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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ **ITA 765/2016**

PR. COMMISSIONER OF INCOME TAX-V .... Appellant
Through: Mr. Raghvendra Singh, Junior Standing Counsel and Mr Ashok Manchanda, Advocate, Senior Standing Counsel.

versus

KUSUM HEALTH CARE PVT. LTD. .... Respondent
Through: Mr. G.C. Srivastava and Mr. Daksh S. Bhardwaj, Advocates.

CORAM: JUSTICE S. MURALIDHAR
JUSTICE CHANDER SHEKHAR

O R D E R

% 25.04.2017

CM No. 40894/2016 (exemption)

1. Allowed, subject to all just exceptions.

CM No. 40895/2016 (for condonation of 309 days' delay in re-filing the appeal)

2. For the reasons stated in the application, the delay of 309 days in re-filing the appeal is condoned.

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3. This appeal, under Section 260A of the Income Tax Act, 1961 ('the Act'), by the Revenue is directed against the order dated 31st March, 2015 passed by the Income Tax Appellate Tribunal, Delhi Bench '1', New Delhi ('ITAT')

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in ITA No. 6814/DEL/2014 for the Assessment Year ('AY') 2010-11.

4. The facts in brief are that the Assessee is engaged in the business of exporting pharmaceutical products to its overseas Associated Enterprises ('AEs') as well as to third parties. The Assessee filed its return for the AY in question on 13th October, 2010 declaring a total income of Rs. 2,06,64,960/- The return was picked up for scrutiny and notices under section 143(2)/142(1) of the Act were issued by the Assessing Officer ('AO'). Since the Assessee had, during the AY in question, entered into international transactions with its AEs, the case was referred to the Transaction Processing Officer ('TPO') under Section 92CA of the Act.

5. As far as the Assessee was concerned, it declared the following international transactions i.e. export of manufactured medicines and export of traded medicines. Both the transactions were benchmarked applying TNMM. The profitability of the Assessee from its manufacturing and trading segments was benchmarked with the average operating profit margin earned by comparable companies performing similar manufacturing and trading functions. In both sets of transactions, the profit level indicators (PLIs) showed the operating profit margin of the Assessee to be higher than that of the comparable companies. Accordingly, the international transactions were projected by the Assessee as having been undertaken at the arm's length price ('ALP').

6. The TPO, however, in his order dated 29th January, 2014 proposed an adjustment by way of addition of Rs. 1,57,54,943/- to the income of the Assessee. The TPO noted that the credit period for the debtors as mentioned

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in the sale contract with unrelated entities was 180 days. However, in the case of the AEs they were "allowed to linger for long". The said receivables *qua* the AE was treated as a separate international transaction.

7. The aforementioned transfer price adjustment as proposed by the TPO was incorporated by the AO in the draft Assessment Order. The Respondent/Assessee filed its objections to the said draft assessment order, before the Disputes Resolution Panel ('DRP') which, by the order dated 24th September 2014, rejected the objections. The TPO gave effect to the aforementioned directions of DRP on 13th November, 2014. On 14th November, 2014 the AOpassed the final assessment order by making an addition of Rs. 93,69,275/- to the income of the Assessee.

8. Aggrieved by the said order, the Assessee filed an appeal before the ITAT. By the impugned order dated 31th March 2015, the ITAT set aside the assessment order. The ITAT noted that the Assessee had undertaken working capital adjustment for the comparable companies selected in its transfer pricing report. It was further noted that "the differential impact of working capital of the Assessee vis-à-vis its comparables had already been factored in the pricing/profitability" which was more than the working capital adjusted margin of the comparables and, therefore, "any further adjustment to the margins of the Assessee on the pretext of outstanding receivables is unwarranted and wholly unjustified."

9. Mr. Raghvendra Singh, learned counsel appearing for the Revenue submitted that the ITAT overlooked the fact that the expression "international transaction" as defined in Explanation (i)(c) to Section 92B of

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the Act included "payments or deferred payment or **receivable** or any other debt arising during the course of business", and therefore, the outstanding receivables could by themselves constitute an international transaction. He further referred to the OCED Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. Paras 3.48 & 3.49 under Chapter III para A.6.1 of the said Guidelines titled "Different types of comparability adjustments" spoke of the need to eliminate differences that may arise from different accounting practices between controlled and uncontrolled transactions. In particular, it was noted under para 3.49 that "a significantly different level of relative working capital between the controlled and uncontrolled parties may result in further investigation of the comparability characteristics of the potential comparable." Mr. Singh submitted that the ITAT erred in disagreeing with the TPO, who had characterised the outstanding receivables as an international transaction by itself which required benchmarking.

10. The Court is unable to agree with the above submissions. The inclusion in the Explanation to Section 92B of the Act of the expression 'receivables' does not mean that *de hors* the context every item of 'receivables' appearing in the accounts of an entity, which may have dealings with foreign AEs would automatically be characterised as an international transaction. There may be a delay in collection of monies for supplies made, even beyond the agreed limit, due to a variety of factors which will have to be investigated on a case to case basis. Importantly, the impact this would have on the working capital of the Assessee will have to be studied. In other words, there has to be a proper inquiry by the TPO by analysing the statistics over a period of

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time to discern a pattern which would indicate that vis-à-vis the receivables for the supplies made to an AE, the arrangement reflects an international transaction intended to benefit the AE in some way.

11. The Court finds that the entire focus of the AO was on just one AY and the figure of receivables in relation to that AY can hardly reflect a pattern that would justify a TPO concluding that the figure of receivables beyond 180 days constitutes an international transaction by itself. With the Assessee having already factored in the impact of the receivables on the working capital and thereby on its pricing/profitability vis-à-vis that of its comparables, any further adjustment only on the basis of the outstanding receivables would have distorted the picture and re-characterised the transaction. This was clearly impermissible in law as explained by this Court in ***CIT v. EKL Appliances Ltd. (2012) 345 ITR 241 (Delhi)***.

12. Consequently, the Court is unable to find any error in the impugned order of the ITAT giving rise to any substantial question of law for determination. The appeal is, accordingly, dismissed.

S.MURALIDHAR, J

CHANDER SHEKHAR, J

APRIL 25, 2017/*rd /b'nesh*

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