, it is not required to pay any interest. There have been some situations that there has been delay in making the payments by the A.Es beyond the normal credit period, however, no interest has been charged for the reason that there is no interest cost to the assessee. Moreover, there is no such agreement between the assessee and the A.E. to charge interest on delayed payments. He, therefore, contended that charging of notional interest in the international transaction is wholly erroneous. Learned Counsel further pointed out that the assessee has been raising the bills on quarterly basis and the payment has thus received after the bills only. Therefore, the delay cannot be attributed purely on account of delayed payments made by the A.Es. Moreover, the business transaction has to be decided between the two parties and there cannot be any presumption by the A.O. about charging of notional interest on such delayed payment.

27. Learned Departmental Representative, on the other hand, relying upon the order of the TPO and DRP's direction, submitted that in some cases delay is of more than 200 days and if one has to judge in relation to the third party whether such a long credit would have been given by the assessee. Therefore, the TPO has rightly charged the interest.

28. After carefully considering the rival submissions and the orders of the TPO as well as the direction of the DRP, we find that the assessee has no interest liability and it does not have any external borrowings. Even if the payments have been made by the A.E. beyond the normal credit period, there is no interest cost to the assessee. Moreover, there is no such agreement whereby interest is to be charged on such a delayed payment. From the summary of payment submitted by the learned Counsel, it is seen that the billing is done on quarterly basis and, accordingly, the payment is being received. Therefore, the delay is not wholly on account of late payment by the A.Es only. Moreover, the T.P. adjustment cannot be made on hypothetical and notional basis until and unless there is some material on record that there has been under charging of real income. Thus, on the facts and circumstances of the case, we are of the opinion that addition an account of notional interest relating to alleged delayed payment in collection of receivables from the A.Es, is uncalled for on the facts of the present case and is, accordingly, deleted.

29. In ground no.3, the assessee has challenged the Assessing Officer's action of treating network access charges as capital expenditure.

30. The Assessing Officer on perusal of accounts found that the assessee has debited a sum of Rs. 12,60,835, in the Profit & Loss account under the head 'software expenses'. In response to the show cause notice as to why the said expenditure may not be treated as capital in nature, it was submitted by the assessee that the expenditure have been incurred towards the payment made to the group entities towards e-mail

infrastructure and network access charges. Since these expenditures were incurred for the purpose of smooth and efficient running of business, the same is to be treated as revenue in nature. The Assessing Officer rejected the said contention of the assessee on the ground that the assessee has not given the details of all the infrastructure installed. He held that mere nomenclature of 'software expenditure' shows that it relates to only as capital expenditure.

31. Learned Counsel for the assessee submitted before us that the payment has been made for e-mail infrastructure provided by the parent companies for providing communication facility between the personnel of the assessee with outside business partners. The parent companies have provided Virtual Private Network (VPM) which is a secured internet access network to various systems to be used by the employees of the assessee for day-to-day functioning. He submitted that the e-mail infrastructure are not owned by the assessee and the expenditures have been incurred for accessing the said infrastructure, therefore, the same is to be treated as revenue expenditure.

32. Learned Departmental Representative on the other hand relied upon the findings of the Assessing Officer as well as the direction of the DRP.

33. We have carefully considered the rival contentions of the parties, perused the material placed on record as well as the order passed by the Assessing Officer. From the records, it is seen that the assessee has made the payment for availing e-mail infrastructure like lotus notes accounts for the employees, usage of VPN, network infrastructure excess service which are owned by the parent company and not by the assessee. The assessee is making the payment for using this e-mail infrastructure facilities for communication between employees of the assessee and outside business partners. Such facilities of secured internet facilities, facilitates the day-to-day business operation of the assessee and does not bring into an existence any enduring benefit or creation of a new asset to the assessee. It is not a capital software expenditure as held by the Assessing Officer

even though the same has been classified under the head "software expenditure". Thus, on these facts and circumstances, we hold that such an expenditure is purely revenue in nature and is allowable under section 37(1) of the Act. Consequently, ground no.3 is allowed.

34. Ground no.4, is an alternative ground for giving depreciation on software expenditure, the same has become infructuous in view of our finding given in ground no.3, above. Thus, this ground is dismissed as infructuous.

35. परिणामतः निर्धारिती की अपील आंशिक स्वीकृत की जाती है ।

35. In the result, assessee's appeal is partly allowed.

आदेश की धोषणा खुले न्यायालय में दिनांक: 21/11/2012 को की गई ।
Order pronounced in the open Court on 21/11/2012.

Sd/-
बी. रामकोटय्य
लेखा सदस्य
B. RAMAKOTAIAH
ACCOUNTANT MEMBER

Sd/-
अमित शुक्ला
न्यायिक सदस्य
AMIT SHUKLA
JUDICIAL MEMBER

मुंबई MUMBAI, दिनांक DATED: 21/11/2012

आदेश की प्रतिलिपि अग्रेषित / Copy of the order forwarded to:

- (1) निर्धारिती / The Assessee;
- (2) राजस्व / The Revenue;
- (3) आयकर आयुक्त(अपील)/ The CIT(A);
- (4) आयकर आयुक्त / The CIT, Mumbai City concerned;
- (5) विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / The DR, ITAT, Mumbai;
- (6) गार्ड फाईल / Guard file.

आदेशानुसार / By Order

प्रदीप जे. चौधरी / Pradeep J. Chowdhury
वरिष्ठ निजी सचिव / Sr. Private Secretary

उप / सहायक पंजीकार / (Dy./Asstt. Registrar)
आयकर अपीलीय अधिकरण, मुंबई / ITAT, Mumbai