IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCH 'A', HYDERABAD

BEFORE SHRI G.C. GUPTA, VICE PRESIDENT AND
SHRI AKBER BASHA, ACCOUNTANT MEMBER

ITA No.1082/Hyd/2010	:	Asst. Year: 2004-05
DCIT, Circle- 1(2), Hyderabad.	VS	M/s Deloitte Consulting India Pvt. Limited, Hyderabad. (PAN AABCD 0476 H)
(Appellant)		(Respondent)

ITA No.1084/Hyd/2010		Asstt. Year 2004-05
M/s Deloitte Consulting India Pvt. Limited, Hyderabad. (PAN AABCD 0476 H)	–v-	DCIT, Circle- 1(2), Hyderabad.
(Appellant)		(Respondent)

Appellant by	**:**	*Shri V. Srinivas (DR-CIT)*
Respondent by	:	*S/Shri A.V. Sonde, Manisha Gupta, Manish Matha & Ayush Rajani*

O R D E R

Per Akber Basha, Accountant Member:

These cross appeals are directed against the order of the CIT (A)-III, Hyderabad dated 31-5-2010 and they pertain to the assessment year 2004-05.

2. Brief facts of the case are that the assessee is a company which derives income from Software Development and IT Enabled Services. For the assessment year under consideration, it has filed the

return of income on 20-10-2004 showing income of Rs.4,68,64,880/-. During the previous year, the assessee has entered into International transactions with its associated enterprises. For determining the arm's length price of such transactions, the assessing officer has made a reference under section 92CA (1) of the Act to the Addl. CIT (Transfer Pricing). In response to this, the TPO vide his order dated 21-12-2006, passed under section 92CA (3) of the Act, while adopting Transactional Net Margin Method (TNMM in short) as the most appropriate method, has determined the ALP of the transactions in respect of IT Enabled Services (BPO Segment) at Rs.25,66,92,632/- as against Rs.20,96,64,974/- shown by the assessee, thereby suggesting for adjustment of Rs.4,70,27,658/- on that account. Further, he determined the ALP of the transactions relating to Software Development Services at Rs.33,40,15,302/- as against Rs.31,61,40,091/- shown by the assessee thereby suggesting for adjustment of Rs.1,78,75,211/- under that head. Later, on basis of such order of the TPO, the assessing officer has made additions of Rs.6,49,02,869/- and after allowing deduction of Rs.4,65,50,115/- under section 10A of the Act, completed the assessment under section 143(3) of the Act determining total income at Rs.6,68,13,850/-. Being aggrieved by the order of the assessing Officer, the assessee went in appeal before the CIT (A). On appeal, the CIT (A) after elaborately discussing the grounds raised by the assessee before him held that the TPO was justified in directing the assessee to conduct a fresh search of comparables during the transfer pricing proceedings and also justified in adhering to the data of the current financial year 2003-04 for determining the ALP. It was also held that the assessing officer has to

compute the total income of an assessee in conformity with the ALP as determined by the TPO.

3. While adjudicating the issue, the CIT (A) confirmed the action of the TPO in not considering the following companies as comparable, in respect of back office segment, for the purpose of determining the ALP. (a) ACE Software Export Limited (b) C.S. Software Export Limited (c) Max Health Scribe Limited (d) Online Media Solutions Limited (e) Apollo Health Street Limited (f) Idea-space Solutions Limited (g) Netvista Information Technology Limited (h) Saffron Global Limited (i) Vakrangee Software Limited (j) MCS Limited (k) Tata Share Registry Limited and (l) BNK Solutions Private Limited . However, the CIT (A) considered the following companies as comparable, for the purpose of determining the ALP. (a) North Gate BPO/North Gate Technologies Limited (b) Spanco Tele-systems & Solutions Limited (c) Vishal Information Technologies Limited (d) Fortune Infotech Limited (d) Tricom India Limited and (e) Wipro Limited. He also held that the assessee is not entitled to any adjustment for the alleged entrepreneurial risk borne by various comparables. The CIT (A) rejected the claim for allowing an adjustment for the difference in depreciation policy followed by the comparables holding that the assessee has not raised any ground on that account before him and no such plea has been taken during the transfer pricing proceedings before the TPO. He also held that if the difference between the ALP determined by the TPO does not exceed 5% of the price of the international transactions shown by the assessee, then such price as shown by the assessee, shall be deemed to be ALP. In respect of software development services, the CIT (A) upheld the action of the TPO in rejecting the eight companies as

mentioned in his order at page-32, para-16 of his order as comparables while determining the ALP.

4. He also held that the assessing officer was justified in reducing the communication expenses from the export turnover for the purpose of computing the deduction under section 10A of the Act and the CIT [A] held that the communication expenses has to be excluded from the total turnover also. The CIT [A] allowed the ground raised by the assessee with regard to the exclusion of interest received on bank deposits which has already been offered by the assessee for taxation as income under the head other source from the figure of total turnover for the purpose of determining the deduction under section 10A of the Act. Aggrieved by the findings of the CIT (A), both the assessee as well as the Revenue is in appeal before us.

5. The learned counsel for the assessee, Shri. A.V.Sonde, submitted that, during the previous year relevant to assessment year 2004-05, the assessee had the following international transactions [a] Back office services-Rs.20,96,64,974 and [b] SAP project work-Rs.31,61,40,091 with associate enterprise [AE]. The assessee company is a captive contract service provider rendering Business Process Outsourcing ("BPO") services to D.C. Outsourcing BPO LP and Software Development Services to D.C. Outsourcing ITO LP based on the instructions received from its AEs. The assessee company provides software development services to its AE in the areas of SAP implementation and back office support services in the nature of routine follow-up calls with insurance companies regarding claims status, documenting the call minutes and communicating the summary of the

calls to its AE. During the relevant previous year, the assessee company was billed on a cost plus 7 per cent mark-up basis for back office services and software development services. For the above purpose, 'cost' has been defined as total direct costs and expenses incurred in connection with the performance of such services.

6. In its transfer pricing study undertaken in compliance with the provisions of section 92D of the Act read with rule 10D of the Income Tax Rule, 1962, the assessee company selected Transactional Net Margin Method ('TNMM') as the most appropriate method for back office services and software development services. Once having selected TNMM as the most appropriate method, the Appellant conducted a methodical search process to select potentially comparable companies on the following publicly available databases- Prowess and Capitaline Plus. With regard to the software development services, the assessee company applied various quantitative and qualitative filters and arrived at a final set of 13 comparable companies. The search process was conducted by the assessee company during October, 2004, wherein the database as updated on October 22, 2004 was used. Accordingly, the data used for computing the profit margins of the comparable companies was the latest data which was available as on October 22, 2004. The due date for filing the income tax return for assessment year 2004-05 was October 31, 2004. Accordingly, the data used by the assessee company clearly complied with the requirement of Rule 10D (4), which requires the data to exist by the specified date. For applying TNMM, the assessee company computed the 'net profit margins'.

7. The assessee company arrived the arithmetical mean of 13 comparable companies at 8.69% against the 7% declared by the assessee company. Since the net margin of the assessee company was within the 5% price range of the average cost plus markup of comparable companies, it was concluded that the transactions for sale of software development services by DCIPL to its associate enterprises were at arm's length. Similarly, with regard to the Back office Services, after the application of the filters, a set of 6 comparable companies were selected arrived the arithmetical mean of 6 comparable companies at 9.29 % as against 7% declared by the assessee company. Since the net margin of the assessee company was within the 5% price range of the average cost plus markup of comparable companies, it was concluded that the transactions for sale of software development services by DCIPL to its associate enterprises were at arm's length. The TPO issued notice dated July 4, 2006 instructing the assessee company to undertake a fresh search of independent comparable companies taking the sales criteria of Rs.10 crores to 30 crores, in respect of back office services and sales criteria of Rs.15 crores to 45 crores in respect of ERP project work (software development services) and providing details of the net sales, total cost, operating profit, and operating profit margin on sales and on total cost, of such comparable companies. The assessee company provided the requisite details on 27th September 2006. In case of software development services, the assessee company provided 9 comparable companies with an average operating margin of 4.72% and in case of back office services, it provided 10 comparable companies with an average operating margin of 4.93%. The TPO issued a show cause notice on 16th Oct, 2006 stating that, in respect of back office, he has rejected 5 companies out of 6 companies identified as

comparable by the assessee company and accepted only one company called Mercury as comparable. The TPO proposed 6 additional companies as comparable after undertaking a fresh analysis of comparables from the public database and arrived net profit margin of the 7 comparables at 35.60% and concluded that the ALP was different from that of computed by the assessee company. Similarly, out of 13 companies selected as comparable by the assessee company in its TP study, the TPO rejected 9 companies and accepted only 4 companies as comparable. The TPO computed a net profit margin of the 4 comparable companies at 16.78% and concluded that the ALP was different from that of computed by the assessee company. The assessee company rebutted to the comparables proposed by the TPO by making a detailed submissions which are placed at pages 174 to 215 of the paper book filed by the assessee company.

8. The TPO passed his order on December 21, 2006. The findings of the TPO are summarized below:

Findings of TPO

Particulars	**Software development services**	**Back office services**
Mark-up proposed in the Show Cause Notice	16.78%	35.60%
Mark –up as per TP Order	15.05%	33.00%
Less: Working Capital Adjustment as per TP order	2.00%	2.00%
Proposed Adjustment	**13.05%**	**31.00%**

9. The ALP alleged by the TPO based on the seven comparable companies accepted by him is 31.00% after providing working capital adjustment. Accordingly the ALP as per the TPO for back office services was Rs.25,66,92,632/- based on which he made an adjustment of Rs.4,70,27,658/-.

10. The TPO accepted five comparables of the 13 selected by the assessee company in the transfer pricing order and computed the net cost plus margin to be 13.05 per cent after providing working capital adjustment. Accordingly the ALP, per the TPO for software development services, was Rs.33,40,15,302/- based on which he made an adjustment of Rs.1,78,75,211/-.

11. It is contended that the TPO findings are wrong on following grounds.

(a) The assessee company had followed a methodical search process in the TP study, and arrived at a set of comparable companies which were functionally comparable to the assessee company. However, without highlighting any deficiency or insufficiency in the independent comparables, functionally or otherwise, selected in the TP study, or the search process followed for arriving at those comparables, the TPO has rejected the comparables.

In case of show cause notice issued in for back office services, the TPO has undertaken a fresh search and selected the

comparable companies; the search process was not been shared with the assessee company. However, for software services, the TPO not undertake a fresh search process and accepted the search process undertaken by the assessee company which consisted of 13 comparables of which he rejected 8 comparable companies and accepted 5 as final set of comparables.

(b) The TPO issued notice dated July 4, 2006 instructing the assessee company to undertake a fresh search of independent comparable companies, which are in the similar line of business, taking the sales criteria of Rs.10 crores to 30 crores, in respect of back office services and sales criteria of Rs.15 crores to 45 crores in respect of software development services. However, the TPO did not follow such criteria while carrying out a fresh search in case of back office services and accepted the search process of the assessee company for software services.

(c) Rule 10D(4) clearly specifies that the information relating to the international transactions, including the comparability analysis has to be kept and maintained latest by the specified date, i.e. the date of filing of the return. However, in case of back office services, the TPO conducted a fresh comparability analysis during October 2006, using the data which was available after the specified date.

(d) The assessee company does not bear significant business and operational risks and is only a captive contract back office services and software development service provider rendering

services to its AEs. The profile of the assessee company clearly distinguishes it from full-fledged entrepreneurial companies. The TPO did not grant the assessee company, an adjustment on account of risk as computed by the assessee company as per Capital Asset Pricing Model ('CAPM') method at 5.13 per cent.

(e) The proviso to section 92C (2) of the Act prior to the amendment by the Finance (No. 2) Act, 2009 with effect from October 1, 2009, provided that while arriving at the arm's length price ('ALP'), at the option of the assessee, a price which may vary from the arithmetical mean by 5%, can be considered as the arm's length price.

In the instant case, the TPO / CIT(A) have not applied the second proviso to section 92C(2) prior to its amendment in October 2009 i.e. they have not allowed a standard deduction of 5% from the arithmetical mean and have thus ignored a specific and mandatory provision of law.

12. The CIT [A] in his order, after elaborate discussions, has observed that in the case of back office services segment, one comparable company Northgate Technologies Limited was rejected by the TPO on account of non-availability of segmental information. Based on the submissions made by the assessee company, the CIT (A) observed that Northgate Technologies Limited had only one segment being BPO services and hence the reason given by the TPO on account of non-availability of segmental information is incorrect and non-acceptable. The average net cost plus mark-ups of the final comparable

companies as accepted by the CIT(A) are, in respect of Software development, 29.17% as against 31% arrived by the TPO and in respect of Back office services, he confirmed the TPO workings. Aggrieved by the findings of the CIT [A], both assessee and the Revenue is appeal before us.

13. The learned counsel for the assessee submitted that the assessee company is a captive service provider and does not incur any research and development expenses whereas the Visualsoft incurred around 4% of the revenue towards these expenses. The assessee company undertakes SAP projects which is the software development service segment for its associated enterprise outside India. For such services, the assessee company is remunerated at cost plus 7% by its associated enterprise. These facts have been accepted by the learned TPO in para 6.1.2 on page no. 10 of his order and have not been objected by the CIT (A). Accordingly, the comparable, i.e. Visualsoft Technologies Limited ought to be rejected by the TPO as the said company cannot be treated as comparable to the assessee company. For this proposition he relied on the decision of Kolkata Bench of the Tribunal in the case Development consultants vs. DCIT reported in 115 TTJ 577 and the decision of the Bangalore Tribunal in the case of Philips Software reported in 119 TTJ 721. He also relied on the decision of the Delhi Bench of the Tribunal in the case Mentor Graphics reported in 109 ITD 101. It is also submitted that, relying on catena of decisions, assessee company entitled to point out to the Tribunal that comparables selected by the TPO was erroneously considered as a comparable. The assessee further places reliance on the recent judgment given by Delhi Tribunal in case of Sapient Corporation Pvt. Ltd in I.T.A. No.

5263/Del/2010 wherein it was held that the fact that the comparable selected initially by the assessee himself cannot act as estoppel in rejecting the company. Hence, it is submitted that though Visualsoft Technologies Limited was earlier accepted as a comparable company in the assessee's TP study, it is not estopped, from pointing out any facts which have a material bearing on the case on hand even though such facts are as a result of the evidence adduced by the taxpayer.

14. With regard to Back office segment, it is submitted that the TPO had accepted the International call center segment of Spanco Tele-systems & Solutions Limited as an independent comparable company. While conducting the comparability analysis, the TPO rejected companies having substantial related party transactions. The TPO in his remand report to the CIT (A) has commented that the criteria to be used to exclude companies having related party transactions should be 25 per cent over its sales but whereas Spanco has got its related party transactions works out to be more than 25% of its sales. Thus Spanco Tele-systems & Solutions Limited ought to be rejected.

15. It is submitted that the TPO has selected Vishal Information Limited as a comparable company on the basis that it is functionally comparable given that it was in the business of IT Enabled. However, it appears that the TPO did not consider any other filters while considering the inclusion of the said comparable company in the final set of comparables and assumed that intangibles held by Vishal Information Limited will not materially affect the price or profit arising from the transactions in open market. It submits that determining an arm's length markup should be governed by the standards of comparability.

Hence, it is important to recognize that service providers catering to a niche market segment, or owning valuable intangibles cannot be an appropriate comparables to the assessee which provides routine low-end services without owning any intangibles or bearing financial risk. Integrated service providers operate on a fundamentally different business model than a captive service provider. Hence, it is incorrect to consider large integrated service providers as comparables. The assessee being a captive service provider its personnel/employee cost comprises a major component of cost of the assessee. The assessee company has wages to total operating revenue ratio of 52.12 per cent whereas in the case of Vishal Information Limited the wages to total operating revenue ratio is only 1.38 per cent. For this proposition, he relied on the decision of Delhi Bench in the case of Avaya India in ITA No.5150/Del/2010. Without prejudice to the fact that Vishal Information Limited owns valuable intangibles and it has a very low wages to sales ratio of 1.38 per cent as compared to that of the assessee company which is 52.12 percent. Hence, in view of the above, it cannot be considered as a comparable and accordingly should be excluded from the final list of comparable companies.

16. It is submitted that TPO has selected Wipro BPO Solutions Limited as a comparable company without appreciating the fact that the comparable company has a huge variation in the size of its business operations vis-à-vis the assessee and enjoys the benefits of 'economies of scale'. It is submitted that Wipro BPO Solutions Limited is not comparable to the assessee as it is evident from the fact that its turnover is Rs.4,30,30,70,635/- which is 20 times that of the assessee's turnover of back office service segment of Rs.20,96,64,974/-. Similarly,

the learned counsel for the assessee compared the capital base of the Wipro with the assessee company. It is submitted that Delhi Tribunal in the case of Agnity India Technologies Pvt. Ltd. [2010] (ITA. No. 3856/2010) has observed that where there is a huge variance in the turnover of comparable companies vis-à-vis the taxpayer it should not be considered as a comparable company.

17. It is submitted that Ace Software Exports Limited was selected by the assessee during the methodical search process conducted by it to select potentially comparable companies in the back office services segment for the purpose of its TP Study in compliance with the provisions of section 92D of the Act. However, the TPO/CIT (A) has rejected the said comparable company stating that Ace Software Exports Limited is catering only to a single customer, Apex Data services Inc., USA and that the company sources its business exclusively from Apex Data Services Inc., USA. On account of this reasoning, the TPO/CIT(A) has concluded that the transactions of Ace Software Exports Limited are controlled transactions as the services were rendered to a single customer and that there is a deemed AE relationship between the company and Apex Data Services Inc., USA under section 92A(2)(i) of the Act. It is submitted that Ace software Exports Limited does not render services to Apex Data Services Inc., USA, but only sources business from it. Therefore, Ace Software Exports Limited directly renders services to the third party customers. The fact that as per the related party disclosure in the financials of Ace Software Exports Limited, the only transaction with Apex Data Services, Inc., USA is purchase of Fixed Asset amounting to Rs.85,383/- clearly demonstrates that there are no controlled transactions between Ace Software Exports

Limited and Apex Data Services Inc. On further, on reference to the annual report, in the schedule to related party, it is clearly disclosed as "no materially significant related party transactions" exist. Hence, it is clearly evident that there are no controlled transactions between Ace Software Exports Limited and Apex Data Services Inc. Secondly, the TPO has concluded that Ace Software Exports Limited and Apex Data Services Inc. are deemed associate enterprises under section 92A (2)(i) of the Act and the prices and other conditions must have been influenced by the other entity. Section 92A (2)(i) has two limbs. The first limb provides that the section is applicable only to goods or articles manufactured or processed by one enterprise and sold to the other enterprise. It is important to note that the section does not specify regarding rendering of services by one enterprise to the other enterprise. The second limb provides that in order for the two entities to be deemed as an AE, the prices and other conditions must have been influenced by the other entity. In the present case, the TPO has wrongly concluded that Ace Software Exports Limited and Apex Data Services Inc. are deemed AE merely on the ground that Ace Software Exports Limited sources business exclusively from Apex Data Services Inc. As the first limb of Section 92(A)(2)(i) is applicable only to goods or articles manufactured and not to services the provisions of Section 92A(2)(i) cannot be applied in the given case. Further, the prices and other conditions between Ace Software Exports Limited and Apex Data Services Inc. cannot be considered to be influenced, as it is clearly evident that there are no materially significant related party transactions between Ace Software Exports Limited and Apex Data Services Inc. Hence, it is a mere assumption of the TPO that the prices and other conditions between Ace Data have been influenced by Apex Data

Services Inc. Further, it is clear that if the intention of the legislature was to include services it would have clearly specified services in the provisions of Section 92(A)(2)(i) of the Act. There is a clear distinction between 'articles/goods' and 'provision of services'. Section 92A (2)(i) clearly deals with manufacturing of the goods/articles and not with provision of services. Thus, the TPO has erroneously considered Apex Data Services Inc. to be associated to Ace Software Exports Limited by applying the provisions of section 92A(2)(i) of the Act.

18. The assessee company in its TP study, based on a methodical search process on the publicly available data sources has arrived at a final set of functionally comparable companies for both the software development services & back office services segment. However, during the course of hearing, the TPO had asked the assessee to conduct fresh search and provide contemporaneous data for the financial year 2003-04. Consequently, on the request of the TPO, the assessee conducted a fresh search based on contemporaneous data following the same methodical search process and submitted the same to the TPO. However, without highlighting any deficiency or insufficiency in the search process followed or on the basis of functional comparability, the TPO, in case of the back office services segment has rejected certain comparables merely on account of the fact that these companies do not generate foreign exchange revenue. The five companies rejected by the TPO are listed below:

- C S Software Enterprise Limited
- Ideaspace Solutions Limited
- M C S Limited.
- Tata Share Registry Limited

- Vakrangee Softwares Limited.

In this regard, the assessee submits that for the purpose of comparability, it is essential to consider the activity/ functions performed by the company (functional comparability), the specific characteristics of the services provided, the contractual terms and the conditions prevailing in the markets in which the respective parties to the transaction operate, for which, the learned counsel for the assessee relied on Rule 10A[a] wherein "uncontrolled transaction" has been defined to mean a transaction between any two enterprises so long as they are not related. Nowhere does the provision mention that such transaction should be between resident and non-resident. More so, the provision specifically mentions that such transactions could be between enterprises whether 'resident or non-resident'. In other words an uncontrolled transaction can be between a resident and a non-resident or a resident and a resident. If the intention of the legislature was to restrict the choice of uncontrolled transaction to between a resident and a non-resident, the provision should have mentioned that any transaction between two unrelated parties would be considered to be an uncontrolled transaction provided it is between a resident and a non-resident. Contrary to that, the provisions in fact clearly mentions that any transaction between two unrelated parties would be considered to be an uncontrolled transaction whether it is between a resident and non-resident or a resident and another resident. In the case under consideration, where comparables do not have foreign exchange revenue i.e. transaction between two residents, it would still be considered as an uncontrolled transaction. Therefore, the action of the TPO of rejecting comparable companies on account of no foreign

exchange revenue is not sustainable within the provisions of the law. Further he relied on Rule 10B [2][d] and submitted that the market conditions are important in the comparability analysis. For instance, one is to evaluate one of the market conditions mentioned in Rule 10B (2)(d), being geographical, location and size it means that uncontrolled comparables ordinarily derive from the geographic market in which the control tax payer operates, because there may be significant differences in the economic conditions in different markets. Further to illustrate, if the controlled tax payer is operating in India and has controlled transactions with its AE in Poland. It would be appropriate to evaluate the geographical locations and the size of the market in India and not Poland. Similarly, in case of other market conditions specified in rule 10B(2)(d) like regulatory laws and government orders, cost of labour and capital etc. it would be appropriate to evaluate the government laws, the labour cost where the controlled tax payer operates which is India and not the government laws, cost of labour in Poland. In the case under consideration, the TPO has rejected uncontrolled comparables operating in the same geographical market as the assessee merely on the account of the fact that these companies do not have any foreign exchange revenue. The companies rejected by the TPO operate in similar market conditions as the assessee and the fact that these companies do not have any foreign exchange revenue cannot be a valid reason for rejecting them as comparable companies. Hence, the action of the TPO of rejecting comparable companies on account of no foreign exchange revenue is not sustainable within the provisions of the law.

19. It is also submitted that the TPO while selecting his set of comparable companies has not demonstrated that the comparable

companies selected by him satisfy the criteria of different market conditions as discussed. The assessee company is a captive contract service provider rendering services to its AE in USA. For instance, if we consider one of the conditions being geographical location and size, the TPO has not demonstrated that the comparable companies selected by him make their exports only to USA as in the case of the assessee. There is no mention in the entire TP order of the market condition in which the comparable companies selected by the TPO have carried out their operations. On verifying the annual reports of the comparable companies selected by the TPO, the assessee observed that the comparable companies have exported their services to varied geographies like USA, Uk, Canada and Ireland etc., However, while rejecting the comparable companies selected by the assessee, the TPO without applying any basis concluded that companies with no foreign exchange revenue should be rejected as the ultimate customer of these companies is located in India. The TPO has adopted a contradictory approach, wherein he expects the assessee to demonstrate the market conditions in which the comparable companies selected by the assessee operate whereas in case of the companies selected by the TPO the market conditions in which such companies operate is not relevant. Hence, it is prayed that the five companies as listed above should be included in the final set of comparables.

20. On the issue of adjustment on account of difference in accounting policies followed by the assessee and the comparable companies, it is submitted that the assessee follows a depreciation policy, whereby, the rates at which it charges depreciation on its assets is much higher than the rates at which the comparable companies

charge depreciation. Accordingly, due to the difference in the rates of depreciation, the profit margins of the comparable companies are much higher than that of the assessee. In order to conduct a fair and equitable comparison of the profit margins in terms with Rule 10B (1)(e)(iii), the assessee made adjustments to the depreciation rates charged by the comparable companies placed at page 511 of paper book filed by the assessee. The CIT (A) has observed that neither such ground relating to depreciation adjustment was raised by the assessee in the appeal memo before him nor any such plea was placed before the TPO and hence, the said adjustment was not allowed. The CIT (A) has not expressly rejected the need for making depreciation adjustment in the instant case. The learned counsel for the assessee relied on the decision of Chandigarh Bench in the case Quark Systems [supra] in support of his view that the taxpayer is not estopped from pointing out any facts which have a material bearing on the case on hand even though such facts are as a result of the evidence adduced by the taxpayer. He also submitted the workings, relating to depreciation issue in the paper book filed.

21. On the issue of adjustment on account of difference in the risk profile, it is submitted that Rule 10B(1)(e) provides that the margins of the comparable companies need to be adjusted to take into account the functional and other differences which could materially effect such margins in the open market. During the course of the proceedings, the assessee had requested the TPO/ CIT (A) to grant an adjustment to the margin of the comparable companies on account of the difference in the risk profile of the comparable companies. However, the TPO has not approved of the claim of the assessee on the basis that

in the competitive times of today, no entity can operate in a risk-free environment even if it is a captive service provider. The claim of the assessee for an adjustment on account of differences in risk profile is also supported by the decision of the Delhi Bench in the case of Mentor Graphics (Noida) Pvt. Ltd (supra) and also decision of Pune Bench in the case E-Gain Communications reported in 118 TTJ 354. The other case laws relied on him for this propositions are a] Delhi Bench in the case of Sony India reported in 315 ITR 150 AT and jurisdictional Bench in the case of Cordys in ITA No.212/Hyd/06. Thus, the assessee submits that there is enough in the law which provides and recognizes the need to perform adjustments while determining the ALP with respect to the risks assumed by the comparable companies vis-à-vis the taxpayer. The assessee works out 5.13% towards entrepreneurial risk to adjust the average cost plus mark ups for final comparables.

22. On the issue of 5% deduction before computing the ALP, it is submitted that the proviso to section 92C (2) of the Act, prior to the amendment by the Finance (No. 2) Act, 2009 with effect from October 1, 2009, provided that while arriving at the arm's length price ('ALP'), at the option of the assessee, a price which may vary from the arithmetical mean by 5%, can be considered as the arm's length price. He drew our attention to the relevant extracts from the explanatory memorandum and notes to clauses of the Finance Bill, 2002. The circular No.12-2001 dated 23-08-2001 issued by CBDT is not relevant in the context of the issue raised as the said circular does not address the treatment in a case where the arm's length price determined varies by more than 5% and the Circular was issued in August 2001 whereas the proviso to Section 92C of the Act was amended in 2002. The TPO did not allow any

benefit to the assessee, as in his view the above provision was not applicable in this case. As per the TPO, the margin earned by the assessee falls substantially short of the margin earned by comparable companies or the arm's length margin. As the assessee was not falling in the +/-5 per cent range, it was not entitled to any benefit. Aggrieved by the stand taken by the TPO, raised this ground before the CIT (A). The assessee submitted that upward adjustments, if any made should be only after giving effect to the option available for the assessee as provided in the proviso to Section 92C (2). During the course of the appellate proceedings, the CIT (A) remanded the matter to the TPO. After considering the remand report and submissions of the assessee, the CIT [A] found no force in the submissions advanced by the assessee. He was of the view that the real intention of the legislature behind such proviso has been made clear following the amendment made vide Finance (No. 2) Act, 2009 with effect from 01/10/2009. The erstwhile proviso to section 92C(2) regarding the marginal relief of 5 per cent contemplated in the computation of the arm's length price has been substituted by the Finance (No. 2) Act, 2009 with effect from October 1, 2009. He held that since the appellate proceedings before him in this case is practically a continuation of the assessment proceedings, the said amended proviso is fully applicable to this case. As per the above proviso, if the difference between the arm's length price determined by the TPO/AO, does not exceed 5 per cent of the price of the international transaction shown by the assessee, then such price as shown by the assessee, shall be deemed to be the arm's length price. The learned counsel for the assessee submitted that present case is relating to the assessment year 2004-05. Therefore, the amended proviso as explained above is not applicable to the present case in hand. Further, the learned

CIT(A) erred in not allowing the benefit of +/-5% variation in light of the fact that the said amended proviso is applicable from October 1, 2009 onwards and not in case where the appellate proceedings are ongoing as erroneously interpreted by the learned CIT(A). The CBDT in its Circular No. 5 of 2010 dated June 3, 2010 [324 ITR (St.) 293 2010] has clarified on determination of arm's length price in case of international transactions. Later, a Corrigendum (No.142/13/2010-SO(TPL) in partial modification of the original circular no. 5/2010 was issued by CBDT wherein it was clarified that the amendment shall apply in relation to all cases in which proceedings which are pending before the Transfer Pricing Officer (TPO) on or after 01 October 2009. As evident from the above circular cited, these new provisos are effective from April 1, 2009 onwards. In fact these provisos have been brought into the Act by the Finance (No. 2) Act, 2009. So, it will be applicable to the assessment year 2009-10 and subsequent years only. In the case under consideration, the TPO / CIT(A) have not applied the second proviso to section 92C(2) prior to its amendment in October 2009 i.e. they have not allowed a standard deduction of 5% from the arithmetical mean and have thus ignored a specific and mandatory provision of law. The CIT (A) did not have the benefit of the said circular which clearly states that the amended proviso is applicable from October 1, 2009 onwards and not a continuation of the assessment as concluded by the CIT (A) as he has passed the order on May 31, 2010 which is prior to the issuance of Circular and Corrigendum cited above. He relied on the decision of Delhi Bench in the UE Trade Corporation in ITA No.4405/Del/2009 wherein it has been categorically held that the proviso to section 92C (2) was substituted with effect from October 01, 2009 and not retrospectively. Therefore it comes in to operation from assessment year 2009-10 and

applies to subsequent years. Similar view was taken by the Bangalore Bench in the case SAP Labs India in ITA No.418/Bang/2008. He also relied on the judgment of the Bombay High Court in the case of Tata Sons & Steel reported in 96 ITR 1 for the proposition that a circular which places a burden on an assessee cannot be relied on by an assessing officer.

23. It is also submitted that, as per the decision of Delhi Bench in the case of I policy Network in ITA No.5504/Del/2010, the Corrigendum, in partial modification of the original circular No. 5/2010 was issued by CBDT, was issued on 30 September 2010 which was after the date when the TPO passed his order. Hence, the same can not be applied. He relied on catena of decisions wherein a standard deduction of 5% variation was allowed.

- Tecnimount ICB Pvt. Ltd - ITA No. 7098/Mum/2010)
- Recent decision of the Hon'ble Bangalore Tribunal in the case of TNT India Pvt. Ltd. – (Bang ITAT) (ITA no. 1442(BNG)/2008) – para 15 of the said order – relied on SAP Labs and Schefenacker Motherson.
- E-gain Communication Pvt. Ltd. reported in (supra)
- Skoda Auto India Pvt. Ltd reported in [2009] (30 SOT 319)
- Schefenacker Motherson Ltd reported in [2009] ITA No. 4459 and 4460/Del/07, (Delhi).
- MSS India Private Limited reported in [2009] (32 SOT 132)
- Cummins India Limited (ITA No. 277 & 1412/PN/07)

24. Relying on the above decisions, it is submitted that it is well settled from the aforesaid decisions of the Tribunal that "at the option of the assessee" the benefit of 5% standard deduction is available irrespective of the fact that the arm's length price determined by the TPO exceeds by 5% or more from the transfer price. Thus the assessee is eligible for the said deduction while computing the adjustment to the transfer price as determined by the assessee in its TP study. The learned counsel for the assessee concluded that its claim for adjustments relating to risk, difference in depreciation policy adopted by the assessee vis-à-vis the comparable companies and the benefit of +/- 5% variation, the transactions of the assessee company with its associated enterprises in case of software development and back office services satisfy the arm's length test, and that the order of the TPO is bad in law and on facts.

25. On the other hand, the learned departmental Representative Sri V. Srinivas submitted that just because the company called Wipro BPO has high turnover, it does not mean that it is earning super normal profits. Hence, it is submitted that the lower authorities are right in including the Wipro BPO as comparable company. It is submitted that the range of margins between 6% to 40% is reasonable and the same has to be accepted in the case under consideration also. For this proposition, he relied on the decision of the Bangalore Bench of the Tribunal in the case of SAP LABS India Pvt. Limited. It is submitted that under the mutual agreement procedure (MAP), the competent authorities of US and India have agreed for a mark-up for software services at 19% for the financial year under consideration whereas the mark-up of the assessee company is only 7%. It is submitted that ACE

Software Exports was one of the comparables accepted by the assessee company during the methodical search process conducted by it to select potentially comparable companies in the ITES Segment for the purpose of its transfer pricing study. If the objection, having low wages to the cost ratio, of the learned counsel for the assessee in selecting Vishal Information as comparable is to be accepted, then applying the same principle ACE Software should also be rejected as comparable since the said company's salary cost constitutes only 9.32% of the operating revenue. It is also submitted that the assessee cannot object to the exclusion of Vishal Information Limited from the final list of comparable companies before this Tribunal, since no such objections were raised before the CIT (A). It is also submitted that the assessing officer is correct in not excluding the communication charges from the total turnover for the purpose of computation of deduction under section 10A of the Act. The case-law on which the learned counsel for the assessee relied on has not become final and the same is pending before the High Court. The CIT (A) should have confirmed the action of the TPO in the case of North-gate Technologies Limited that it failed to fulfill the RPT filter conditions.

26. The learned Departmental Representative further submitted that the provision of section 92C (2) of the Act does not operate to confer a benefit in the nature of a standard deduction. It is in the nature of a tolerance band to provide for an acceptable margin of error, within which an adjustment will not be made. Once this band is breached the entire adjustment is to be made. The case law relied upon by the assessee does not provide an adequate basis for deciding the matter because these cases have not had the benefit of considering the

important issue of intended retrospectively laid down by the Supreme Court in the case of CIT vs. Gold Coin Limited Health Foods Pvt. Limited reported in 304 ITR 308 which is relevant in the facts of the case. Reference had been made to the decision of the ITAT, Bangalore Bench in the case of SAP Labs India Pvt. Limited. In paragraphs 57-60 of its order dated 30-8-2010, it was held that after the amendment in 2009 the provision does not operate to confer a standard deduction. Since the amendment apparently came into force from 1-4-2009, it was felt that the amended proviso had no application to an earlier assessment year. The decision thus turned on the date of coming into effect of the amended proviso. Moreover, this date of coming into effect noticed by the Bench turned out to be a typographic mistake in the circular, which was corrected by a corrigendum subsequently issued on 30-9-2010, clarifying that the proviso come into effect from 1-10-2009, and not 1-4-2009, and that it would apply to all pending proceedings before the TP authorities. In support of his contentions, he relied on the decision in the case of Podar Cements reported in 226 ITR 625 and decision of the Vizag Bench of the Tribunal in the case of Sri Padmavati Srinivasa Cotton Ginning & Pressing Factory, reported in 318 ITR (AT) 156. It is further contended that the successive changes in the proviso to section 92C (2) of the Act, and the intention of the lawmakers as exemplified by the various instructions/circulars issued from time to time, seen in the light of the above decisions of the Supreme Court, should offer guidance in the matter of deciding the issue. Further he relied on the Circulars of the CBDT and key operational words. In view of the Instructions Nos. 12 and 14/2001, 8/2002 and 5/2010, the intention of the lawmakers and the stand of the department would be apparent from the above that the 5% margin is not, and never was a standard deduction. For similar

reasons, minus reliance on case law cited herein above, the ITAT Delhi Bench in the case of ST Microelectronics Pvt. Limited, in a decision dated 3rd June, 2011 ruled that the assessee was not entitled to such an interpretation of then proviso to section 92C(2) of the Act as is being claimed in the present case. It is important to note that Transfer Pricing legislation cannot be seen as incentive provisions admitting of liberal construfction. It seeks to protect a nation's tax base by correcting an artificial assumption of margin made possible in the first place by the fact that transacting parties are but limbs of the same enterprise, though legally distinct entities across separate sovereign taxing nations. It is, therefore, respectfully urged that applying the ratio of the above referred decisions of the Supreme Court in the case of Gold Coin [supra] and in the case of Pedar Cement [supra] as followed by the Vizag bench of this Tribunal, the department is right in denying the assessee's claim of 5% deduction.

27. With regard to rejection of multiple year data in ground No.5, the learned departmental representative submitted that the matter stands covered in favor of the department in catena of decisions, such as Mentor Graphics Noida Pvt. Ltd reported in 109 ITD 101, Aztec Software reported in 294 ITR (AT) 322,(Customer Services India Pvt. Ltd., reported in 009 TIOL 424, besides the recent decision of the Delhi Bench of the Tribunal in the case of ST Microelectronics Pvt. Limited, in a decision dated 3 June, 2011 (ITA Nos. 1806, 1807/Del/2008 for assessment years 2003-04 and 2004-05).

28. As regards the issue of selection of comparables it is submitted by the learned departmental representative that with the

exception of Northgate BPO Services Pvt. Limited, the CIT (A) upheld the TPO's rejection of assessee's comparables and confirmed the TPO's selection of comparables. The TPO's argument rests on application of filters relating to forex earnings, export transactions, related party transactions, functional differences, data incompatibility, and persistent losses and which is found to be correct. In response to the learned counsel's arguments, on certain specific comparables retained by the CIT (A), he invited our attention to the recent decision of the Delhi Bench of this Tribunal in the case of ST Microelectronics Pvt. Limited (supra). It is further submitted that on the subject of size of companies measured in terms of Turnover being relevant or not, the assessee's case is that Wipro BPO Solutions Limited deserves to be excluded. In this regard, two submissions were placed before the Bench for their consideration. Firstly, in a situation of TNMM, where the PLI adopted is the margin, size of turnover is not a relevant criterion and secondly, industry watchdog NASSCOM also does not recognize any classification based on size of turnover. Reference was also made to a study of M/s Infosys carried out by the TPO from which it is seen that over a ten year period margins fluctuated within a narrow band of around 5% in spite of the fact that turnover went steadily up 150 times. It is an established fact that in the software development services sector the principal element of cost being personnel cost is variable in proportion to the turnover. The gross margins therefore tend to be constant, unlike say, the manufacturing industry with significant fixed costs that result in margins responding differently to turnover. Secondly, the figures in Wipro's financials supplied by the assessee's counsel during the hearing by itself bears out this point. In the category of services income though the turnover increases from Rs.194.23 cr. to Rs.430.3 cr. from financial

year 31-3-2003 to 31-3-2004, Profit before tax, as a percentage of turnovers, moved from 23.68% to 23.91%, which is as good as static. It is further contended that the assessee has nowhere shown that Wipro is charging more from its clients than the present assessee, for any given service. Besides, it is important to notice that Transfer Pricing Rules, or for that matter, even OECD guidelines do not prescribe any turnover range for comparability across companies. It is finally submitted that the adjustment made by the TPO against the industry background and in a booming industry, where even a 40% markup by an Indian company still made it more profitable than its American principal, the assessee was operating on a meager margin of 6.99% determined by a contract dated 15-6-2000 and the assessee never found it necessary to align the contract with prevalent market realities. It is also submitted that, in many cases, in MAP proceedings between the Tax Administration of India and USA, a margin of 19-20% was considered acceptable for certain companies, which in turn was accepted by the companies. With reference to the department's appeal against the order if CIT (A) against directing removal of Northgate as a comparable, it is submitted that the case of Northgate, proposed by the assessee, was found by the TPO to be un-realiable because it had two segments-Software Services and BPO, but segmental results were not available to TPO and CIT (A) took cognizance of some figures furnished before him, without affording any opportunity for the TPO to be heard in the matter and the conclusion of the CIT (A) to this extent is vitiated by lack of opportunity. It is further submitted that the adjustment of margins proposed by the TPO deserves to be considered for acceptance.

29. In the rejoinder, the learned counsel submitted that it would be appreciated that similarly, Wipro BPO Solutions Limited is another giant in the industry of providing IYeS services, assuming all the risks and thus leading to higher profits. Based on the above, the assessee submits that Wipro BPO Solutions Limited ought to be excluded from the list of the comparable companies. In connection with the comparables discussed in the case of SAP Labs India Pvt. Ltd (supra) with the alleged comparables proposed by the TPO in the present case, the assessee drawn the attention of the Tribunal to page Nos. 64 of the decision wherein the Bangalore Tribunal held that the extremes are to be excluded from the samples to avoid all sorts of extremities. In the case before the Bangalore Tribunal the TPO had selected a list of 8 comparables companies having net margins within the range of 16.33% to 111.45% and thus after excluding the extremes it came to 6% to 40%. It would be appreciated that the TPO had arrived at the arithmetic mean of 22.24% before allowing working capital adjustment. Further, the said decision was pertaining to assessment year 2003-04 which cannot be considered for the purpose of comparability of operating margins of comparables proposed by the assessee as final set of comparable companies. It is submitted that the MAP does not deprive the tax payer from taking recourse to ordinary legal remedies available i.e. domestic appeal process and MAP are mutually exclusive. It has been held by the A.P. High Court in the case of Vishakhapatnam Port Trust (144 ITR 146) that MAP is available in addition to and not in substitution to the domestic remedies. Findings under MAP are not even binding on the assessee itself and it cannot therefore be binding on any other taxpayer as well. Further, the tax payer has to accept the MAP ruling for resolution to be reached. A settlement, if accepted, is only

binding for the financial year under dispute and would not apply for either past or future years. It is evident from the above that an assessee has an option to take recourse to the appeal process and apply for a MAP simultaneously. The assessee has not applied for MAP this year and the assessee further submits that a MAP ruling is taxpayer specific and varies from country to country. A MAP ruling depends upon negotiations held between the Competent Authorities of two contracting states which varies from case to case. Countries negotiate MAP rulings on considerations which are non judicial for example, Country A may concede an issue qua country B because it benefits Country A in a position it may take vis-à-vis country C or Country A may agree to a position qua company X because Country B concedes a position qua company Y. Hence, reliance placed by the Departmental Representative on the MAP ruling issued in case of another taxpayer is erroneous and his application that present case be decided having regard to this MAP ruling is illegal and unwarranted, bad in law, void and inadmissible and without prejudice, the learned counsel for the assessee submits that the departmental representative has not set out the facts and the back ground of the company in respect of which the MAP ruling was administered. In view of the foregoing, the reliance placed by the departmental representative on MAP ruling in case of another taxpayer is erroneous. It is further submitted that Ace Software Exports Limited was one of the comparable accepted by the assessee during the methodical search process conducted by it to select potentially comparable companies in the ITES segment of the purpose of its TP study. The departmental representative has made an argument that the assessee is objecting to the selection of Vishal Information Limited as a comparable as it has a low wages to cost ratio of 1.38 per cent.

Applying similar principle Ace Software Exports Limited should also be rejected as a comparable as against an operating revenue of Rs.4,41,40,306/- it has a salary cost of Rs.41,14,989/- which constitutes only 9.32 per cent of operating revenue. However, the departmental representative seems to have excluded the Software Sourcing charges for the purpose of calculation of the employee cost of Ace Software. The assessee submits that it is common in the service industry to outsource/subcontract the work to the vendors. In such scenario, the outsourcing cost has to be included for the purpose of calculating employee cost as it substitutes the employee cost. Therefore, to carry out an accurate comparison the software sourcing charges should be included for the purpose of calculation of employee cost of Ace Software. Thus, Ace Software should be accepted as a comparable and there the assessee in the course of proceedings before the Tribunal had requested for the rejection of Vishal Information Limited having wages to total operating revenue ratio at 1.38 per cent which was selected as a comparable by the TPO. As the departmental representative has argued for rejection of Ace Software Exports Limited by comp raring it to Vishal Information Limited it will be appropriate to go through the wages to operating income ratio of Vishal Information Limited.

30. We have considered the rival submissions and perused the material available on record. First we will take up the appeal of the assessee. Firstly, we deal with the issue with regard to the objection of the assessee company in not allowing the use of multiple years' data for the purpose of determining the ALP. We find that, for the purpose of determining the ALP, the transactions entered into the Associate

Enterprises are to be compared with uncontrolled transactions carried on by an entity during the same period as that of the assessee company as provided under Rule 10B [4] of the Income Tax Rules. In view of this matter, the lower authorities are right in considering the data of only one year. The expression "shall" used in the said Rule makes it clear that it is mandatory to use the current year data first and if any circumstances reveal an influence on the determination of ALP in relation to the transaction being compared than other datas for period not more than two years prior to such financial year may be used. This issue is covered in favour of the revenue in a catena of cases including the recent decision of Delhi Bench of the Tribunal in the case of M/s. ST Microelectronics Private Limited vs. CIT (A) XX, New Delhi and others (ITA Nos. 1806, 1807/ Del/2008 and others) dated 30-6-2011. With regard to the contention of the assessee company regarding non availability of current year data in respect of the comparables at the time of filing the return of income is concerned, we find force in the finding of the CIT (A) in confirming the action of the TPO in directing the assessee company to conduct fresh search of the comparables during the transfer pricing proceedings as the Rule 10B(4) of the IT Rules require use of current year data for the purpose of comparability analysis. In view of the above, the ground raised by the assessee on this issue is rejected.

31. Next we deal with the issue with regard to the allowance of 5% deduction before computing the ALP. It is contention of the learned counsel for the assessee that the arithmetical mean of the comparable price should be reduced by 5% for determining the ALP. We have gone through the submissions and also the case law relied upon by him. He

pointed out that the amendment made under section 92C of the Act would be applicable prospectively and not retrospectively. Whereas the learned Departmental Representative objected to the above proposition and submitted that under the proviso, no standard deduction has been provided to the assessee company. In our considered view, the tolerance band provided in the aforesaid provision is not to be taken as a standard deduction. If the arithmetic mean falls within the tolerance band, then there should not be any ALP adjustment. If it exceeds the said tolerance band, then ALP adjustment is not required to be computed after allowing the deduction at 5%. That means, actual working is to be taken for determining the ALP without giving deduction of 5%. Our view is supported by the recent decision of the Delhi Bench of the Tribunal in the case of M/s. ST Microelectronics Private Limited vs. CIT (A) XX, New Delhi and others (supra). We also find that the issue is covered in favour of the revenue by the decision of co-ordinate Bench in the case of ADP Private Limited, Hyderabad vs. DCIT, Hyderabad (ITA No.106/Hyd/2009 and ITA No.155/Hyd/2009 dated 25-2-2011, to which one of us was a party of that order and the same is binding on us. Since the decision of co-ordinate Bench is binding on us, we are not inclined to follow the decisions rendered by other Benches of this Tribunal which are relied on by the learned counsel for the assessee. We are also in agreement with the elaborate findings of the first appellate authority in dealing with this issue and accordingly we do not see any infirmity in his order. Hence, the grounds raised by the assessee on this issue are rejected.

32. Next we deal with the issue relating to the assessee's contention that the TPO had violated the rules of natural justice by not

providing/sharing the complete details of the bench marking analysis carried out by him. At the time of hearing, the learned counsel for the assessee did not press this ground. Accordingly, the ground raised by the assessee is dismissed as not pressed.

33. Now, we deal with the issue relating to the assessee's contention that the first appellate authority failing to take cognizance of differences in accounting policies followed by the assessee company and the alleged comparable companies selected by him, by not allowing the depreciation adjustment made by the assessee company. It is the contention of the assessee company that the lower authjorities not allowed any adjustment for the difference in depreciation policy followed by the assessee company vis-à-vis the comparable companies. We find that the assessee company has not raised any ground on this issue before the first appellate authority. Further, no such plea has been made during the transfer pricing proceedings before the TPO. Under these circumstances, the ground raised by the assessee company before us is not entertainable and the same is rejected.

34. Now we deal with the issue relating to the action of the TPO/CIT (A) in considering the Visualsoft Technologies Limited as comparable (Software Development Services Segment) even though the said company has incurred research and development expenses in excess of 3% of its sales. We find that the assessee has not raised any objection vide its letter dated 28-11-2006 in considering the said company as comparable being unrelated party having similar functions and risks as that of the assessee company, by the TPO. Before the TPO, the assessee company has agreed that it is an unrelated party and

can be comparable with that of the assessee company. We do not see any merit in the contentions of the learned counsel for the assessee that even though the assessee company earlier accepted Visualsoft as comparable company in the assessee's TP study, it is not estopped from pointing out any facts before us, which have material bearing in the case under consideration, even though such facts are as a result of the evidence adduced by the tax payer. We find that the assessee company not adduced any cogent reason as to why it had selected Visualsoft as comparable in its TP study erroneously. Moreover, the assessee company agreed before the TPO that the Visualsoft is an unrelated party and can be comparable with that of the assessee company. Since the TPO included the aforesaid company on agreed basis, the TPO had no occasion to verify the veracity of present claim made by the assessee company contending that the TPO should have excluded the Visualsoft from the list of comparable companies. Hence, the ground raised by the assessee on this issue is rejected.

35. Now, we turn to the issue relating to the selection of Spanco Tele-system as comparable company in the back office services segment by the TPO. We find that the TPO has applied the criteria of excluding the companies having related party transaction of more than 25% of the turnover from the list of comparable companies. Having done so, the TPO should have excluded the Spanco Tele-system from the list of comparable companies as it is evident from the paper book filed by the assessee company that the percentage of related party transaction in the case of Spanco Tele-system is 28.73% and it fails to satisfy the TPO's own criteria. In view of this matter, we find force in the arguments of the learned counsel for the assessee that Spanco Tele-

system should be excluded from the final list of comparable companies. We direct accordingly.

36. Now, we deal with the issue relating to inclusion of Vishal Information Technology Limited (VITL in short) in the final list of comparable companies by the TPO. It is contention of the assessee company that VITL has employee-cost at 1.38% of its revenue when compared to that of the assessee company which is at 52.12%. Thus, the VITL cannot be considered as comparable company and to be excluded from the list of comparable companies. It is also an alternate contention of the assessee that VITL owns valuable intangible when compared to the assessee company. Hence, the said company has to be excluded. The assessee company itself agreed before the TPO that VITL is a comparable company offering IT enabled services and this company is an extension of one Indian company Amex IT Ltd., having agreed so it is not correct on the part of the assessee company to raise a new plea that the VITL has got low wages compared to the assessee company. It appears that the VITL has outsourced the manpower and the cost of outsourcing appears to have been included in the other heads of the expenditure instead of wages-employee cost. Moreover, the intangibles will not materially affect the price or profit earning. By outsourcing the manpower, the VITL would have incurred more cost compared to the assessee company, thus resulting in lesser operating profit. But, having considering the findings of the TPO, we find that the intangibles or outsourcing the manpower will not materially affect the price or profit margin. In our considered opinion, no two comparable companies can be replicas of each other. The application of Rule 10B should be carried out and judged not with technical rigor, but on a broader prospective. In

this view of the matter, we find no infirmity in the order of the CIT (A) in confirming the action of the TPO by selecting the VITL as comparable company. The case-law relied on by the learned counsel for the assessee is distinguishable on facts. Hence, the ground raised by the assessee on this issue is rejected.

37. Now, we deal with the issue whether the TPO was correct in selecting Wipro BPO having turnover of 20 times more than the assessee company as comparable or not. We find that this issue is covered in favor of the assessee by the decision of Delhi ITAT in the case of Agnity India Technologies Pvt. Limited (2010) ITA No. 3856/Del/2010. We find that the Wipro BPO is not at all comparable as the assessee company is pigmy compared to giant Wipro. Wipro Company's turnover is 20 times more than the assessee company. Hence, the assessee company is not comparable with Wipro BPO, the reasoning being that the latter is a giant company having 20 times more turnover than the assessee company. In view of this, based on the facts and the circumstances of the case, and following the decision of Delhi Bench of ITAT in the aforesaid case, we are of the view that Wipro BPO should be excluded from the list of comparable companies. Hence, the ground raised by the assessee on this issue is allowed.

38. The next issue is with regard to the rejection of Ace Software Limited (ASL in short) as comparable company in back office services segment on the basis that the company sources its exclusively from Apex Data Services Inc. USA and thus, has related party transactions. We find that ASL does not render any services to Apex Data but only sources business from them. Therefore, ASL renders

services directly to the third parties and not to the Apex Data. The learned counsel for the assessee clearly demonstrated that ASL had only transaction with Apex Data in purchasing of fixed assets. Relevant papers are placed at page No.250 of the paper book filed by the assessee. In view of this matter, we find no controlled transaction between the ASL and Apex Data. Thus, no materially significant related party transactions exist. Section 92A(2) (i) clearly deals with manufacturing of goods and articles and not with provision of services. Therefore, the TPO/CIT (A) is not justified in rejecting the ASL as comparable company from the final list of comparable companies. Hence, ASL should be accepted as an independent comparable company. The ground raised by the assessee is accepted.

39. The next ground is with regard to rejection of independent comparable companies by TPO/CIT (A) on the basis that they do no have any foreign exchange revenue. We find that the TPO, in the case of back office services segment, has rejected the following five companies on account of the fact that these companies do not generate foreign exchange revenue.

i) C.S. Software Enterprise Limited
ii) Ideaspace Solutions Limited
iii) MCS Limited
iv) Tata Share Registry Limited
v) Vakrangee Softwares Limited

We find that the domestic BPO is much smaller business segment than the export BPO. The productivity and return in domestic segment is also much less than the export segment. The TPO clearly demonstrated in his

order at page-9 that the earnings per seat in domestic segment is 0.45 lakhs as against 2.37 lakhs in the export segment which works out to 5.27 times more than the domestic segment. In the export segment, the earnings will be more due to the fact that they have advantage of time zone and higher productivity etc. It appears that the assessee company agreed that one criterion for selection/rejection of the comparables is FAR analysis. The aforesaid companies do not have any export business for the year under consideration whereas the assessee company has full-fledged export business. The functions, risks and assets are entirely different. Hence, the aforesaid company cannot be considered as a comparable company for determining the ALP. It is the contention of the learned counsel for the assessee that there is nothing mentioned in the Indian TPR that comparables may be rejected merely on the ground that it has no foreign exchange revenue. He referred to the meaning of the "uncontrolled transaction" as given in Rule 10A of the Income-tax Rules wherein it states that the transaction between enterprise other than the associate enterprise whether resident or non resident. In our considered view, the reference to resident and non-resident in Rule 10A of IT Rules, is related to the residential status and not related to the domestic or export. Moreover, the Delhi Bench of the Tribunal in the case of Mentor graphics (supra) held that the ALP should be determined by taking results of a comparable transaction in comparable circumstances. Rule 10B (2)(d) also emphasizes that the comparability of the transaction should be international transaction. We do not find any merit in the argument of the learned counsel for the assessee that the companies rejected by the TPO operate in similar market condition as that of assessee company due to the fact that the aforesaid companies do not have any international transaction. In view

of the above, the reasoning given by the CIT (A) in confirming the action of the TPO in rejecting the aforesaid company as not comparable is justified. In view of the above, five companies listed above shall not be included in the final list of comparable companies.

40. The next ground is with regard to the issue that the TPO/CIT (A) not allowing any adjustment towards valuable intangibles owned by and in respect of entrepreneurial risk borne by the comparables. We find that there are several factors such as market risks, environmental risk, entrepreneurial risk and functional risk etc., which affect this matter and which ultimately affect the results of the company. All the aforesaid factors make it impracticable to any authority to find out exact duplicate company of the assessee as comparable. Some variation bound to exist. We find that the TPO had made efforts to identify the comparables whose functions are similar to the assessee company by applying filter quantitatively and qualitatively to eliminate the differences between the assessee companies with that of comparable companies to neutralize the aforesaid risk factors. The argument of the learned counsel for the assessee in the written submissions as well as submissions made before us were all in the back ground of showing the assessee company as low end performer. We do not find force in the contention of the learned counsel for the assessee that the assessee is a risk free service provider and sufficient adjustment needs to be allowed to compare with the other comparable companies. The learned counsel for the assessee placed reliance on several decisions in support of his case that there should be some adjustment for risk to be given. However, we find that the first appellate authority after going through the agreement, entered by the assessee company with the AE,

observed that the assessee company is an independent contracting entity and shall be solely responsible for determining the manner, means and methods by which it performs its obligation under the said contract as per Article-5, the assessee company has undertaken the warranty that all its work and documentation to be delivered to the associate enterprise shall be free of error. In a nutshell, the assessee company was carrying several risks while undertaking various works/ services for its associate enterprise. In view of this matter, after considering the detailed reasoning given by the CIT (A)/TPO in their orders, in our considered opinion, it cannot be said that the assessee company was operating in a risk free environment and accordingly the assessee company is not entitled to any adjustment towards risks borne by various comparable companies. Therefore, we confirm their orders on this issue. Hence, the ground raised by the assessee on this issue is rejected.

41. The next ground raised by the assessee is that the TPO/AO needs to demonstrate the motive of the assessee company to shift profits outside of India by manipulating the prices charges in its international transactions at the time of framing the transfer pricing assessment. We find that transfer pricing rules shall apply when one of the parties to the transaction is a non-resident, even if the transaction takes place within India. There is no need to find out the legislative intent behind the transfer pricing provision when the provisions themselves were unambiguous. Therefore, existence of actual cross border transactions or motive to shift profits outside India or to evade taxes is not free conditions for transfer pricing provisions to apply. In view of this, the lower authorities, during transfer pricing assessment,

are not required to demonstrate the motive of the assessee company to shift the profits outside India by manipulating the prices.

42. The next ground is with regard to charging of interest under section 234B and 234C of the Act. We find that charging of interest under sections 234B and 234C are mandatory and merely consequential in nature to the assessed income. Hence, the grounds raised by the assessee on these issues are rejected as such.

43. The last ground raised by the assessee is with regard to the initiation of penalty proceedings under section 271(1) (c) of the Act. We find that there is no provision in the Act for allowing appeal against initiation of penalty proceedings under section 271 (1) (c) of the Act. Hence, the ground raised by the assessee on this issue is not entertainable and the same is accordingly rejected.

44. Now, we will take up the appeal filed by the Revenue. Ground Nos. 1,4 and 7 are general in nature and no adjudication is required. Ground Nos. 2 and 3 are with regard to the exclusion of communication charges from the total turnover for the purpose of computation of benefit under section 10A of the Act. We find that this issue is squarely covered in favour of the assessee by the decision of Chennai Special Bench in the case of Sak Soft Limited reported in 313 ITR (AT) 353 and accordingly we held that the telecommunication charges incurred by the assessee company, which has been excluded by the assessing officer from export turnover, has to be excluded from the total turnover also, if such amount stands included therein, while computing the admissible deduction 10A of the Act. We direct

according. Hence, the grounds raised by the Revenue on these issues are rejected.

45. The ground Nos. 5 and 6 raised by the revenue are with regard to the inclusion of Northgate Technologies Ltd., (NTL in short) as comparable company in the BPO segment. We find that the TPO in his order accepted the contention of the assessee company that NTL is in the business of providing high end back office services and also observed that this company is a comparable company with that of assessee company having similar functions. The TPO simply rejected the aforesaid company on the ground that segmental results are neither available in the public data base nor provided by the assessee company. Moreover, we do not find any observation of the TPO in his order that NTL has failed to fulfill the RPT filter conditions. In view of this matter, we do not find any infirmity in the findings of the CIT (A) in holding that the aforesaid company should be considered as comparable for the purpose of determining the ALP and accordingly we confirm his directions on this issue. Hence, the grounds raised by the Revenue are rejected.

46. In the result, appeal by the assessee is allowed in part and the appeal filed by the Revenue is dismissed.

Order pronounced in the Court on 22-7-2011.

Sd/-	sd/-
(G.C. Gupta)	**(Akber Basha)**
Vice President.	**Accountant Member.**

Dt/-22 -07-2011.

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5. The DR, ITAT, Hyderabad.

Jmr*