IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH 'I(2)', NEW DELHI

Before Sh. N. K. Saini, AM And Sh. I. C. Sudhir, JM

ITA No. 6134/Del/2012 : Asstt. Year : 2008-09

Infogain India Pvt. Ltd., I-25, Jangpura Extension, New Delhi-110014	Vs	Deputy Commissioner of Income Tax, Circle 11(1), New Delhi
(APPELLANT)		**(RESPONDENT)**
PAN No. AABCA3223B		

Assessee by : Sh. Salil Kapoor, Sanat Kapoor, Vikas Jain, Advs. & Sh. Rajan Sachdev, CA
Revenue by : Sh. Rahul Garg, Sr. DR

Date of Hearing : 21.05.2015		**Date of Pronouncement : 19.08.2015**

ORDER

PER N.K. SAINI, A.M.

This is an appeal by the assessee against the order dated 01.10.2012 of the AO.

2. Following grounds have been raised in this appeal:

The addition amounting to Rs. 145,259,630/- undertaken by the Deputy Commissioner of Income Tax, Circle 11(1), New Delhi ("the Ld. AO") vide Assessment Order dated October 01, 2012 (received by the Appellant on October 12, 2012) passed under section 143 (3) read with section 154 of the Income Tax Act, 1961 (received by the Appellant on November 01, 2012) is not in accordance with the law and therefore not sustainable.

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Transfer Pricing ("TP") Adjustment: Rs. 145,259,630

That the Hon'ble Dispute Resolution Panel, New Delhi ("the DRP") has erred both in law and on facts by summarily rejecting the Appellant's objections to the draft order passed by the Ld. AO under section 143(3) read with section 144C(1) of the Act. The Hon'ble DRP while issuing directions under section 144C(5) of the Act did not consider the facts and merits of Appellant's objections to the proposed adjustments, and merely relied on the reasoning given by the Additional Commissioner of Income-tax, Transfer Pricing Officer - I (2) vide order under section 92CA(3) of the Act dated October 27, 2011 ("TP Order"). On the facts and in the circumstances of the case, the Ld. TPO and the Ld. AO have erred in proposing and the Hon'ble DRP has further erred in confirming the transfer pricing adjustment of Rs. 145,259,630/- without due application of mind and without affording a reasonable opportunity of being heard in the matter to the Appellant on the following grounds:

1.1. The DRP has erred on the facts and circumstances of the case and in law in rejecting/disregarding the comparability analysis (most appropriate method) without giving any cogent basis and without demonstrating the inadequacy or infirmity in the economic analysis conducted by the Assessee. In this regard, the Ld. TPO erred in demonstrating correctness of the presumption/hypothesis so framed to reject the comparability analysis of the Assessee and has accordingly misconstrued the provisions of Section 92C (3) (c) of the Act.

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1.2. The DRP has erred on the facts and circumstances of the case and in law in rejecting/disregarding the profit split percentage embedded in the Transfer Pricing Documentation.

1.3. The DRP has erred on the facts and circumstances of the case and in law by alleging that the whole arrangement is too subjective and is not weighted on any empirical data as to how the split was arrived at.

1.4. The DRP has erred on the facts and circumstances of the case and in law by alleging that assessee has not made attempt by evaluating the contribution made by Infogain India and Infogain US on the basis of FAR (Functions, Assets and Risk Analysis)

1.5. The DRP has erred on the facts and circumstances of the case and in law by alleging that TP Report is subjective and completely inadequate to support its conclusions.

Notwithstanding and without prejudice to the above-mentioned grounds relating to applicability of profit split method, we present below the grounds relating to application of transactional net margin method that has been adopted by the Ld. TPO:

1.6. The Ld. TPO erred in the facts and circumstances of the case and in law by substituting the comparability analysis conducted by the Assessee for its software development services function with a fresh comparability analysis based on his own conjectures and surmises. Specifically, the Ld. TPO erred by using an approach that had an inherent upward bias and employed erroneous

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filters, that were designed to select only high margin comparable companies. Accordingly, the fresh search conducted by the Ld. TPO is liable to be quashed.

1.7. The Ld. TPO erred on the facts and circumstances of the case and in law by misconstruing Rule 10B (1) of the Income Tax Rules, 1962 ("Rule") and its applicability on the facts and circumstances of the case. In this context the Ld. TPO has erred in disregarding independent legal status accorded to an overseas branch of an Indian company in view of the provision of clause (iii) of Section 92F of the Income Tax Act, 1961 ("Act").

1.8. The Ld. TPO erred in the facts and circumstances of the case and in law by using data called pursuant to issuance of notice under Section 133(6) of the Act which was not available to the Assessee at the time of maintenance of Transfer Pricing Documentation. Further, the Ld. TPO also erred by not providing the complete information which was called pursuant to issuance of notice under Section 133(6) of the Act and by conducting the assessment based on unfair analysis.

1.9. The Ld. TPO erred by misconstruing the functional and risk profile of the Assessee and by not allowing risk adjustments. The Ld. TPO also erred in the facts and circumstances of the case and in law by selecting comparable having dissimilar functional profile vis-a-vis the Assessee.

1.10. The Ld. TPO has erred in the facts and circumstances of the case and in law by applying the wages-to-sales ratio based upon conjectures and surmises and further, applying an arbitrary filter of 25 percent

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without following a cogent economic basis and without establishing any statistical veracity of the presumption/ hypothesis framed. Further, the Ld. TPO has also erred by juxtaposed application of two or more methods to conclude a single benchmarking analysis as application of wages-to-sales screen tantamount to adoption of the cost-plus method.

1.11. By using an incorrect computation of Net Cost Plus ("NCP") margin of selected comparable companies and accordingly erred in computing the amount of adjustment on account of transfer price.

1.12. The Ld. TPO erred in facts by changing the computation methodology by misconstruing certain line items as operating/ non-operating which represents an unjustified approach.

2. General

2.1. That in view of the facts and circumstances of the case the addition/adjustment made in the return is illegal, unjust, bad in law and highly excessive.

2.2. The Ld. TPO has erred on the facts and circumstances of the case and in law in determining the arm's length price by relying upon data of the cam parables for financial year 2007-08 only for determination of the arm's length price, disregarding the multiple year data approach.

2.3. The Ld. TPO has erred on the facts and circumstances of the case and in law by not allowing the benefit of (+/-)5% as provided in the proviso to Section

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92C(2) of the Act, while determining the arm's length price of the international transactions of the Assessee.

2.4. The Ld. TPO has erred on the facts and circumstances of the case and in law by not allowing appropriate comparability adjustment on account of risk of the comparable companies for the purpose of comparison with the results of the Assessee.

2.5. That the explanations given, evidence produced and material placed and made available on record have not been properly considered and judicially interpreted and the same do not justify the addition made.

2.6. That the addition / disallowance made are illegal, unjust and bad in law and are based on mere surmises and conjunctures and the same cannot be justified by any material on record.

3. From the above grounds it would be clear that only grievance of the assessee in this appeal relates to the addition amounting to Rs. 14,52,89,630/- made by the AO on account of transfer pricing adjustment.

4. Facts of the case in brief are that the assessee was engaged in the business of software development and filed the return of income on 30.03.2010 declaring income of Rs. 1,41,28,871/- which was processed u/s 143(1) of the IT Act, 1961 (hereinafter referred to as the Act). Later on the case was selected for scrutiny.

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5. During the course of assessment proceedings it came to the notice of the AO that the assessee had international transactions for which the assessee had filed form no. 3 CEB as per the provisions of Section 92E of the Act relating to international Transactions in access of Rs. 5 crores. The AO as per the provisions of Sec. 92CA(3) referred the matter to the Transfer Pricing Officer (TPO) who proposed an addition of Rs. 16,86,58,151/-. The AO then proposed the draft assessment order u/s 144C(5) of the Act which was forwarded to the assessee who filed objections in Form no. 35A to the Dispute Resolution Penal (DRP) on 27.01.2012 and highlighted the following events which contributed to shift in its functional matrix:

> *(i) Formation of Global Delivery Organization in India in September, 2005.*
> *(ii) Relocation of key Personnel to India in July 2006.*
> *(iii) Establishment of Chief Technology Officer in December 2006.*
> *(iv) Appointment of General Manager Sales in October 2007.*

6. It was stated before the DRP that the entire pricing decision based on project costing estimates, resource requirements, time commitments has entirely shifted to Infogain India (the assessee). It was further stated that õas per the submissions in the TP report at page 43, the assessee does not undertake any contract risk and

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credit risk but the market risk, Product liability and price risk, manpower risk, forex risk and capacity risk is stated to be significantly resting with Infogain India. The TP study undertaken has, on the basis of fuctions/responsibilities and based on interviews with the key management personnel of the Infogain US and Infogain India, identified the functions in the value chain of software services provided by Infogain US and Infogain India to customers based in US and assigned weightages to the functions. It was further stated that based on such weightage a weight split of 40:60 has been made for Infogain India and Infogain US. It was pointed out that the TP documentation prepared by BSR and Co- states that based on this analysis, it is reasonable to conclude that a profit split of 60:40 in favour of Infogain US appear to be consistent with the armøs length standard from an Indian Transfer Pricing perspective. In this manner the profit split method has been applied.ö

7. The DRP after considering the submissions of the assessee rejected the objection of the assessee by observing as under:

> *"As per the form 3CEB, it is mentioned that Infogain India has provided Software Development Services (including human resource services) to its AEs namely Infogain Corp US and Infogain Limited UK. However, the transaction with Infogain UK is miniscule and only Rs. 6.7 lacs. The*

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transaction with Infogain US is Rs. 54.07 crores. By a mere reading of the form 3CEB it automatically transpires that the assessee has provided software development services to its overseas AE. The TP report in its executive summary has also stated that Infogain India provides software services to Infogain US which in turn provides these services to the end customers.

However, we are also given the pre migration and post migration flow charts by which we understand that pre migration the contractual arrangement for services was made by the US AE with the customer which further made a contractual arrangement for development with Infogain India. Infogain India, after developing the same delivered it to Infogain US who in turn provided it to the end customer.

Post Migration, flow chart shows that there is no shift as far as the contract with end customer and AE and further sub contract to Infogain India is concerned, there is no marked shift. However, the delivery models have been different. Infogain US develops onshore in addition to sales and marketing services and Infogain India after the development process is over delivers directly to clients. The flow charts are only representative of functions and not funds. We however see that the assessee has, by virtue of this diagram carried out a contractual obligation no doubt but has not provided these services to the overseas AE as it was earlier, rather than it has delivered the Software on behalf of its overseas AE. Another issue that has not been sufficiently documented at all is that whether the software developed in totality is partially developed onsite and partially in India. If we were to go strictly by the economic analysis carried out in the TP report,

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Conceptualization and scoping, System Requirement and design, Coding, Documentation and Testing is done majorly in India. We however have no project wise data to prove this. No specific contracts to support this. Also going by the TP Report it is evident that this Inference is drawn on the basis of interviews and discussions with key management people. Again we do not have any details of these interviews undertaken. Going by the theory of the assessee in this year, it is presented that the overseas AE has offloaded the vital functions to Infogain India and is retaining the extra chunk of the split for sales and marketing functions. There is no gainsaying that as far as Software Development is concerned, since the major functions such as conceptualization and designing is performed in India and still the US entity has the larger chunk of the split it is assuming a huge disproportionate profit chunk for the alleged sales and marketing function. As discussed and examined by us, this whole arrangement is too subjective and is not weighted on any empirical data as to how the split was arrived at. Moreover, since the majority of the conceptualization and designing functions are being performed in India, the unique intangibles, if any are in India itself and if they are getting transferred, the larger chunk of the split that is actually deriving the revenues should have been in India. In view of the same, we are not convinced that the split even if applicable is proper.

Even if we are to assume that in the instant case, the profit split method is the most appropriate, the mandate of the Rule 10B(1)(d) is that "the relative contribution made by each of the associated enterprises to the earning of such combined net profit, is then evaluated on the basis of the functions performed, assets employed or to be employed

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and risks assumed by each enterprise and on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances.

We have nowhere in the submissions, or during the course of discussion seen that the assessee has made any attempt by evaluating the contribution made by Infogain India and Infogain US on the basis of FAR of each one of them and have reliably employed any external market data which may be indicative of how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances. The moot issue here is to reasonably and reliably identify a basic return appropriate for the type of international transaction in which the parties at test are engaged, with reference to market returns achieved for similar types of transactions by independent enterprises. In none of the methods employed for determination of ALP, the issue of comparability is dispensed with. The foremost requirement of determination of ALP is to identify a comparable transaction. In the case of Profit Split Method, the way that has to be done is also mentioned. We do not find that the assessee has demonstrated this comparability anywhere. The TP Report is subjective and completely inadequate to support its conclusions. We are constrained to reject the same for the reasons given above and agree with the action of the TPO. We are of the opinion that Profit Split Method is not the most appropriate method in this case for this year as the same was not demonstrated by the assessee and the TPO was right in proceeding with the analysis on the basis of TNMM. The objection is rejected."

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8. As regards to the objection of the assessee that the TPO collected selective information of companies by exercising power u/s 133(6) of the Act that was not available to the assessee in public domain and relying on the same for comparability purposes, the DRP observed that Sec. 97CA(6) of the Act gives power to obtain information u/s 133(6) of the Act and if this provision is involved, it cannot be considered illegal and abuse of power by TPO. It has further been observed that:

> *"If the use of justifiable powers u/s 133(6) can lead to better results, there is no harm. The assessee has been confronted with the results of this exercise so there is no secrecy. Hence, the tenets of natural justice have also been followed and no further opportunity, in view of DRP, is needed to be provided to the assessee."*

9. The DRP also did not accept the assesseeøs claim of risk adjustments by referring to the revised OECD guidelines of 2010 observed as under:

> *"It can be seen that unless it is shown that how the risk adjustment would change the result of each comparable and how the same would improve the comparability and unless adequate reasons are given for such adjustment, no adjustment can be allowed to the taxpayer. In the present case, except pointing out various risks, the taxpayer has not shown with evidence as to whether each of the risk was actually undertaken or not by the comparables and if so, how these risks affected each of them and whether such*

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adjustment would improve the comparability. Mechanical adjustment cannot be made to the margins of the comparables without knowing which risk was taken by the entity concerned and how its profitability was affected. Probability of risk and certainty of risk are two different aspects and cannot be equated for the purpose of adjustment. In the view of DRP assessee cannot be compared to a risk free security."

10. The DRP, however directed the TPO to exclude Celestial Labs Limited from the set of comparables because it is not suitable. The DRP also directed to exclude rental and corresponding rental expenses to work out the margin in the case of Softsol Limited. As regards to the objection of the assessee with reference to forex and provision for bad debts, the DRP directed the TPO as under:

"These are an accounting issue and depend on the facts of the case and whether they are materially impacting the results of the taxpayer and should be accordingly considered for comparables. Provision for doubtful debts is not a normal operating expenses/income hence has been rightly excluded. Issues of forex is to be examined by TPO if it is not materially affecting assessee should not be taken for comparables either."

11. As regards to the objection of the assessee for considering the multiple year data instead of single year data while working out the Arm's Length Price, the DRP observed as under:

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"This issue has been examined in detail in TPO's order. Briefly summarized, the arguments put forth by TPO are based on the law as it exists. Persuasive value of OECD guidelines have also been considered and the relevant case laws. The TPO has articulated the relationship between Rule 10B(4) and 10D(4). Rule 10D(4) refers to maintenance of documentation, while Rule 10B(4) is very clear that for the purposes of benchmarking an international transaction, data of the comparables used should be of the year in which the transaction took place. The proviso can be invoked only if it is established that earlier years circumstances do have a bearing in the performance of the year under audit. The Delhi High Court in Schefenacker Motherson Ltd. Vs ITO 2009-TIOL-376-ITAT Delhi has upheld the use of current year data. ITAT Hyderabad in M/s Deloitte Consulting India Pvt. Ltd. ITA No. 1082 and 1084 of 2010 in order dated 22.07.2011 has again reaffirmed the use of single year data. Jaipur ITAT in case of Sakata Insx. Order in 2012 has upheld use of current year data. Thus the weight of judicial decisions is in favour of single year. The DRP does not find merit in this objection of the assessee and is rejected."

12. Accordingly, the DRP directed the TPO/AO u/s 144C of the Act to complete the assessment. On the directions of the DRP the AO completed the assessment vide order dated 01.10.2012 and made the adjustment.

13. Being aggrieved the assessee is in appeal. The ld. Counsel for the assessee reiterated the submissions made before the authorities

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below and further submitted that Infogain India (the assessee) was established in 1997, as a back-end software services company, which performed services mainly for its parent Infogain Corporation, USA (õInfogain USö). However, in the relevant assessment year there was a significant change in the functional matrix of the Infogain Group, with Infogain India assuming critical delivery functions and the corresponding. There was a process shift with the formation of Global Delivery Organization (GDO) in Infogain India and Client Service Organization (CSO) in Infogain US. It was further stated that during the initial years of the formation of Infogain Group, the execution and delivery of the software services as well as the marketing of these services was handled from Infogain US. To support such a structure, consequently all the key personnel/decision makers were stationed in Infogain US. However, gradually the fulcrum of the entire business witnessed a shift towards India. Therefore, the organizational structure was aligned by client services and delivery function and currently the team at Infogain US has been reduced to one-fourth since the conversion year. It was further stated that Infogain India assists Infogain US, to a limited extent, in client identification and marketing functions and in respect of international regions (regions other than US and UK), Infogain India is engaged in performing client identifications, marketing and

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client relationship management functions. It was further stated that the Ingfogain Group provides software services to its clients/customers by adopting any of the following delivery models:

1. *Offshore Service Delivery Model;*
2. *Dual Shore Service Delivery Model.*

14. It was stated that Infogain India adopted Profit Split Method (PSM) as the most appropriate method for the financial year 2007-08 relevant to the assessment year under consideration, in view of the fact that it transitioned from a back end software services company of its AE to being fully responsible for the execution and delivery of software services to the end customers. It was submitted that under the offshore service delivery model, the entire project is developed and managed offsite (i.e. in India) by Infogain India while an employee of the AE acts as the onsite coordinators for managing client expectations and acting as an interface/communication channel between the client/customer and Infogain India. It was explained that under the dual shore model, Infogain US outsources only part of the software project to Infogain India, while the other part is executed by it onsite team requirement analysis, design and implementation support. However,

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the software engineers engaged in providing onsite services to the client/customers work under the direction of the Practice Directors (õPDsö) stationed in India. It was further stated that the Infogain India is responsible for program and project execution, customer satisfaction and technical support. The said work is undertaken through coordinated efforts of various teams including Global Resource Management, Global Process Management, Delivery Practices, Strategic Delivery Practice and Local Delivery Management. It was further stated that during the initial years of the formation of the Infogain Group, the execution and delivery of the software services as well as the marketing of these services was handled from Infogain US. However, gradually the fulcrum of the entire business witnessed a shift towards India. The ld. Counsel for the assessee explained the various functions undertaken by Infogain India and Infogain US vide a written statements which read as under:

"***Coding, Testing and Documentation Functions***

Infogain India and Infogain US are responsible for the coding, testing and documentation functions in accordance with the functional specifications and protocols agreed with the client/customer. The

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coding, testing and documentation functions are primarily performed by Infogain India, with Infogain US performing these functions only in respect of the onsite software services. Further, Infogain India and Infogain US are responsible to monitor operations and quality of project works in accordance with the standards and agreed specifications. The delivery functions performed by Infogain US are continuously monitored by the PDs based in Infogain India.

Sales and Marketing Functions

Infogain US plays a vital role in marketing and selling Infogain Group's software services in US. In this regard, Infogain US performs the following functions:

- *Soliciting orders, initiating sales, pricing and other contractual provisions and managing customer relationship for clients/customers in such regions:*

- *Formulating the sales strategy for such regions; and*

- *Account management of clients in such regions.*
  In the software services rendered by the Infogain Group, customer relationship management is a critical function which is performed by Infogain US.

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In October 2007, for expansion into non-United States regions, another SBU i.e. International was created in India and a General Manager was appointed. This was done in order to reduce Infogain Group's dependence on United States which was experiencing a slow done. This led to a marketing department being instituted in India. The marketing department was responsible to perform marketing and selling activities to target customers/clients in regions where Infogain US/Infogain UK are not operating.

Infogain India also performs the marketing fuctions which include the following activities:

- *Infogain India receives markeing leads through its website, which is operated, maintained and updated from India. Leads in relation to regions where its AEs operate are forwarded to respective AEs, while those from rest of the world are handled and harnessed by Infogain India;*

- *Infogain India also engages in outreach campaigns which are carried out from India. These campaigns include advertising through newsletters, information collection on potential clients and through e-mails and tele-marketing; and*

- *Infogain India also conducts and participates in seminars, exhibitions and conferences by various IT associations, etc. to increase its visibility and market presence.*

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However, the aforesaid marketing functions performed by Infogain India are ancillary to the marketing functions performed by Infogain US. Additionally, Infogain India also provides support in marketing and advertising initiatives (such as, preparation of forecast, etc.) also to a limited extent.

Customer Service and Warranty Functions

With Infogain India being responsible for the delivery of software services it is also responsible for provision of any after sales support and technical support required by the customers in respect to these services.

General management functions

The functions listed below are common functions that are carried out by any business irrespective of their size and type:

- ***Human Resource Management Function***

The management of both Infogain India and Infogain US are responsible for coordinating their human resource functions including hiring personnel, determining compensation and benefits and formulating human resource policies wherein it even decides the increments and promotions based on revenue targets, business growth and delivery excellence in accordance with the Infogain Group's policy.

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- ***Corporate strategy determination***

  All long term strategic policies in respect of the Infogain Group are developed and formulated by Infogain US and Infogain India.

- ***Finance and Accounting Function***

  Infogain India and Infogain US are responsible for managing their finance, treasury and accounting functions.

- ***Legal and Administrative Function***

  Infogain India and Infogain US are responsible for ensuring compliance with the local statutory requirements and performing their administrative function.

- ***Information Technology Function***

  With the establishment of Chief Technology Officer (CTO) in Infogain India, Infogain India became responsible for performing the following information technology functions:

- *Preparation of technology roadmap – it has to assess future technology trends and provide directions to realize the best return on investments, create the technology strategy roadmaps, evaluate and promote tools, technology for internal usage;*

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- *Launching of the knowledge management portal and head the steering committee;*

- *Assist the development teams in architecture design, frameworks and evaluate current architecture of specific projects, execute gap analysis and suggest improvement, develop new framework based solutions, such as, performance and scalability framework for marine terminal systems, develop, formalize, packaging and adoption of best practices, such as, assessment offerings, managed services offerings; and*

- *Implement center of excellence laboratories in each verticals, publish technology white-papers, review technical design in bids/proposals, etc.*

The following table depicts the split in the functional responsibilities of Infogain and its AEs:

Table 5: Functional Responsibilities of Infogain and its AEs

Functions Performed	*Entity*
Identifying Clients/Maintaining client relationship/Client contracts Function	
• *Identification of clients* •*Contract formulation, negotiation, commitment*	*Infogain US/Infogain India (to limited extent)*
• *Lead Generation, Soliciting orders and initiating sales*	*Infogain US/Infogain India (leads generated by a website that is operated and maintained by Infogain India are passed to Infogain US)*
• *Client relationship management*	*Infogain US*
• *Formulating sales strategy*	*Infogain US*
• *Engagement management*	*Infogain US/Infogain India (to*

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	limited extent)
Project Management including Defining of Functional Specifications Functions	
• Overall project management	*Infogain India, as PDs are now based out of India. (Although Infogain US is responsible for onsite project management, the onsite engineers work under the direction of the PDs in India)*
• Conceptualization, Requirement analysis and Scoping	*Infogain India/Infogain US (However, the delivery team at Infogain US work under the direction of the PDs located at Infogain India.)*
• System requirement/architecture requirement design	*Infogain India/AEs*
Coding, Testing and Documentation Function	
• Undertakes code generation	*Infogain India/Infogain US*
• Testing of the software	*Infogain India/Infogain US*
• Make available the documentation for the software developed	*Infogain US*
• Monitoring the quality of project work in accordance with the standards and specifications	*Infogain India/Infogain US*
Human Resource Management Function	
• Formulating human resource polices	*Infogain India/Infogain US*
Others	
• Capacity Utilization, Labour Arbitrage, Funds Acquisition and Forex Management	*Infogain India/Infogain US*

15. As regards to the pricing decision, the ld. Counsel for the assessee submitted that in the pre-restructuring phase, Infogain US was solely responsible for determining the key terms and conditions of the contract with the customers, including pricing. However, with the introduction of an online costing tool in August 2006, Infogain India also began to provide important inputs in

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the entire pricing decision based on project costing estimates, resource requirements, time commitments etc. as the entire delivery responsibility had migrated to Infogain India. It was further stated that the Price Decisions based out of Infogain India are responsible to feed in information on individual projects in the online tool and thus the pricing decision is taken jointly out of Infogain India and Infogain US. However, the ultimate decision for closing sales deal is taken by the CSO (Sales) and CEO based out of United States. It was emphasized that during the preceding assessment year 2007-08 no joint discussion with Infogain India was held in relation to price decision but the same was changed in the assessment year under consideration, in view of shift in functional matrix.

16. The ld. Counsel for the assessee explained that the Profit Split Method (PSM) is normally used in multiple international transactions, which are so closely interrelated that they cannot be evaluated separately for determining the Armøs length price or in situations involving transfer of unique intangibles. The ld. Counsel for the assessee further explained that based on the

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functions, asset and risk analysis (õFAR analysisö), as detailed in Chapter 3 of the documentation, it was determined that Infogain India is responsible for the significant delivery functions while Infogain US is responsible for the marketing, client identification and customer relationship management functions. It was pointed out that the functional analysis revealed that the activities performed by Infogain India and Infogain US are inextricably linkage and collaborative functions performed by Infogain India and Infogain US. Therefore, the Profit Split Method (PSM) has been selected as most appropriate method for the determination of Armøs length price in respect of International transactions between Infogain India and Infogain US. It was further stated that none of the direct methods (CUP, RPM and CPLM) can be applied to establish Armøs length value of the assesseeøs international transactions due to paucity of comparables. It was stated that the Rules provide that, under the TNMM, the net profit margin realized by the enterprise from a comparable uncontrolled transaction is taken into account to arrive at an Armøs length in relation to the international transaction. However, from the functional analysis of the assessee, it is clear that the operations of Infogain India and Infogain US are inextricably linked, involving fungibility of human resources,

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making it difficult to evaluate either entity separately as both the entities were vested with critical functions and risks for providing software services to the end-customers. Therefore, the TNMM method was not considered as most appropriate method for determining the Armøs length basis. It was further stated that based on interviews with the key management personnel of Infogain India and Infogain US, the functions in the value chain of software services provided by Infogain US, customers based in the US and weights were assigned to the functions having regard to their relative importance in the value chain and subsequently functions were allocated between Infogain India and Infogain US based on discussions with key personnel and details provided by Infogain India/Infogain US and thereafter the split ratio of 40:60 in between Infogain India and Infogain US is worked out. It was submitted that the methodology adopted by the assessee is supported by the OECD 2010 guidelines and accordingly the assessee had chosen the PSM as the most appropriate method. The ld. Counsel for the assessee referred to page no. 229 of the assesseeøs paper book which is the copy of FAR analysis done by the assessee, a reference was also made to page no. 213 of the assesseeøs paper book and it was stated that functions were clearly designed which clearly shows that Infogain India and Infogain US, both were making the contribution. Therefore, TNMM was not the correct

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method and the PSM method adopted by the assessee is most appropriate method. It was pointed out that in the assessment year 2011-12 also the Profit Split Method has been accepted while framing the assessment u/s 92CA(3) of the Act vide order dated 16.12.2014 (copy of the said order was furnished, which is placed on record). It was stated that the assesseeøs case is also covered by the decision of the ITAT Delhi Bench ÷Iø, New Delhi in the case of Global One India Pvt. Ltd. Vs ACIT in ITA No. 5571/Del/2011 for the assessment year 2007-08 order dated 15.04.2014. It was further stated that the said order was also followed in the case of M/s Orange Business Services India Networks Pvt. Ltd. Vs DCIT in ITA No. 1201/Del/2015 for the assessment year 2010-11 order dated 08.05.2015. The ld. Counsel for the assessee stated that the assesseeøs case falls in category 1 mentioned in Circular No. 6/2013 dated 29.06.2013 issued by the Income Tax Department. Therefore, the TNMM method adopted by the TPO/AO was not the correct method and the PSM adopted by the assessee was the most appropriate method. The reliance was placed on the decision of the ITAT Delhi Bench ÷Gø, New Delhi in the case of ITO, Ward 7(1), New Delhi Vs Net Freight (India) P. Ltd., New Delhi in ITA No. 4670/Del/2009 for the assessment year 2004-05, order dated 31.12.2013.

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17. In his rival submissions the ld. DR strongly supported the order of the TPO/AO and further submitted that each assessment year is an independent, therefore, the findings given in the assessment year referred by the ld. Counsel for the assessee i.e. assessment year 2011-12 are not conclusive for the assessment year under consideration i.e. assessment year 2008-09. It was further submitted that in the assesseeøs case there was no international transaction, therefore, the PSM was not the most appropriate method. It was stated that for applying the PSM, risks is to be quantified in scientific manner on creditable objectives information which had not been done in the present case. It was further stated that in assesseeøs case no external data was available for uncontrolled transaction to substantiate the relative contribution by each entity, therefore, the split was not evenly placed. It was further stated that few of the functions were not listed and that the commitments, contract formation, engagement management function were not mentioned. It was also stated that there was no sales strategy for soliciting the orders and there was only subjective estimation without any objective data and there was no basis for giving the weightage. It was further stated that Circular No. 6 issued by the CBDT has no relevancy for the functional profile of developer in R&D sector. Therefore, the PSM was not applicable in assesseeøs case and the TPO/AO rightly applied the TNMM

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method as most appropriate method. The reliance was placed on the following case laws:

- *Haworth (India) (P) Ltd. Vs DCIT(OSD) (2011) 131 ITD 215 (Del)*
- *Sony India (P) Ltd. Vs DCIT (2008) 114 ITD 448 (Del)*

18. It was further submitted that while applying the PSM the assessee has not given any objective way of weightage, there was only subjective estimation without any objective data, therefore the profit split method simply fails and TNMM was rightly applied by the AO.

19. In his rejoinder of the ld. Counsel for the assessee submitted that the applicability of the method is based on interrelated transactions. He referred to page no. 243 of the assesseeøs paper book and submitted that the grouping of function has been done and weight has been assigned to each function for which neither the TPO nor the DRP raised any objection. It was further stated that in the succeeding assessment year 2009-10, no such adjustment has been made by the department, even when the facts in the said year were similar as were involved in the year under consideration. It was submitted that even on the principle of consistency, the department ought to have accepted the PSM method adopted by the assessee. Reliance was placed on the following case laws:

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- *CIT Vs Neo Poly Pack (P) Ltd. (2000) 245 ITR 492 (Del)*
- *RADHASOAMI SATSANG Vs CIT (1992) 193 ITR 321 (SC)*
- *Azitech Software and Technology Ltd. Vs ACIT 107 ITD 147*

20. We have considered the submissions of both the parties and carefully gone through the material available on the record. In the present case, the controversy revolves around the most appropriate method, the claim of the assessee is that the Profit Split Method (PSM) is the most appropriate method while the AO is of the view that the TNMM is the most appropriate method, while working out the Armøs length value in respect of international transactions between Infogain India i.e. assessee and Infogain US i.e. parent company. Rule 10B(1)(d) of the Income Tax Rules, 1962, defines the Profit Split Method as follows:

> *"Profit Split Method, which may be applicable mainly in international transactions involving transfer of unique intangibles or in multiple international transactions which are so inter related that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction, by which-*
>
> *(i) The combined net profit of the associated enterprises arising from the international transaction in which they are engaged, is determined;*

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(ii) The relative contribution made by each of the associated enterprise to the earnings of such combined net profit, is then evaluated on the basis of the functions performed, assets employed or to be employed and risks assumed by each enterprise and on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances;

(iii) The combined net profit is then split amongst the enterprises in proportion of their relative contributions, as evaluated under sub clause (ii);

(iv) The profit thus apportioned to the assessee is taken into account to arrive at an arm's length price in relation to the international transaction;

Provided that the combined net profit referred to in sub-clause (i) may, in the first instance, be partially allocated to each enterprise so as to provide it with a basic return appropriate for the type of international transaction in which it is engaged, with reference to market returns achieved for similar types of transactions by independent enterprise and thereafter, the residual net profit remaining after such allocation may be split amongst the enterprise in proportion to their relative contribution in the manner specified under sub clauses (ii) and (iii), and in such a case the aggregate of the net profit allocated to the enterprise in the first instance together with the residual net profit apportioned to that enterprise on the basis of its relative contribution shall be taken to be the net profit arising to that enterprise from the international transaction;

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21. From the provisions contained in the above said Rule 10B(1)(d), it is clear that õPSMö may be applicable in case where transaction involved transfer of unique, intangibles or any multiple transactions interrelated international transactions which cannot be evaluated separately for determining the Armøs Length Price of anyone transaction. The Profit Split Method (PSM) first identifies the profit to be split for the associated enterprise from the controlled transactions in which the AEs are engaged. It then splits these profits between the AEs on an economically valid basis that approximates the division of the profit that would have been anticipated and reflected in an agreement, transaction or a residual profit intended to represent the profit that cannot readily be assigned to one of the parties. The contribution of each enterprise is based upon a functional analysis and valued to the extent possible by any available reliable standard market data. The functional analysis is an analysis of the functions performed (taking into account assets used and risk assumed) by each enterprise.

22. Before us there are two methods for consideration i.e. PSM and TNMM. A perusal of the function of the assessee company reveals that the international transactions are highly integrated and interrelated. The ITAT Special Bench in the case of Aztech Software and Technology Ltd. Vs ACIT reported at 107 ITD 147

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discussed the various methods of determination of ALP as well as the OECD in Transfer Pricing Guidelines for multinational enterprise. The Coordinate Bench in the case of Global One India Pvt. Ltd. Vs ACIT in ITA No. 5571/Del/2011 for the assessment year 2007-08 after taking note of the decision of the Special Bench in the case of Aztech Software and Technology Ltd. Vs ACIT (supra), OECD in transfer pricing guidelines for multinational enterprise and tax administration, the United Nations-Practical manual on Transfer Pricing for developing countries and then after deliberating on the methodology and precedence available thereon arrived at a conclusion in para 17.3 to 18.2 of the order dated 15.04.2014 as under:

"17.3. Before us there are two methods for consideration, i.e. PSM and TNMM. The Special Bench of the Tribunal, in the case of Aztech Software and Technologies Services Ltd. vs. ACIT, reported in 107 ITD, at page , states as follows:

"Profit Split Method (PSM)

Rule 10B (1) (d) prescribes PSM as follows:

(i) The combined net profit of the associated enterprises arising from the international transaction in which they are engaged, is determined;

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(ii) The relative contribution made by each of the associated enterprises to the earning of such combines net profit, is then evaluated on the basis of the functions performed, assets employed or to be employed and risks assumed by each enterprise and on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprises performing comparable functions in the similar circumstances;
(iii) the combined net profit is then split amongst the enterprises in proportion to their relative contributions, as evaluated under sub clause(ii);

(iv) the profit thus apportioned to the assessee is taken into account to arrive at an arm's length price in relation to the international transaction;

181. This method may be applicable in case where transactions involved transfer of unique, intangible or any multiple interrelated international transactions, which cannot be evaluated separately for determining the ALP of any one transaction.

182. The profit split method first identifies the profit to be split for the associated enterprise from the controlled transactions in which the associated enterprises are engaged. It then splits those profits between the associated enterprises on an economically valid basis that approximates the divisions of profits that would have been anticipated and reflected in an agreement transactions or a residual profit intended to represent the profit that cannot readily be assigned to one of the parties, such as the profit arising from high value, sometimes unique, intangibles.

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183. The contribution of each enterprise is based upon a functional analysis and valued to the extent possible by any available reliable external market data. The functional analysis is an analysis of the functions performed (taking into account assets used and risks assumed) by each enterprise. The external market criteria may include, for example, profit split percentages or returns observed among independent enterprises with comparable functions."

17.4. The OECD transfer pricing guideline for multinational enterprises and tax administration in Chapter 2 on transfer pricing methods, at page 93, para C.1 states as follows:

"C.1 In general

2.108 The transactional profit split method seeks to eliminate the effect on profits of special conditions made or imposed in a controlled transaction (or in controlled transactions that are appropriate to aggregate under the principles of paragraphs 3.9-3.12) by determining the division of profits that independent enterprises would have expected to realize from engaging in the transaction or transactions. The transactional profit split method first identifies the profits to be split for the associated enterprises from the controlled transactions in which the associated enterprises are engaged (the "combined profits"). References to "profits" should be taken as applying equally to losses. See paragraphs 2.124-2.131 for a discussion of how to measure the profits to be split. It then splits those

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combined profits between the associated enterprises on an economically valid basis that approximates the division of profits that would have been anticipated and reflected in an agreement made at arm's length. See paragraphs 2.132-2.145 for a discussion of how to split the combined profits."

17.5. On residual analysis, it is stated as follows:

"C.3.2.2 Residual analysis

2.121 A residual analysis divides the combined profits from the controlled transactions under examination in two stages. In the first stage, each participant is allocated an arm's length remuneration for its non-unique contributions in relation to the controlled transactions in which it is engaged. Ordinarily this initial remuneration would be determined by applying one of the traditional transaction methods or a transactional net margin method, by reference to the remuneration of comparable transactions between independent enterprises. Thus, it would generally not account for the return that would be generated by any unique and valuable contribution by the participants. In the second stage, any residual profit (or loss) remaining after the first stage division would be allocated among the parties based on an analysis of the facts and circumstances, following the guidance as described at paragraphs 2.132- 2.145 for splitting the combined profits.

2.122 An alternative approach to how to apply a residual analysis could seek to replicate the outcome of bargaining between independent enterprises in the

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free market. In this context, in the first stage, the initial remuneration provided to each participant would correspond to the lowest price an independent seller reasonably would accept in the circumstances and the highest price that the buyer would be reasonably willing to pay. Any discrepancy between these two figures could result in the residual profit over which independent enterprises would bargain. In the second stage, the residual analysis therefore could divide this pool of profit based on an analysis of any factors relevant to the associated enterprises that would indicate how independent enterprises might have split the difference between the seller's minimum price and the buyer's maximum price.

2.123 In some cases an analysis could be performed, perhaps as part of a residual profit split or as a method of splitting profits in its own right, by taking into account the discounted cash flow to the parties to the controlled transactions over the anticipated life of the business. One of the situation in which this may be an effective method could be where a start-up is involved, cash flow projections were carried out as part of assessing the viability of the project, and capital investment and sales could be estimated with a reasonable degree of certainty. However, the reliability of such an approach will depend on the use of an appropriate discount rate, which should be based on market benchmarks. In this regard, it should be noted that industry wide risk premiums used to calculate the discount do not distinguish between particular companies let alone segments of business, and estimates of the relative timing of receipts can be problematic. Such an approach, therefore, would

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require considerable caution and should be supplemented where possible by information derived from other methods."

17.6. The United Nations – Practical Manual on Transfer Pricing for Developing Countries – Chapter VI – Transfer Pricing Methods, states as follows:
"6.3.13.1. The Profit Split Method is typically applied when both sides of the controlled transaction contributes significant intangible property. The profit is to be divided such as is expected in a joint venture relationship.

6.3.13.2. The Profit Split Method seeks to eliminate the effect on profits of special conditions made or imposed in a controlled transaction(or in controlled transactions that it is appropriate to aggregate) by determining the division of profits that independent enterprises would have expected to realize from engaging in the transaction or transactions. Figure 5 illustrate this.

6.3.13.3 The Profit Split Method starts by identifying the profits to be divided between the associated enterprises from the controlled transactions. Subsequently, these profits are divided between the associated enterprises based on the relative value of each enterprise's contribution, which should reflect the functions performed, risks incurred and assets used by each enterprise in the controlled transactions. External market date (e.g. profit split percentages among independent enterprises performing comparable functions) should be used to value each enterprise's contribution, if possible, so that the division of combined profits between the associated enterprises is in accordance with that between independent enterprises performing functions comparable

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to the functions performed by the associated enterprises. The Profit Split Method is applicable to transfer pricing issues involving tangible property, intangible property, trading activities or financial services.

17.7. Residual analysis is stated as follows:

6.314.7 The Residual Profit Split Method is used more in practice than the contribution approach for two reasons. Firstly, the residual approach breaks up a complicated transfer pricing problem into two manageable steps. The first step determines a basic return for routine functions based on comparables. The second step analysis returns to often unique intangible assets based not on comparables but on relative value which is, in many cases, a practical solution. Secondly, potential conflict with the tax authorities is reduced by using the tow step residual approach since it reduces the amount of profit that is to be split in the potentially more controversial second step.

6.3.17.3. In step 1 of the residual analysis, a basic return for the manufacturing function is determined for Company A and Company B. Specially a benchmarking analysis is performed to search for comparable independent manufactures which do not own valuable intangible property. The residual profit, which is the combined profits of company A and company B after deducting the basis (arm's length) return for the manufacturing function, is then divided between Company A and Company B. This allocation is based on relative R & D expense which are assumed to be a reliable key to measure the relative value of each company's intangible property. Subsequently, the net profits of Company A and

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Company B are calculated in order to work back to a transfer price."

17.8. In "Practical Guide to U.S. Transfer Pricing by Robert T Cole, Chapter 10, PSM authored by Arlow N. Higinbotham, pg nos.10-52, it is stated as follows:

"Thus, to summarize, RPSM provides a test of arm's length transfer pricing between value- added stages of an integrated enterprise that is consistent with the separate enterprise standard under conditions of resource mobility and competitive capital and product markets. By valuing functional activities and capital in terms of the competitive norms of the market place, RPSM attributes extra- normal profit or loss in proportion to the relative investment cost (or other valuation) of the non-routine intangible assets to which such extraordinary profits pertains. This approach is consistent with the IRS statutory objective u/s 482 of requiring consideration for intangible property transferred in a controlled transaction to be commensurate with the income attributable to the intangible. It is also consistent with the result that would obtain at arm's length under a hypothetical joint venture agreement between the different parties contributing their respective investments of functional and entrepreneurial capital."

17.9. Residual Profit Split Method is stated as follows:

10.04 Residual Profit Split Method

As illustrated in Figure 10-2, RPSM proceeds in two steps:

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Step 1: Functional capital is provided a return derived from data for functional comparables, i.e. independent companies performing similar routine manufacturing or distribution functions; and

Step 2:The remaining "residual" operating profit or loss is allocated based on residual, "entrepreneurial" capital so as to equalize the rate of return on such capital, adjusted for market differences in the cost of capital.

In actual practice, implementation of the RPSM concept outlined above involves the determination of a number of interrelated valuations of functional and entrepreneurial activities in different countries and economic circumstances. The existing IRS regulations provide relatively little specific guidance concerning these valuations, and thus leave open the question of how best to determine the "relative value of each controlled taxpayer's contribution to the success of the relevant business activity in a manner that reflects the functions performed, risks assumed, and resources employed by each participant in the relevant business activity, consistent with the comparability provisions of 1.482- 1(d) (3)".

18. We now consider TNMM. In Aztek Software and Technology Services (supra) the TNMM is stated as follows:

"Transactional Net Margin Method (TNMM) :

Rule 10(B)(1)(e) describes TNMM as under:

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(i) The net profit margin realized by the enterprise from an international transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;

(ii) The net profit margin realized by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;

(iii)The net profit margin referred to in sub clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;

(iv)The net profit margin realized by the enterprise and referred to in sub clause (i) is established to be the same as the net profit margin referred to in sub clause (iii);

(v) The net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction.

The TNMM requires establishing comparability at a broad functional level. It requires comparison between net margins derived from the operation of the uncontrolled parties and net margin derived by an AE on similar operation.

Under this method, the net profit margin realized by an AE from an international transaction is computed in relation to a particular factor such as costs incurred,

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sales, assets utilized etc. The net profit margin realized by an AE is compared with net profit margin of the uncontrolled transactions to arrive at the ALP. The TNMM is similar to RPM and CPM to the extent that it involves comparison of margin earned in a controlled situation with margins earned from comparable uncontrolled situation. The only difference is that, in the RPM and CPM methods, comparison is of margins of gross profits and whereas in TNMM the comparison is on margins of net profit.

TNMM requires comparison between net margins derived from the operations of the uncontrolled parties and net margins derived by an AE from similar operations. Net margin is indicated by the rate of return on sales or cost or operating assets, and this forms the basis for TNMM. A functional analysis of the tested party or the independent actions are comparable and the adjustments that are required to be made to obtain reliable results. The tested party would have to consider other factors, like cost of assets of comparable companies, etc. while applying the return on assets measure. Ordinarily, the tested party, has to be the party provided services because it is on the basis of rate of return on sales or cost or operating assets that transactional margin is computed. These parameters generally available in the case of party providing service.

18.1. The, in its review of comparability and methods, dt. 22nd July,2010 in Part III B Transactional Net Margin Method, B I, page 33, paras 2.58 to 2.59, held as under:

"B. Transactional net margin method

B.1. In general

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2.58 The transactional net margin method examines the net profit relative to an appropriate base (e.g. costs, sales, assets) that a taxpayer realizes from a controlled transaction (or transactions that are appropriate to aggregate under the principles of paragraphs 3.9 – 3.12). Thus, a transactional net margin method operates in a manner similar to the cost plus and resale price methods. This similarity means that in order to be applied reliably, the transactional net margin method must be applied in a manner consistent with the manner in which the resale price or cost plus method is applied. This means in particular that the net profit indicator of the tax payer from the controlled transaction (or transactions that are appropriate to aggregate under the principles of paragraphs 3.9-3.12) should ideally be established by reference to the net profit indicator that the same tax payer earns in comparable uncontrolled transactions, i.e. by reference to "internal comparables" (see paragraphs 3.27- 3.35). A functional analysis of the controlled and uncontrolled transactions is required to determine whether the transactions are comparable and what adjustments may be necessary to obtain reliable results. Further, the other requirements for comparability, and in particular those of paragraphs 2.69-2.75, must be applied.

2.59. A transactional net margin method is unlikely to be reliable if each party to a transaction makes valuable, unique contributions, see paragraph 2.4. In such a case, a transactional profit split method will generally be the most appropriate method, see paragraph 2.109. However, a one-sided method (traditional transaction method or transactional net margin method) may be applicable in cases where one of the parties makes all the unique contributions involved in the controlled transaction, while

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the other party does not make any unique contribution. In such a case, the tested party should be the less complex one. See paragraphs 3.18-3.19 for a discussion of the notion of tested party."

18.2. In the working draft of a chapter of the practical Manual in Transfer Pricing for Developing Countries, in Chapter 5 Transfer Net Margin Method is discussed at para2.1.

"Transactional Net Margin method

2.1. Definition and choice of tested party

The transactional net margin method ('TNMM') is a profit based method that can be used to apply the arm's length principle. The TNMM can be applied on either the related party manufacturer or the related party distributor as the tested party for transfer pricing purposes.

The TNMM examines the net profit margin relative to an appropriate base (e.g. costs, sales, assets) that a tax payer realizes from a controlled transaction (or transactions that are appropriate to be aggregated). The profit margin indicators are discussed in paragraph 2.3 below.

The TNMM compares the net profit margin (relative to an appropriate base) that the tested party earns in the controlled transactions to the same net profit margins earned by the tested party in comparable uncontrolled transactions or alternatively, by independent comparable companies. As such, the TNMM is a more indirect method than the cost plus/resale price method that compares gross margins. It is also a much more indirect method than the CUP method that compares prices, because it uses net profit margins to determine (arm's length) prices. One

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should bear in mind that many factors may affect net profit margins, but may have nothing to do with transfer pricing.

The TNMM is used to analyse transfer pricing issues involving tangible property, intangible property or services. When the TNMM is applied on controlled transactions involving tangible property, the tested party in the analysis can either be the related party manufacturer or the related party distributor. The choice of the tested party depends on the availability of comparable data. This usually implies that the TNMM is applied to the least complex of the related parties involved in the controlled transaction, because generally more comparable data will then be in existence and fewer adjustments will be required to account for differences in functions and risks between the controlled and uncontrolled transactions. In addition, the tested party should not own valuable intangible property. This, by the way, is also the reason why it is recommended to select the least complex entity for the application of the cost plus method or resale price method."

23. Now by keeping in view the findings given by the Co-ordinate Bench in the aforesaid referred to case of Global One India P. Ltd. Vs ACIT, 12(1) in ITA Nos. 5571/Del/2011 and 5896/Del/2012 order dated 15.04.2014. In the present case, we have to see as to whether the PSM is the appropriate method as adopted by the assessee or TNMM method as adopted by the AO. In the present case, the different activities performed by the Infogain India i.e.

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assessee and Infogain US are inextricably linked and both the entities are contributing significantly to the value chain of provision of software services to the end customers. In the instant case Global Delivery Organization Group (GDO) in India is responsible for delivery of services to the customers globally. The primary objective of the group is to bring synergies amongst geographic groups and project, to make efficient use of the available resources, to broaden areas of service offerings, to improve opportunity fulfillment ration, and to maximize customer satisfaction with each project execution. However, the TPO had not considered the role of the GDO. In the present case, the TPO mentioned that the shifts in the assesseeøs case started from 2005 onwards, however, the assessee chose to change the method in the financial year under consideration, the explanation of the assessee was that though the transition process started from September 2005 which was very gradual and led to the complete shift in the functional matrix of Infogain Group over a period of 2-3 years, therefore, the pricing model was changed w.e.f April 2007, the said explanation appears to be a plausible. In the instant case, the assessee assigned weights to each activity

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keeping in view the relative importance in the entire value chain, based on interviews with the key management personnel and the functions in the value chain of software services provided by the Infogain Group to the customers based in the US were identified and weights were assigned to the functions having regard to their relative importance in the value chain, which is evident from page nos. 229 to 234 of the assesseeøs paper book wherein the functions are clearly designed in a tabular form. In the present case, both the parties i.e. Infogain India (assessee) and Infogain US are making contribution. Therefore, the Profit Split Method is the most appropriate method for determination of ALP. In the instant case, it is noticed that the TPO in the show cause notice has pointed out that the assessee changed the method due to loss incurred, in our opinion, the conclusion drawn by the TPO was not justified because the decision as what is the most appropriate method does not depend on the fact as to whether an assessee is having loss or has a profit. Moreover, the TPO has not demonstrated or substantiated how the change in method was dependent upon the loss incurred. Therefore, we are of the view that the conclusion of the TPO that the PSM is adopted by the assessee only to camouflage loss at

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the net level is merely an allegation and hence devoid of merit. In the present case, the assessee adopted Profit Split Method, for application of the said method, the provisions are contained in Rule 10B(1)(d) of the Income Tax Rules, 1962. According to the said provisions the Profit Split Method is applicable mainly in international transactions which are so interrelated that they cannot be evaluated separately, for the purpose of determining the armsø length price. The combined net profit is then split amongst the enterprises in proportion to relative contribution as evaluated on the basis of the functions performed, assets employed or to be employed and risks assumed by each enterprise and on the basis of reliable external market data which indicated how such contribution would be evaluated by unrelated enterprise performing comparable functions in similar circumstances. In the present case, Infogain India i.e the assessee is responsible for the significant delivery functions while Infogain US is responsible for the marketing client identification and customers relation management functions. However, the activities performed by the Infogain India and Infogain US are inextricably linked with both entities contributing significantly to the

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value chain of provision of software services to the end customers.

24. Therefore, by keeping in view the aforesaid discussion and considering the totality of the facts we are of the view that Profit Split Method was rightly applied by the assessee for determining the armøs length price. Moreover, in the instant case, it is an admitted fact that in the preceding years as well as in the succeeding year i.e. assessment year 2011-12, the same method i.e. Profit Split Method has been accepted by the department. Therefore, we are of the view that the TPO/AO was not justified in applying the TNMM method instead of Profit Split Method adopted by the assessee. For the aforesaid view we are fortified by the following decisions of the Coordinate Bench:

- *Global One India P. Ltd. Vs ACIT in ITA No. 5571/Del/2011 order dated 15.04.2014*
- *M/s Orange Business Services India Networks Pvt. Ltd. Vs DCIT in ITA No. 1201/Del/2015 order dated 08.05.2015*
- *ITO Vs Net Freight (India) P. Ltd. in ITA No. 4670/Del/2009 order dated 31.12.2013*

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25. In the former part of this order, we have held that in the assesseeøs case to determine the Armøs Length Price, the most appropriate method is the Profit Split Method, now question arises that how the allocation is to be done for residuary profits. It is well settled that as per the Rule 10D, the benchmarking should be done with the external uncontrolled transactions, however, in the present case, it is not possible to get a comparable. Therefore, such allocation can be done on the basis that how much each independent enterprise might have contributed. Therefore, relative contribution has to be determined, based on key value drivers because benchmarking is not practicable. In the present case, as the comparables having similar transactions would be difficult to find out, therefore, in such a situation, a harmonious interpretation of the provisions is required to make the rule workable, so as to achieve the desired result of the determination of the ALP. Both the OECD Transfer Pricing Guidelines as well as the UN draft method of transfer pricing for developing countries, suggest that an allocation of residual profits under PSM should be done, based on contributions by each entity. In the present case, since the department has accepted in the preceding year and the succeeding year

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40:60 ratio between the Infogain India and Infogain US and if the facts are similar for the year under consideration then no deviation is to be done. We, therefore, set aside the issue to file of the AO/TPO to decide the issue following the clear directions given in former part of this order as well as by the Coordinate Bench in the aforesaid referred to orders and after providing due and reasonable opportunity of being heard to the assessee. Accordingly, Ground No. 1.1 to 1.5 are allowed for statistical purposes, others grounds are of academic interest.

26. In the result, appeal of the assessee is allowed for statistical purposes.

(Order Pronounced in the Court on 19/08/2015).

Sd/-
(I. C. Sudhir)
JUDICIAL MEMBER

Sd/-
(N. K. Saini)
ACCOUNTANT MEMBER

Dated: 19/08/2015
Subodh
Copy forwarded to:
1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

ASSISTANT REGISTRAR

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