आयकर अपीलीय अधिकरण "सी" न्यायपीठ पुणे में ।
IN THE INCOME TAX APPELLATE TRIBUNAL "C" BENCH, PUNE

(Through Virtual Court)

BEFORE SHRI R.S. SYAL, VICE PRESIDENT
AND
SHRI S.S. VISWANETHRA RAVI, JUDICIAL MEMBER

आयकर अपील सं. / ITA No.584/PUN/2015

निर्धारण वर्ष / Assessment Year : 2005-06

M/s. Honeywell Automation India Limited,
56 & 57, Hadapsar Industrial Estate,
Hadapsar, Pune – 411013

PAN : AAACT3904F

.....अपीलार्थी / Appellant

बनाम / V/s.

Deputy Commissioner of Income Tax,
Circle – 7, Pune

.....प्रत्यर्थी / Respondent

आयकर अपील सं. / ITA No.620/PUN/2015

निर्धारण वर्ष / Assessment Year : 2005-06

The Deputy Commissioner of Income Tax,
Circle -11, Pune

.....अपीलार्थी / Appellant

बनाम / V/s.

M/s. Honeywell Automation India Limited,
(Formerly known as Tata Honeywell Limited),
56 & 57, Hadapsar Industrial Estate,
Hadapsar, Pune – 411013

PAN : AAACT3904F

.....प्रत्यर्थी / Respondent

Assessee by : Shri Ajit Kumar Jain
Revenue by : S/Shri Kalika Singh &
Mahadevan A.M. Krishnan

सुनवाई की तारीख / Date of Hearing : 25-05-2021

घोषणा की तारीख / Date of Pronouncement : 03-06-2021

आदेश / ORDER

PER S.S. VISWANETHRA RAVI, JM :

These two appeals by the assessee and Revenue against the common order dated 27-02-2015 passed by the Commissioner of Income Tax (Appeals)-13, Pune ['CIT(A)'] for assessment year 2005-06.

2. We note that the issues raised in both the appeals are similar basing on the same identical facts. Therefore, with the consent of both the parties, we proceed to hear both the appeals together and to pass a consolidated order for the sake of convenience.

3. First, we shall take the appeal in ITA No. 584/PUN/2015 for the A.Y. 2005-06.

4. Ground Nos. 1 to 10 raised by the assessee questioning the order of CIT(A) in enhancing the income by invoking the provisions of section 10A of the Act.

5. Heard both the parties and perused the material available on record. We find that the similar issue has been decided by this Tribunal in assessee's own case, the latest being in ITA No. 583/PUN/2016 for A.Y. 2003-04, order dated 03-03-2020 which is at page Nos. 142 of the paper book. The relevant portion from Paras 5 to 8 are reproduced here-in-below:

> *"5. Ground Nos. 2 to 11 raised by the assessee challenging the action of CIT(A) in enhancing the income thereby consequently enhancing the income of the assessee by invoking the provisions contemplated in sub-section (7) of section 10A of the Act.*
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> *6. Heard both parties and perused the material available on record. The contentions of CIT(A) that the assessee earned more than ordinary profit in the eligible business in respect of Software Design Engineering Services for both the A.Ys. 2003-04 and 2005-06 and the deduction u/s. 10A should be restricted to the*

ordinary profit earned by the comparable companies. The assessee earned net margin of 92.98% and comparable companies is at the average net margin of comparable at 26.62% and by invoking the provisions of sub-section (7) of section 10A proposed to disallow by restricting the deduction to ordinary profit. The contention of assessee is that the AO did not make any addition in terms of sub-section (7) of section 10A of the Act and enhancement proposed by the CIT(A) is not warranted u/s. 251(2) of the Act. The case of CIT(A) is that the deduction u/s. 10A is to be restricted to the extent of ordinary profit earned by the assessee be that of comparable companies by invoking the provisions of sub-section (7) of section 10A of the Act.

7. The assessee submitted that the provisions of section 10A(7) of the Act is not applicable to the fact that the net profit earned by it is not more than ordinary profit. The CIT(A) observed that section 10A(7) can be applied even if there is no corresponding benefit derived by other party and closely connected enterprises by arranging their international transactions amongst themselves denying the right share of revenue as provide in the statute. Therefore, according to him the closely arranged between the assessee and other parties reducing its domestic tax base and sub-section (7) of section 10A of the Act be denied excessive tax collection i.e. deduction on more than ordinary profit in the eligible business. The ld. AR placed on record the order dated 06-03-2019 passed by this Tribunal in assessee's own case in ITA No. 473/PUN/2016 for A.Y. 2011-12 and submitted the similar issue came up before this Tribunal and the Tribunal by placing reliance in the case of CIT Vs. Schmetz India Pvt. Ltd. of Hon'ble Bombay High Court and directed to delete the addition made thereon by invoking section 10A(7) of the Act. The Tribunal came up such conclusion basing on the order of this Tribunal in assessee's own case for A.Y. 2006-07 in ITA No. 18/PUN/2011. The relevant portion at para No. 7 is reproduced here-in-below :

> *"7. We have perused the case records and have given thoughtful consideration to the various judicial pronouncements placed before us. On the same issue in assessee's own case in ITA No.18/PUN/2011 for assessment year 2006-07, the Tribunal has held as under:*
>
> > *"22. Before we proceed further, it would be appropriate to examine the scope and intent of the provisions of section 10A(7) r.w.s. 80-IA(10) of the Act. In this context, a reference has been made to the CBDT Circular No.308 dated 29.06.2008 wherein the reasons for introduction of sub-section (7) to section10A of the Act has been explained. In-particular, reference has been made to the following contents of the Circular :-*
> >
> > > *"The provisions of sub-section (8) and sub-section (9) of section 80-I will also apply in relation to the industrial undertaking referred to in the new section 10A as they apply in relation to an industrial undertaking referred to under section 80-I. Under the applied sub-section (8) of section 80-I, it is provided that where an Assessee has several units, some in the free trade zone and some outside, the profits of the unit in the free trade zone will be computed after taking the cost of the goods transferred to or from the unit on the basis of the market value of such goods. The applied sub-section (9) of section 80-I empowers the Income-tax Officer to determine the reasonable profits that could be attributed to the qualifying undertaking in the free trade zone in cases where, owing to the close connection between the Assessee and any other persons or for any other reason, the course of the business is so arranged that the industrial undertaking set up in the free trade zone derives more than ordinary profits which may be expected to arise in that business. This provision has been made with a view to avoiding abuse of the new tax concessions by manipulation of profits between associate concerns or different units of the same concern."*
> >
> > *[underlined for emphasis by us]*
> >
> > *23. Quite clearly, the provisions of section 10A(7) of the Act intend to plug abuse of tax concession by manipulation of profits between associated concerns or between different units of the same concern.*

The objective of the aforesaid Provision is that the tax concessions are not abused by manipulation of profits. In our considered opinion, the aforesaid explanation in the CBDT Circular (supra) signifies the legislative intent and it is also manifested in the language of section 10A(7) r.w.s. 80-IA(10) of the Act. We say so for the reason that the phraseology of section 80-IA(10) of the Act itself suggests that the profits and gains of an eligible business cannot be tinkered with by the Assessing Officer merely because they are more than the ordinary profits or that they are quite high. The existence of substantial or more than ordinary profits by itself does not sufficiently empower the Assessing Officer to disregard them and determine the profits which he may consider to be reasonably deemed to have been derived therefrom. The presence of the expression "the course of business ..... is so arranged ..... that the business transacted ..... produces to the assessee more than ordinaryprofits" is significant and its understanding has to be prefaced by the legislative objective of plugging abuse of the tax concessions granted u/s 10A of the Act by manipulation of profits between associated parties. In other words, the import of the expression "so arranged" has to be read in conjunction with the legislative intent that there should not be any abuse of tax concession by manipulation of profits. Therefore, section 10A(7) r.w.s. 80- IA(10) of the Act can be invoked only where it is shown that the course of business is so arranged which reflects an abuse of tax concession whereby the business transacted between two entities is so arranged, which produces to the assessee more than the ordinary profits which might be expected to arise in such eligible business. The emphasis is to eschew those 'more than the ordinary profits' which are as a result of a business between two closely connected concerns having been arranged with the intent of abuse of the tax concession. Ostensibly, in the present case, the Revenue would have to justify that the course of business between assessee and the associated enterprises has been 'so arranged' which produces to the assessee more than the ordinary profits which might be expected to arise in such eligible business with the intention of abusing the tax concession granted in section 10A of the Act. The mere existence of (i) a close connection between the assessee and the other person; and, (ii) more than ordinary profits is not sufficient to justify invoking of section 80-IA(10) of the Act in the absence of there being any material to say that the course of business between them is "so arranged" to abuse the tax concessions granted u/s 10A of the Act by manipulating profits between associated persons. Ostensibly, the same is required to be demonstrated on the basis of a cogent material and evidence. In other words, the presence of the expression "so arranged" has to be understood in the context of the abuse of tax concession which is sought to be plugged by the provisions of section 10A(7) r.w.s. 80-IA(10) of the Act.

24. On this aspect, the Ld. CIT-DR had vehemently argued, based on the judgement of the Hon'ble Bombay High Court in the case of Bank of India Ltd. (supra) that the meaning of the word "arranged' in section 80-IA(10) of the Act has to be understood to mean an agreement or an understanding between the parties concerned. The relevant portion of the decision of the Hon'ble Bombay High Court has been reproduced in the earlier part of this order, according to which, it is said that the term arrangement in plain language means any agreement or understanding between the parties concerned. On this basis, the Ld. CIT-DR submitted that undeniably there is an agreement between the assessee and the associated enterprises whereby the services have been provided by the assessee to them and therefore the same is to be understood as an "arrangement" within the meaning of section 10A(7) r.w.s. 80-IA(10) of the Act. Along with the aforesaid, it has also been emphasized, on the basis of the language of section 80-IA(10) of the Act that, the Assessing Officer is not required to be prove that there is an arrangement for producing more than ordinary profits. Whereas, as per the Ld. CIT-DR, section provides that arrangement leading to production of more than ordinary profit will satisfy the necessary condition of section 80-IA(10) of the Act. Thus, according to the Ld. CIT-DR, in the instant case there is an arrangement and it has lead to production of more

than the ordinary profits. According to the Ld. CIT-DR, the meaning of the words "so arranged" in section 80-IA(10) of the Act only seeks to ensure that there was an agreement between the assessee and associated enterprise.

25. We have carefully examined the aforesaid contentions of the Ld. CITDR. In our considered opinion, the import of the expression "arranged" in section 80-IA(10) of the Act is not to be understood in its plain language but the same has to be understood in the context in which it is placed in the section. Notably, section 80-IA(10) of the Act restricts the plain meaning of the term "arranged" because it is placed between the words "……..the course of business between them is so arranged that the business transacted between them produces to the assessee more than the ordinary profits which might be expected to arise in such eligible business……" . Therefore, it would necessarily mean that the 'arrangement' referred to is an arrangement of the course of business which produces to the assessee more than the ordinary profits with the intent of abusing the tax concession. Thus, the word "arranged" in the section does not envisage a simple arrangement, but a arrangement of "the course of business transacted" which produces to the assessee more than ordinary profits which might be expected to arise in such a business with the intent of abusing the tax concessions. Therefore, the meaning of the words "so arranged" have to be understood in the context in which they are placed in section 80-IA(10) of the Act. A mere agreement between the assessee and the associated enterprises for transacting business is not enough to invoke section 80-IA(10) of the Act.

26. In-fact, even the Hon'ble Bombay High Court in the case of Bank of India Ltd. (supra) has also appreciated the contextual meaning of the expression "arrangement". The issue before the Hon'ble Bombay High Court was with regard to the scheme of re-construction or arrangement contained in section 391(1) of the Companies Act, 1956. In the context of section 391(1) of the Companies Act, 1956, the Hon'ble High Court was dealing with the meaning of the word "arrangement". After having explained the meaning of the term arrangement in plain language, which we have referred earlier, the Hon'ble High Court went on to say as under in the context of the word "arrangement" qua section 391(1) of the Companies Act, 1956 :-

"Section 391(1), however, in any opinion somewhat restricts this otherwise unlimited import of the term "arrangement" in so far as the said section applies only to an agreement or understanding between the company and its creditors or any class of them, or between the company and its members or any class of them, or between the company and its members or any class of them, which would necessarily mean that it must be an agreement or understanding which affects their rights"

[underlined for emphasis by us]

27. The aforesaid clearly points out that the Hon'ble High Court imparted meaning to the word "arrangement" in the context of section 391(1) of the Companies Act, 1956 to mean that it must be an agreement or understanding which affects the rights between the company and its creditors or any class of them and between the company and its members or any class of them. By the same analogy in the present context, we have to understand the meaning of the expression "as arranged" in section 10A(7) r.w.s. 80-IA(10) of the Act to mean a situation whereby the course of business has been so arranged that the business transacted produces to the assessee more that the ordinary profits with an intent to abuse the tax concessions granted in section 10A of the Act. Moreover, if one is to understand the import of the expression "so arranged" in section 80-IA(10) of the Act as canvassed by the Ld. CIT-DR, it would mean that for the purposes of fulfillment of the conditions prescribed in section 10A(7) r.w.s. 80-IA(10) of the Act, existence of mere close connection and more than the ordinary profits would suffice. In other words, as per the Revenue, the existence of close connection and high profits would

lead to a presumption that there is an "arrangement" within the meaning of section 80- IA(10) of the Act. The aforesaid plea, in our view, not only belies the language of section 80-IA(10) but also the legislative intent which seeks to curtail the abuse of tax concession by manipulation of profits between associated concerns. Therefore, an arrangement which is referred to in section 10A(7) r.w.s. 80-IA(10) of the Act has to be one which is prefaced by an intention to abuse the tax concessions, as per the intendment of the legislature. Therefore, existence of a mere agreement to do business is not enough to fulfill the requirement of section 10A(7) r.w.s. 80-IA(10) of the Act in the context of the words "the course of business between them is so arranged".

28. At this stage, we may also address the argument of the Ld. CIT-DR that the burden cast on the Assessing Officer in section 10A(7) r.w.s. 80-IA(10) of the Act is much lighter and even a prima-facie satisfaction of an existence of tax avoidance is sufficient. In this context, we may refer to the decision of the Bangalore Bench of the Tribunal in the case of Digital Equipment India Ltd. (supra), wherein similar argument from the side of the Revenue has been addressed. The Bangalore Bench of the Tribunal was dealing with invoking of section 10A(6) r.w.s. 80-I(9) of the Act for assessment year 1995-96, which are pari-materia to section 10A(7) r.w.s. 80-IA(10) of the Act invoked by the Revenue before us. The following discussion is relevant :-

"The requirements under the section are :

(a) There must be a close connection between the appellant and other person.

(b) The course of business between them should be so arranged that it produces to the appellant more than the ordinary profits from such business.

To satisfy the above test the AO has to adduce evidence and reasons cogently and the same is open to verification by the appellate authorities. The primary rule of evidence is that "what is apparent is real" unless proved otherwise by the person alleging it otherwise. The manner of satisfaction outlined in the section should be based on evidence and not on surmise or suspicion. The question is not whether the onus is light or heavy but whether the AO has discussed objectively the conditions mentioned in the section to disturb the results declared by the appellant. In this case, the AO has failed to adduce any evidence or reason to satisfy the invoking of s. 80-1(9). First of all, a mere substantial profit does not give rise to any valid view that there could be any arrangement. It is a case of joint venture listed Indian company, where all arrangements are open for scrutiny and acceptance not only by digital group worldwide but also from joint venture partners and shareholders. Digital group overseas will not pay undue sum, which it cannot recoup entirely to exclusion of others. Hence nothing can be arranged to the exclusive benefit of overseas partner. One cannot presume the existence of close connection or possibility of an arrangement for earning more than ordinary profits. In this case the profits earned is comparable with the profits earned by other companies in the same industry. Hence there is no case for further verification. The AO has compared the profit of software unit with that of hardware unit. Thus the foundation itself is on wrong premise. There cannot be comparison between an orange and an apple. It is known fact that profitability of software units is always higher than hardware unit. The test whether the appellant has earned more than ordinary profits, in this case, the answer is obvious NO, even as found by the AO. When the profits earned are reasonable and not excessive, there is no reason to sustain the addition Further there is no evidence of existence of any arrangement as contemplated under s. 80-1(9)."

29. Quite clearly, as per the Tribunal the question is not whether the onus is light or heavy but whether the Assessing Officer has

discussed objectively the conditions mentioned in the section to disturb the results declared by the appellant.

30. Now, the case of the Assessing Officer is that the profits derived by the assessee from the eligible business are more than the ordinary profits and therefore he is empowered to arrive at what could be a reasonable profit from such eligible business and such profit be taken as reasonably deemed to have been derived from the eligible business for the purposes of computing the deduction u/s 10A of the Act. We find that in the entire assessment order, there is no material or any evidence which has been brought out to say that the course of business between assessee and the associated enterprises has been so arranged that the business transacted has produced to the assessee more than the ordinary profits.

31. No doubt, there is a close connection between assessee and the associated enterprises and to that extent section 10A(7) r.w.s. 80-IA(10) of the Act has been rightly examined by the income-tax authorities. The second aspect that the course of business was so arranged so as to result in more than ordinary profits is not at all forthcoming from the order of the Assessing Officer. There is no material or evidence referred to in the assessment order to indicate that the course of business has been so arranged so as to inflate profits with the intent to abuse tax concession u/s 10A of the Act. At this point, we may make a reference to the stand of the Assessing Officer that the operating profit margins of the assessee are substantially higher than the average operating margin of the comparables selected by the assessee in its Transfer Pricing Study. This has formed the basis for the Assessing Officer to say that assessee has earned more than ordinary profits which might be expected to arise in such a business. Be that as it may, the aforesaid is not enough to say that the course of business has been so arranged to result in more than ordinary profits. However, from the side of the Revenue, it was pointed out that the Transfer Pricing comparability analysis itself suggests that the profit margins of the assessee are more than the ordinarily accepted margin in this line of business. The moot question is as to whether the same can be considered as a material to indicate that the course of business between the assessee and the associated enterprises has been so arranged, so as to result in 'more than the ordinary profits' within the meaning of section 10A(7) r.w.s. 80-IA(10) of the Act. In this context, we may refer to the decision of the Chennai Bench of the Tribunal in the case of Visual Graphics Computing Services India (P) Ltd. vs. ACIT, 148 TTJ 621 (Chennai), wherein following discussion is relevant :-

> *"We heard both sides in detail and considered the issue. As far as the present case is concerned, the Transfer Pricing Officer has made a categorical finding that the operating profit reported by the assessee is higher than the profit worked out on the basis of arm's length price. The Transfer Pricing Officer, therefore, concluded that no transfer pricing adjustment is called for in the present case. The Assessing Officer has made the reference to the Transfer Pricing Officer under section 92CA. The reference is made for the purpose of computing income arising from an international transaction with regard to the arm's length price as provided in section 92. Therefore, it is to be seen that the scope and extent of reference made by the Assessing Officer to the Transfer Pricing Officer is confined to the singular purpose stated in section 92. Sections 92A, 92B, 92C, 92CB, 92D, 92E and section 92F are all precisely defining and facilitating provisions ultimately for the purpose of computing the income as stated in section 92. All the above stated sections provided in Chapter X of the Income-tax Act, 1961 belong to a separate code as such, enacted for the purpose of computing income from international transactions having regard to the arm's length price so as to confirm that there is no avoidance of tax by an assessee. Therefore, where in a case, the Transfer Pricing Officer suggests that the*

operating profit declared by an assessee is compatible to the arm's length price norms and no adjustment is necessary, the operation of all those provisions come to an end. If the, Assessing Officer has to make any other adjustment towards computing deduction available under section 10A, the computation has to be made in the context of section 10A(7) read with section 80-IA(10).

It is clear that in a case of transfer pricing assessment, it has got two segments. The first segment consists of rules and procedures for computing the income other than the income arising out of international transactions with associate enterprise. The second segment consists of rules and procedures in connection with computation of income from international transactions with associate enterprises on the basis of the arm's length price. The second segment relating to computation of the arm's length price, is a set of rules for the purposes of transfer pricing matters and those procedures and rules can be used only for the purpose serving the object of section 92. When the Transfer Pricing Officer states that there is no need of transfer pricing adjustment, the matter should end there and any other adjustment that the Assessing Officer would like to make with reference to the first segment must be made independent of the order of the Transfer Pricing Office under section 92CA.

To state in simple terms, the transfer pricing regime is different from regular computation of income. Section 10A belongs to that part of regular computation of income and it should be computed independent of transfer pricing regulations and transfer pricing orders. It is not therefore, permissible for the Assessing Officer to work out section 10A deduction on the basis of arm's length price profit generated out of the order of the Transfer Pricing Officer.

In fact these issues have already been considered in various orders of the Tribunal. The Income-tax Appellate Tribunal, Chennai "A" Bench in the case of Tweezerman (India) P. Ltd. v. Addl. CIT [2010] 4 ITR (Trib) 130 (Chennai) (133 TTJ 308) has considered the matter in detail and held that the reduction of eligible profits of an assessee as done by the Assessing Officer by invoking the provisions of section 80-IA(10) read with section 10B(7), in the context of the Transfer Pricing Officer's order is unsustainable. The Tribunal has held that the Assessing Officer was not justified to invoke the provisions of section 80-IA(10) read with section 10B(7) so as to reduce the eligible profits on the basis of the arm's length price computed by the Transfer Pricing Officer without showing how he determined that the assessee had shown more than "ordinary profits".

As rightly argued by learned senior counsel the arm's length price is determined on the basis of the most appropriate method. The most appropriate method is chosen either on profit basis method or price basis method. In the latter ease, profits are not at all considered. In that method, profit is only a derivative of prices. When profits itself is not worked out, how is it justified to adopt the arm's length price profits to determine what is "ordinary profits" for the purpose of section 10A(7)?

In the facts and circumstances of the case, we hold that the Assessing Officer has erred in reducing Rs.4,48,50,795 from the eligible profits of the assessee under section 10A. The said adjustment made by the assessing authority in computing the deduction under section 10A is accordingly, deleted."

32. In our considered opinion, the result of the Transfer Pricing assessment can at best be taken as an indicator for the

> *Assessing Officer to investigate as to whether or not there exists any arrangement which has resulted in more than ordinary profits qua the requirements of section 10A(7) r.w.s. 80-IA(10) of the Act. Even if it is accepted that the difference between the operating margins of the assessee and the comparables show existence of more than the ordinary profits in the hands of the assessee, so however, it was still imperative for the Assessing Officer to establish on the basis of substantive evidence and corroborative material that qua section 10A r.w.s. 80-IA(10) of the Act, the course of business between the assessee and the associated enterprises is so arranged that the business transacted between them produces to the assessee more than the ordinary profits with the intent of abusing tax concession. Quite clearly, in the entire assessment order, there is no whisper of any material or evidence in this regard. In-fact, the approach of the Assessing Officer is quite misdirected as the following discussion in his order shows :-*
>
> > *"Accordingly, the section only encumbers the A.O. to examine if the profits derived from the eligible business by the assessee is more than the ordinary profits, then the A.O. has to arrive as to what could be the reasonable profit from the such eligible business and such profit has to be then taken as reasonably deemed to have been derived from the eligible business for the purposes of computing deduction under the section.*
>
> *33. The aforesaid discussion in the assessment order reveals that as per the Assessing Officer, the existence of close connection and more than ordinary profits is enough to assume an arrangement as contemplated u/s 80- IA(10) of the Act. The aforesaid understanding, in our view, is directly contrary to the judgement of the Hon'ble Karnataka High Court in the case of H.P. Global Soft Ltd. (supra) and our discussion in the earlier part of this order.*
>
> *34. In view of the aforesaid, we conclude by holding that in the present case, the Assessing Officer has not proved that any arrangement had been arrived between the parties which resulted in higher profits. Consequently, the re-working of the profits by Assessing Officer by invoking section 10A r.w.s. 80-IA(10) of the Act is not justified. The action of the Assessing Officer to restrict the deduction u/s 10A of the Act to Rs.7,74,60,281/- as against the claim of Rs.36,35,09,382/- is hereby set-aside. Thus, assessee succeeds on this aspect."*

8. Thus, in view of the above, ground Nos. 1 to 11 raised by the assessee are allowed."

6. Therefore, in view of the above, the order of CIT(A) is not justified and it is set aside, the ground Nos. 1 to 10 raised by the assessee are allowed.

7. In respect of ground Nos. 11 to 15 and 17 to 19, the ld. AR submits that the assessee is not interested to prosecute the same and prayed to dismiss the same as not pressed. Accordingly, the ground Nos. 11 to 15 and 17 to 19 raised by the assessee are dismissed as not pressed.

8. Ground No. 16 raised by the assessee questioning the action of CIT(A) in disallowing the economic adjustment are bad debt.

9. The ld. AR submits that the TPO requested for the single year margin of TP Study comparables considering bad debt as operating (i.e. before bad debt adjustment) and post considering bad debts as non-operating (i.e. after bad debt adjustment). The TPO rejected assessee's argument of considering bad debt as non-operating and instead rejected companies not having bad debts in their financials from the final set of comparables and arriving at the arithmetic mean of comparables of 5.32% as against the assessee's margin from aggregated System Integration segment of -5.39%. The ld. AR further submits that with respect to treatment of excessive bad-debts & provision for bad-debts as non-operating (i.e. claiming bad debt adjustment), the ld. CIT(A) held that self-adjustment on account of excess bad debt couldn't be granted to the assessee and the ld. CIT(A) directed that self-adjustment for bad debts (by treating bad debts & bad debt provision as non-operating) could not be made to the profitability of the assessee. He submits that as per the transfer pricing study, the assessee had treated bad debts as well provision for bad debts as non-operating due to exceptional circumstances, but the TPO as well as the ld. CIT(A) held bad debts and provision for bad debts as operating expenditure for calculating the profitability of the assessee. The assessee is not contesting the treatment of bad debts as operating expenditure.

10. The ld. AR submits that with respect to the provision for bad debt amounting to Rs.13,27,38,882/- that this expenditure has been disallowed in the computation of total income under the Income Tax return filed by assessee for A.Y. 2005-06 and the provision for bad debts amounting to

Rs.13,27,38,882/- should be treated as non-operating expenditure for the purpose of computing profitability under transfer pricing provisions. The ld.AR placed reliance on the Pune ITAT judgement in case of Bilcare Limited in ITA No.1693/PUN/2018, wherein it was held that the costs disallowed in return of income should be excluded from the cost base while computing the PLI for transfer pricing purposes. The ld. AR submits that provision for bad debts should be considered as non-operating in nature for computation of PLI of the assessee as the same is disallowed as an expense while computing the income under the ITR. The TPO applied a filter of bad -debt expenses for eliminating the 5 out of 10 TP study comparable companies and considered only those comparables having bad debts. Application of such ad-hoc filters to reject the functionally comparable companies would be an incorrect approach and against the express provisions of law.

11. The ld. AR further submits that bad debts expense is a routine expense which is more likely than not to be incurred by all the companies in some year or the other and application of adhoc bad debt filter for rejecting companies otherwise comparable to the assessee is incorrect. The TPO stated that only the companies which have incurred bad debts expenses were selected as comparable to the assessee to arrive at a better comparability. The TPO further stated that companies having no bad debts or provision would have different risk profiles than assessee. Further, he submits that for the companies which incurred bad debts during A.Y. 2005-06 & which were retained by the TPO in final set, the percentage of bad-debts to sales ratio is very minuscule i.e. 0.01% as shown at page No. 7 of the factual paperbook-II and the argument of the TPO with respect to different risk profile of companies with/without bad debts does not hold good.

12. The ld. DR submits that with regard to the provision for bad debt amounting to Rs.13,27,38,882/-, the assessee has stated that this expenditure has been disallowed in the computation of total income in the Income Tax Return filed by the assessee and the provision for bad debts amounting to Rs.13,27,38,882/- should be treated as non-operating expenditure for the purpose of computing profitability under transfer pricing provisions. The ld. CIT(A) has dealt the said issue extensively in Paras 4.4.1 to 4.4.9. Reliance is placed on the findings and decision of the ld. CIT(A) which is brought out in Paras 4.4.2 to 4.4.9 (Page 124 and 125 of CIT(A)'s order). Further, he placed reliance on the decision of the Hyderabad Bench of the ITAT in the case of Kenexa Technologies (P) Ltd. Vs. DCIT (2015) 67 SOT 195 wherein it was held that bad debts and provision for bad and doubtful debts were part of operating expenses.

13. Having heard both parties. We note that both the lower authorities considered bad debt and provision for bad debt as operating but however the decision on which the ld. AR placed reliance of ITAT Pune Benches in the case of Bilcare Limited in ITA No. 1693/PUN/2018 which held that the cost costs disallowed in return of income should be excluded from the cost base while computing the PLI for transfer pricing purposes. It is needless to mention that the assessee claimed to have disallowed the expenditure in respect of provision for bad debt in the computation of total income for A.Y. 2005-06 and accordingly, the said provision should be treated, in our opinion as non-operating expenditure for the purpose of computing profitability under the transfer pricing provisions. Further, we note that in Para No. 4.4.9 of the impugned order the ld. CIT(A) held the bad debt is an operating expenditure but however observed exclusion of companies by the AO/TPO having bad debt for the purpose of comparability is not justified.

Therefore, we agree with the finding of ld. CIT(A) to the extent of inclusion of comparable companies having bad debt in the final set of comparable companies. Therefore, in the facts and circumstances of the case considering the submissions of ld. AR and ld. DR, we deem it proper to remand the matter to the file of AO and accordingly, the AO/TPO is directed that the provision for bad debt should be treated as non-operating expenditure while computing the profitability of the assessee which has been disallowed as an expense while computing the income under the ITR. The ad-hoc bad debts filter as applied by the TPO liable to be rejected and to include the comparable companies having bad debt should be considered in the final set of comparables.

14. In the result, the appeal of assessee is partly allowed for statistical purpose.

ITA No. 620/PUN/2015, A.Y. 2005-06 (Revenue's Appeal)

15. The only issue raised by the Revenue questioning the action of CIT(A) in computing Arms Length Margin of Total Security Solutions Business Segment by using RPM as against the TNMM as most appropriate method in the facts and circumstances of the case.

16. The ld. AR submits that in the earlier years the assessee used RPM and the appellant Revenue used TNMM. In the appellate proceedings the CIT(A) held RPM is the appropriate method. In the current year the assessee used TNMM and TPO also held the TNMM is the correct method. The ld. AR submits that there was no occasion for the assessee challenging the finding of TPO in view of the fact that the TPO held the method adopted by the assessee is correct. He further submits that the sole ground raised by the Revenue does not arise from order of CIT(A) and prayed to dismiss

the ground raised by the Revenue as infructuous. The ld. DR fairly conceded that the ground raised by the Revenue does not arise from impugned order. Therefore, taking into consideration the facts and circumstances of the case, we hold the ground raised by the Revenue requires no adjudication and is dismissed as infructuous.

17. In the result, the appeal of Revenue is dismissed as infructuous.

18. To sum up, the appeal of the assessee is partly allowed for statistical purpose and the appeal of Revenue is dismissed.

Order pronounced in the open court on 03rd June, 2021.

Sd/-	Sd/-
(R.S. Syal)	(S.S. Viswanethra Ravi)
VICE PRESIDENT	JUDICIAL MEMBER

पुणे / Pune; दिनांक / Dated : 03rd June, 2021.
RK

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

1. अपीलार्थी / The Appellant.
2. प्रत्यर्थी / The Respondent.
3. The CIT(A)-13, Pune
4. The CIT(IT/TP), Pune
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, "सी" बेंच, पुणे / DR, ITAT, "C" Bench, Pune.
6. गार्ड फ़ाइल / Guard File.

//सत्यापित प्रति// True Copy//

आदेशानुसार / BY ORDER,

निजी सचिव / Private Secretary,
आयकर अपीलीय अधिकरण, पुणे / ITAT, Pune