

IN THE INCOME TAX APPELLATE TRIBUNAL, MUMBAI BENCH "C", MUMBAI

BEFORE SHRI N.V.VASUDEVAN(J.M) & SHRI N.K. BILLAIYA(A.M)

ITA NO. 7901/MUM/2011(A.Y.2007-08)

Carlyle India Advisors Private  
Limited, 1<sup>st</sup> Floor, Quadrant "A",  
The IL & FS Centre,  
Plot C-22, "G" Block,  
Bandra- Kurla Complex,  
Bandra (East), Mumbai – 400 051  
PAN: AABCC 4522F  
(Appellant)

The ACIT 10(1),  
Mumbai.  
Vs.  
(Respondent)

Appellant by : S/Shri Porus F.Kaka,  
Vishal Kalra & Mukesh Butani  
Respondent by : Shri Ajit Kumar Jain  
Date of hearing : 28/03/2012  
Date of pronouncement : 04/04/2012

ORDER

PER N.V.VASUDEVAN, J.M,

This is an appeal by the assessee against the order dated 28/10/2011 passed by the ACIT -10(1), Mumbai under section 143(3) of the Act r.w.s. 144C of the Income Tax Act, 1961(the Act). The grounds of appeal raised by the assessee read as follows:

"1.That the Assessing Officer ('AO') erred on facts and circumstances of the case and in law in assessing the income of the Appellant under the normal provisions of the Income Tax Act, 1961 (the Act) at Rs. 17,52,18,050 against returned income of Rs 3,80,76,259 based on the directions received from Hon'ble Dispute Resolution Panel ("DRP") upholding the adjustment to the transfer price proposed by the learned Transfer Pricing Officer ("TPO").

2. That the Ld AO/TPO erred on facts and circumstances of the case and in law in proposing and the Hon'ble DRP further erred in upholding an addition of Rs 13,71,41,793 in respect of the international transactions

relating to investment advisory support services alleging the same to be not at arm's length in terms of the provisions of Sections 92C(1) and 92C(2) of the Act read with Rule 1OD of the Income-tax Rules, 1962 ("the Rules").

2.1 That the Ld AO erred on facts and circumstances of the case and in law, in not accepting the arm's length price determined by the Appellant, and in choosing to determine the arm's length price by making reference to the TPO even though none of the conditions laid down under section 92C(3) of the Act, were satisfied.

2.2 That the Ld AO/ TPO/ DRP erred on facts and circumstances of the case and in law in rejecting the Transfer Pricing documentation submitted by the Appellant and in not appreciating that the arm's length price of the international transactions in relation to investment advisory support services was appropriately determined in the Transfer Pricing documentation applying Transactional Net Margin Method ("TNMM").

2.3 That the Ld AO/TPO/DRP erred on facts and circumstances of the case and in law by not appreciating the business model of the appellant and by comparing the activities of the Appellant, which is engaged in provision of 'investment advisory and related support service' to the activities undertaken by investment and merchant banks.

3. That the Ld AO/TPO/DRP erred facts and circumstances of the case and in law by not taking cognizance of the business model, functional and risk of the Appellant as outlined in the Transfer Pricing documentation and as submitted during the course of the proceedings.

3.1 That the Ld AO/TPO/DRP erred on facts and circumstances of the case and in law by rejecting the search process carried out by the Appellant, without giving adequate reasons for the rejection and further choosing comparable companies which were functionally or otherwise not comparable to the Appellant.

4. That the Ld AOITPO erred on facts and circumstances of the case and in law by proposing and the Hon'ble DRP has further erred in upholding / confirming the action the Ld AO/TPO in denying the (+/-) 5% benefit envisaged under proviso to Section 92C(2) of the Act."

2. In so far as ground No.4 is concerned the ld. Counsel for the assessee has submitted before us that the assessee is not pressing for a standard deduction of (+/-) 5% benefit envisaged under proviso to section 92C(2) of the

Act and that the benefit may be extended only to the extent that the difference between price adopted by the assessee and the ALP as determined by the TPO is within 5% range contemplated by the proviso to section 92C(2) of the Act.

3. The assessee is a company. The Carlyle Group ('TCG') was established in 1987 as a private global investment firm that originates, structures and acts as lead equity investor in management-led buyouts, strategic minority equity investments, equity private placements, consolidations and buildups, and growth capital financings. It is primarily engaged in the business of managing investments of High Net Worth Individuals/Institutional Investors (HNIs). It sets up various Funds, which in turn invests in entities across the globe. TCG is a private partnership and is owned by a group of individuals and one institution, California Public Employees Retirement System ('CaIPERS') which owns 5.5% of the Carlyle Group. Further, each of the fund has a General Partner ('GP') (at times a limited partner), which is a Carlye entity. All the decisions with respect to investment by funds are made by GP who operates and manages the funds. GPs obtain advice in relation to their funds and investments from (1) Carlyle Investment Management LLC ('Carlyle US') (2) Carlyle Asia Investment Advisors Limited ('Carlyle Hong Kong') Carlyle Hong Kong was incorporated as a wholly owned subsidiary of Carlyle US in Hong Kong in February 1998. It provides consulting services, including investment advisory, technology support, management consultancy and other advisory services to the GPs with respect to the investments made by the Group in the Asia-Pacific region.

4. The Assessee Carlyle India Advisors Private Limited ('Carlyle India') was incorporated in India in October 2000, and is a subsidiary of Carlyle Hong Kong. Carlyle India provides investment advisory related support services to Carlyle Hong Kong. It houses six investment personnel who analyse investment opportunities in growth capital and buyout deals in India. In this appeal we

are concerned with the determination of Arm's Length Price (ALP) in respect of the international transaction, viz., rendering of investment advisory and related support services by the Assessee to Carlyle Hong Kong, which is admittedly an Associate Enterprise (AE) of the Assessee.

5. Since the assessee entered into an international transaction with associate enterprise the provisions of section 92C of the Act were applicable. The assessee in support of his claim that the remuneration that it received from Carlyle Hongkong for rendering investment advisory and related support services was at ALP, filed a transfer pricing report, in which the Assessee had described the nature of the services rendered by it.

6. As already stated, Carlyle Hong Kong gives investment advisory related support services to the GPs. To primarily identify and evaluate potential investee companies in India, Carlyle Hong Kong engaged the services of the Assessee. Carlyle Hong Kong had entered into a Services Agreement with the Assessee effective from April 1, 2006 read with letter dated April 1, 2006 exchanged between the two ('Services Agreement') for rendering services.

#### Scope of Services

As per the terms of the Advisory Agreement, Assessee inter-alia provides following services ('the said Services') to Carlyle Hong Kong:

- a. Analysis of investments opportunities and the provision of general advice in relation thereto, as per Carlyle Hong Kong's instructions
- b. Analysis of information to Carlyle Hong Kong on the merits, timing, structure, and appropriate terms of any acquisition or disposal of investments and general advice in relation thereto;
- c. Monitoring of all investments by the Funds from time to time under the instructions of Carlyle Hong Kong, and the provisions of reports thereon to Carlyle Hong Kong;

- d. Provision of information in relation to the economic and political developments in India having a bearing on investment opportunities;
- e. To assist Carlyle Hong Kong in identifying external advisors and consultants, to assist them in identifying or investigating any commercial, legal, regulatory or tax matters in relation to a potential investment opportunity or divestment;
- f. Assistance and support in relation to potential investment opportunities and providing related information to Carlyle Hong Kong as required.
- g. Provision of such other support services incidental or related to the foregoing services, as requested by Carlyle Hong Kong from time to time.

Fees:

In consideration for the said support services provided under the Services Agreement. Carlyle Hong Kong compensates the Assessee, a monthly service fee, which is equal to 115% of actual operating expenses (including depreciation on capital assets), incurred by and for the account of Carlyle India in connection with the provision of the said Services”

7. During the previous year the Assessee had prepared research reports in respect of 33 companies whose shares are listed in Stock Exchanges in India. Ultimately TSG made investments only in shares of one company by name Allsec Technoligies. The companies in respect of which the Assessee prepared research report and the research report in respect of Allsec Technologies are given in page 617 to 624 of the Assessee’s paper book. It is not in dispute that the Assessee was paid 115% of the costs it incurred in providing services to Carlyle Hong Kong. The assessee filed Transfer Pricing Study together with information/documents maintained in accordance with Sec.92D(1) of the Income Tax Act, 1961 read with Rule 10D(1) of the Income Tax Rules, 1962. In the Transfer Pricing Study the actual functions performed by it in the matter of rendering investment advisory related support services to Carlyle Hong Kong, assets employed by the assessee and the risks assumed by the assessee while rendering services to its AE have all been set out. The main aspect highlighted by the Assessee was that it is a limited risk investment advisory entity. It has no decision making authority, does not invest its own capital, does not

guarantee performance, is not at risk for non-payment, and functions solely to provide advice to its customer, which itself is an investment advisor. There is no privity of contract between the Assessee and clients of Carlyle Hong Kong.

8. The assessee had chosen the transaction net margin method as most appropriate method for measuring the ALP in support of the investment advisory services rendered to its AE. It is not dispute that the TNMM is the most appropriate method for determination of ALP.

9. The Assessee searched two widely recognized corporate data bases to identify potential uncontrolled comparables in repect of its advisory/research activity in financial services industries viz., Prowess and Capitaline Plus updated as of February, 15<sup>th</sup>, 2007. The manner which the Assessee had carried out search process as explained in its TP Study is as follows:

#### **Summary of Search Process – Prowess**

Criteria and reason for usage	No. of companies passing the criterion
Total universe of companies available in Prowess as of Feb.15,2007	9,801
Companies with positive sales for the time period under consideration were selected	3,988
Companies classified under 'Financial and leasing services' and 'Business Services' alongwith specific sub-classification in Prowess (Refer para 8.2) were selected as to capture all possible comparables within this industry.	655
Selecting companies classified under the sub-industry as mention in para 8.2 above to arrive at a closer set of comparable companies.	641
Services provided by Carlyle India Ltd., being on a cost plus model; companies having fund Based Income / Sales > 25% was rejected.	329
Companies with Trading Sales / Sales and Manufacturing Sales / Sales gtreater than 5% were eliminated.	287
Companies with a positive net worth were included so as to select companies whose net worth had not eroded.	275
Qualitative : Selected companies engaged in advisory / research/consultancy services in the financial services industry	1

**Summary of Search Process – CapitalinePlus**

Criteria and reason for usage	No. of companies passing the criterion
Total universe of companies available in CapitalinePlus as of Feb.15,2007	13,887
Identified additional companies with positive sales over the time period under consideration were selected i.e. companies for which data was not available in Prowess.	763
Selected companies classified in 'Services' Industry	429
Identified financial services companies from the above	221
Services provided by Carlyle India Ltd. being on a cost plus model; companies having Fund Based Income / Sales > 25% was rejected	24
Companies with a positive net worth were included so as to select companies whose net worth had not eroded.	22
Qualitative: Selected companies engaged in advisory / research / consultancy services in the financial services industry.	0

10. In addition to company level financial data, segmental financial data in both databases were also searched. The summary of such search is as follows:

**Summary of Search Process- Capitaline Plus for segmental data**

Criteria and reason for usage	No. of segments passing the criterion in Prowess	No of segments passing the criterion in Capitaline Plus	Total
Total segment in both databases having data for at least two out of the three financial years under consideration	2,894		3,256
Selected those segments (of companies classified under the main heading of 'financial & Leasing Services' and 'Business Services'	433	--	433
Selected segments ( for companies) falling under the broad category of 'Services'	--	147	147
All companies with positive Net Worth i.e. net worth > 0 (zero) were selected. This would remove companies, which have wiped out their capital completely and would find their business operations vulnerable to closure. Such companies would be operating in less than 'standard' economic circumstances	424	136	560
Selected segments engaged in advisory / research / consultancy services in the financial services industry	1	--	1

11. Thus the assessee arrived at the following two comparable companies:

#### Arm's Length Results

S.No.	Name of the Company	Average PLI
1	IDC (India) Ltd.	13.16%
2	Crisil Ltd	16.44%
	Mean	14.80%

12. The above analysis shows that the mean return on total cost of comparable companies is 14.80%. Since, prices of international transactions of Assessee that achieve a return of 15.02%, is more than 14.80%, the Assessee claimed that it meets with the arm's length standard required under the Indian Regulations.

13. The AO referred the case to the TPO for determination of ALP in respect of the international transaction with the AE. By a notice dated 13/11/2009 the TPO called for contemporaneous data relevant for A.Y 2007-08. The assessee's T.P Study was filed alongwith report in Form No.3CEB dated 17/10/2007. In doing T.P Study the data available for the period from April 1<sup>st</sup>, 2004 to Feb. 15<sup>th</sup> 2007 had been used. The TPO was of the view that it was only the data for the previous year relevant to A.Y 2007-08 that ought to be used for comparative analysis.

14. Thereupon the assessee vide its letter dated 1/12/2009 submitted that it had conducted a fresh search for comparable companies on the Prowess, Capitaline Plus and Venture intelligence and that such fresh search conducted by the assessee resulted in 4 comparable companies. Using the data for FY 2006-07, the assessee has calculated the arithmetic mean of the said 4 comparable companies. The combined set of 4 new and one comparable (from earlier documentation) using F.Y.2006-07 data are given below:



Taable : Arithmetic Mean

No.	Company Name	PLI using date for FY 2006-07
1	Axix Consultants Pvt. Ltd.	5.15%
2	Quantum Advisors Pvt. Ltd.	3.26%
3	Crisil Ltd. (Segment - Information)	22.00%
4	Indian Venture Capital Ltd.	5.91%
5	IDC (India) Ltd.	15.94%
	Average	10.45%

The Assessee pointed out that based on the financial statements for the year ended March 31, 2007, the operating margin of the Assessee works out to 15.02% which according to the Assessee was more than the arm's length margin as computed above. Accordingly the Assessee claimed that it complies with the arms length principle required by Indian transfer pricing regulations. The assessee had also take a stand in this letter that the data available at the time of T.P Study by the assessee alone would be relevant. The assessee in this letter also furnished to the TPO the agreement between the assessee and Carrel Asia Advisors Ltd., Hon Kong.

15. In another letter dated 16/4/2010 the assessee also pointed out that it had updated the margins comparables of TP Report (original report in which the Assessee identified two comparables). The arithmetic mean of the said comparable companies using FY 2006-07 data was also given, which was as follows:

Table: Arithmetic Mean

S.No.	Name of the Company	Operating profit/ Operating cost for A.Y 2006-07
1	Crisil Ltd. (Segment information)	22.00%
2	I D C (India) Ltd.	15.94%
	Average	18.97%

16. The Assessee pointed out that based on the financial statement for the year ended March 31, 2007, its operating margin works out to 15.02% as against 18.97% comparable companies. The Assessee pointed out that it has an option as per the proviso to section 92C(2) of the Income-tax Act, 1961 to adopt a price which is within the range of +/- 5% of the comparable companies. Accordingly the price adopted by the Assessee for its international transactions is within the ALP range and gave the following computation in this regard:

Particulars	Amount (Rs.)
Operating Income (A)	239,077,478
Total Cost (B)	207,855,962
Profit before Taxation (A)-(B) = (C)	31,221,516
Operating Profit / Total cost (C) / (B) (%)	15.02%
Arithmetic Mean of comparables (D)	18.97%

**Working of Arm's Length range:**

Particulars	Amount (Rs)
Arms Length price of services (ALP)	247,286,238
Application of the range ALP x 95%	234,921,926

17. The TPO thereafter gave sets of comparable companies which according to the TPO were functionally comparable with that of the international transaction in question. The TPO had used three search criteria to arrive at the list of comparables given by him to the assessee. These were as follows:

**(i) Search -1:** The TPO selected the comparable companies by using the search word asset management/capital management / investment management /fund management / fund managers / investment managers. By doing so ultimately the TPO arrived at a set of 10 comparables.

**(ii) Search -2:** The TPO conducted a search by using the search word services, mutual funds, other financial services, business consultancy services and financial consultancy services. Though the TPO arrived at a set of 124 comparable the TPO did not consider any one of them as comparables.

**(iii) Search-3:** The TPO thereafter by using the search word asset management activities ultimately arrived at a set of five comparables.

18. The summary of the search conducted by the TPO is as follows:

**C- SUMMARY:**

	SEARCH 1	
1.	No. of companies resulted (including assessee company)	18
2	No. of companies eliminated applying the following filters	
	- companies not having any financial data	2
	-fund based income criteria	4
3	Companies rejected in qualitative review (including assessee company)	2
	No. of companies selected in Search 1 (A)	10
	Search 2	
1.	No. of companies resulted (including assessee company)	124
2.	No. of companies eliminated applying the following filters	
	- Companies not having any financial data	6
	-fund based income criteria	57
3.	Companies rejected in qualitative review (including assessee company)	61
	No. of companies selected in Search (B)	NIL
	Search - 3	
1.	No. of companies resulted	6
2	Companies rejected in qualitative review	1

	No. of companies selected in Search 1©	5
	Total No. of companies selected	15

Accordingly the final list of companies that are selected in the above search are as under:

- Search 1	- 10 companies
- Search 2	- Nil companies
- Search 3	- 5 Companies
-----	
Total	15 companies
-----	

19. Thereafter the TPO arrived at arithmetic mean of the margin of these comparable as follows:

**Net Profit Margin for the Assessment year 2007-08 on the contemporaneous data:**

S.No.	Name of the company	2007-08
1.	Canbank Investment Management Services Ltd.	82.26
2.	HDFC Asset Management Company Ltd.	53.73
3.	IL & FS Investment Managers Ltd.	50.45
4.	Jeevan Bima Sahayog Asset Management Co. Ltd.	NA
5.	Kotak Mahindra Asset Management Co. Ltd.	17.53
6.	Principal PNB Asset Management Company Pvt. Ltd.	25.35
7.	Prudential ICICI Asset Management Co. Ltd.	30.36
8.	Reliance Capital Asset Management Ltd.	37.74
9.	SREI Venture Capital Ltd.	79.33
10.	SBI Fund Management Pvt. Ltd.	39.76
11.	Sundaram BNP Asset Mngt. Co. Ltd.	15.91
12.	Tata Asset Management Limited	43.38
13.	Taurus Asset Management Company Ltd.	9.19
14.	Unit Trust of India Investment Advisory Services Ltd.	51.93
15.	UTI Asset Management Company Pvt. Ltd.	57.45
	Arithmetic Mean	42.53
		-----

19. By a letter dated 20/7/2010 the assessee gave its objections to the above comparable arrived at by the TPO pointing out as to how the companies chosen by the TPO were not comparable functionally with that of the assessee. Thereafter by another letter dated 5/10/2010 the assessee gave another submission. After considering the assessee's reply, the TPO by his notice dated 15/10/2010 gave a final 8 list of comparables and proposed to adopt arithmetic mean of the set of comparables to arrive at ALP of the functional transaction in question. The list of companies was as under:

**Segment wise information annual frequency:**

Company Name	Segment Name	Segment Year	OP/OC
Centrum Capital Ltd.	Investment banking	Jun.2006	48%
Edelwiss Capital Ltd.	Agency Business	Ma.2007	106%
Keynote Corporate Services Ltd.	Services	Mar.2007	156%
Khandwala Securities Ltd.	Fee Based Operations	Mar.2007	128%
Sumedha Fiscal Services Ltd.	Consultancy	Mar 2007	36%
			95%

Overall	Annual	
Company Name	Pbt/exp. total	Mar 07
Chartered Capital & Investment Ltd.		84%
L&T Capital Co. Ltd.		85%
SREI Capital Market Ltd.		5%
		58
All Companies		81%

The Assessee was accordingly called upon to show cause as to why arm's length price of the investment advisory services be not determined as per the average operating margin of the above comparable companies. According to the TPO, the PLI ought to be taken on operating profit margin with respect to operating cost. As per the above search conducted by the TPO, the OP/ OC came to 81%.

20. The assessee by letter dated 19/10/2010 gave its objection as to how the companies chosen by the assessee were not comparable.

21. The TPO vide an order dated 29/10/2010 passed under section 92C(a) of the Act however held that the ALP has to be determined by adopting an Arms Length Margin of 81% and accordingly determined the addition on account of adjustment to ALP. The addition to the total income of the assessee on account of adjustment of ALP was follows:

Amount in (Rs.)

Turnover (Service Fees)	(A)	23,90,77,498
Total Cost (TC)	(B)	207,855,962
Operating Profit (OP)	(C)	31,221,516
OP/TC*100		15.02%
Arm's length margin	(D)	81%
Arms Length service fee	(E) + (B)*(D)=(B)	37,62,19,291
5% lower limit of F	(F)	324,510,964
Amount of adjustment	(E) - (A)	13,71,41,793

The assessee has received service fees of Rs. 239,077,4981- from its AE for investment advisory and related support services. The arms length value of these services was calculated at Rs. 37,62,19,2911-. Thus, an adjustment of Rs. 13,71,41,793/- was being made to the income of the assessee.

22. In his order the TPO has observed that the TP study report of the assessee is being rejected for the reasons discussed in para 6D. However, in para 6D of the order of the TPO it is seen that the TPO has not found fault with the two comparables chosen by the assessee in its TP study. Nor the TPO given any reason as to why he considers the comparable instances chosen by the assessee as not comparable functionally with that of the assessee. To this extent the TPO's conclusion that the TP study of the assessee is being rejected has to be considered as a rejection without assigning any reason. The AO passed a draft assessment order dated 28/12/2010 making the addition as

proposed by the TPO in his order. On appeal by the assessee against the said draft assessment order the Dispute Resolution Panel (DRP) confirmed the order of the AO without given any independent reasons after considering the submissions made by the Assessee, which are at pages 738 to 760 of the paper book filed by the Assessee. Thereupon the AO passed a fair assessment order dated 28/10/2011 confirming the addition made on account of TP adjustment in draft assessment order. Aggrieved by the aforesaid order the assessee has preferred the present appeal before the Tribunal.

23. We have heard the rival submissions. The learned counsel for the Assessee took us through the Transfer Pricing Study conducted by the Assessee and highlighted as to how the search process, the functions, assets and risks analysis had been, according to him, rightly carried out by the Assessee. His submission was that the out of the 8 comparable companies chosen by the TPO, three companies were already rejected by him in his earlier hearing. He has given no reasons as to how he ultimately again came to the conclusion that these companies were comparable. His submission was that the comparable companies chosen by the TPO were not functionally comparable with that of the Assessee and in this regard took us through the relevant submissions made before the TPO. He filed a gist of legal propositions and relied on several orders of the Tribunal and submitted that both on facts and in law, the addition made by way of adjustment to the ALP deserves to be deleted. The learned DR relied on the order of the TPO and submitted that the TPO has given valid reasons as to why the TP study carried out by the Assessee has to be rejected.

24. We have considered the rival submissions. The provisions of the Act and the Rules that are relevant for deciding the issue have to be first seen. Sec.92. of the Act provides that any income arising from an international transaction shall be computed having regard to the arm's length price. Sec.92-B provides

that “international transaction” means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises. Sec.92-A defines what is an Associated Enterprise. In the present case there is no dispute that the transaction between the Assessee and its group companies in Germany whereby the Assessee provided services in the form of contract testing and research services was an international transaction attracting the provisions of Sec.92 of the Act. Sec.92C provides the manner of computation of Arm’s length price in an international transaction and it provides:

“(1) that the arm’s length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely :—

- (a) comparable uncontrolled price method;
  - (b) resale price method;
  - (c) cost plus method;
  - (d) profit split method;
  - (e) transactional net margin method;
  - (f) such other method as may be prescribed by the Board.
- (2) The most appropriate method referred to in sub-section (1) shall be applied, for determination of arm’s length price, in the manner as may be prescribed:

Provided that where more than one price is determined by the most appropriate method, the arm’s length price shall be taken to be the arithmetical mean of such prices:

Provided further that if the variation between the arm’s length price so determined and price at which the international transaction has actually been undertaken does not exceed five per cent of the latter, the price at which the international transaction has actually been undertaken shall be deemed to be the arm’s length price.



(3) Where during the course of any proceeding for the assessment of income, the Assessing Officer is, on the basis of material or information or document in his possession, of the opinion that—

- (a) the price charged or paid in an international transaction has not been determined in accordance with sub-sections (1) and (2); or
- (b) any information and document relating to an international transaction have not been kept and maintained by the assessee in accordance with the provisions contained in sub-section (1) of section 92D and the rules made in this behalf; or
- (c) the information or data used in computation of the arm's length price is not reliable or correct; or
- (d) the assessee has failed to furnish, within the specified time, any information or document which he was required to furnish by a notice issued under sub-section (3) of section 92D,

the Assessing Officer may proceed to determine the arm's length price in relation to the said international transaction in accordance with sub-sections (1) and (2), on the basis of such material or information or document available with him:

25. Rule 10B of the IT Rules, 1962 prescribes rules for Determination of arm's length price under section 92C.

“10B. (1) For the purposes of sub-section (2) of section 92C, the arm's length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, in the following manner, namely :—

- (a).....
- to
- (d).....
- (e) transactional net margin method, by which,—
  - (i) the net profit margin realised 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 realised 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 realised 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.

(2) For the purposes of sub-rule (1), the comparability of an international transaction with an uncontrolled transaction shall be judged with reference to the following, namely:—

(a) the specific characteristics of the property transferred or services provided in either transaction;

(b) the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;

(c) the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;

(d) conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

(3) An uncontrolled transaction shall be comparable to an international transaction if—

(i) none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market; or

(ii) reasonably accurate adjustments can be made to eliminate the material effects of such differences.

(4) The data to be used in analysing the comparability of an uncontrolled transaction with an international transaction shall be the data relating to the financial year in which the international transaction has been entered into :

Provided that data relating to a period not being more than two years prior to such financial year may also be considered if such data reveals facts which could have an influence on the determination of transfer prices in relation to the transactions being compared.

26. A reading of the provisions of Rule 10B(2) of the Rules shows that uncontrolled transaction has to be compared with international transaction having regard to the factors set out therein. Before us there is no dispute that the TNMM is the most appropriate method for determining the ALP of the international transaction. The disputes are with regard to the comparability of the comparable relied upon by the TPO and whether the difference between ALP (being the highest arithmetic mean of the three proposed by the Assessee viz., 18.97%) and the Price adopted by the Assessee would be less than 5% plus or minus contemplated by the second Proviso to Sec.92C(2) of the Act and consequently there would be no need to make any adjustment to the price adopted by the Assessee in respect of the international transaction entered into with its AE.

27. We will now consider 8 comparable cases selected by the TPO and see whether they can be functionally compared with that of the assessee.

**(1). M/s. Chatered Capital & Investment Ltd**

**(2). M/s. Khandwala Securities Ltd.**

**(3). M/s. Sumedha Fiscal Services Ltd.**

As far as these companies are concerned the TPO himself has selected these company as a comparable companies in his earlier correspondence with the assessee in the course of proceedings before him. We have already seen that the TPO conducted three different searches and while doing search No.1 he arrived at a set of list of 18 companies out of which he has selected only 10 comparables. In Search -2 the TPO selected 124 companies and rejected all those companies as not comparable. The list of comparables rejected by the TPO is at page 75 of the Paper Book. In this list the above three companies which were included in the final list of eight comparable companies selected by the TPO and which were earlier rejected by him have been listed. The reasons

given by the TPO for rejecting these companies are comparable in his earlier correspondence were as follows:

(i) M/s. Chatered Capital & Investment Ltd., on the ground that the company on a qualitative review and for the reason that its income is from merchant banking services.

ii) M/s. Khandwala Securities Ltd., on the ground that the company on a qualitative review and for the reason that its income is from acting as Security and stock brokers.

iii) M/s. Sumedha Fiscal Services Ltd. on the ground that the company on a qualitative review and for the reason that its income is from loan syndication and project consultancy services.

In the final list the TPO has included these companies as comparable companies. The TPO has given no reasons whatsoever for changing his stand. Apart from the above, the Assessee in its submissions dated 19.10.2010 filed before the TPO had highlighted as to how these companies are not functionally comparable with that of the Assessee. The TPO has not even considered these objections. We have seen the reasons given by the Assessee as to why these companies should not be treated as comparable companies, and they are part of the reply dt.19.10.2010 filed by the Assessee before TPO (the whole reply is at pages 127 to 573 of the Assessee's paper book). On perusal of the reasons so given, we are of the view that these companies are not functionally comparable with the functions performed by the Assessee.

**(4) M/s. Centrum Capital Ltd: (CCL)** The nature of services provided by this system is investment banking. In a letter dated 15/10/2010 the TPO has himself accepted that asset management companies are not functionally comparable with that of the assessee. Nevertheless the TPO has proceeded to consider this company as a comparable. CCL is a leading investment bank, offering' comprehensive financial services composing fund raising by way of equity and debt for corporate, Government undertakings and state entities. The main income stream of the said company is' Syndication Fee, Brokerage &

commission-and income from trading in bonds. CCL is engaged in the business of Merchant Banking and Investment Banking and the income generated by the company is syndication fees and brokerage commission as against the Assessee which is engaged in the business of investment advisory and related support services, and is compensated on a cost-plus basis for the activities it performs. Hence, this company cannot be considered as a comparable.

**(5) Edelweiss Capital Ltd. :**

Description as per Website:

It is the practice of -this core thought that has led to Edelweiss becoming one of the leading financial services company in India. Its current business include Investment banking, securities broking, and investment management. It is amongst top give domestic brokerages and top three derivative desk in India. This company has structured itself in 5 Lines of Business ('LOBs') to the current 8 LOBs, investment Banking, Institutional Equities, Private Client Services, Principal strategies and Insurance brokerage joined by Asset Management, Wealth Management and financing this year.

The Profit and Loss account for only consolidated accounts is available in the annual report. Having regard to the difference in functionality and absence of availability of data, this company cannot be considered as a comparable.

**(6) Keynote Corporate Services Ltd.:**

Description as per Website:

Keynote is a full service investment banking group focused on mid market companies in India. With services that enable our clients to access Capital Markets, Corporate Finance\_ Advisory, Mergers and Acquisitions Advistory,

ESOP Advisory, Equity/Debt Placements and Restructuring, Keynote has emerged as a one-stop-botique for mid market companies across the country.

The Company's main revenue stream consists of Issue management fees, underwriting fees. The company's primary segment consists of 3 main activities viz. Services, Dealing in shares and other income.

Service Description: Managing of Public Issue of Securities, Underwriting, Project Appraisal, Equity Research, Capital Structuring / Re-structuring, Loan & Lease Syndication, Corpora Advisory Services, Mergers & Acquisition, Placement Services, Portfolio Management. Debenture Trustee, Managing /advising on International Offerings of Debt/Equity, i.e. GOR, ADR, bonds and other instruments, Private Placement of securities, Corporate Advisory Services related to Securities Market e.g. Takeovers, Acquisitions, Disinvestments etc., Advisory services for Projects, International Financial Advisory services. Warehousing/ Parking of Securities, Bridge Financing, Bought out Deals relating to Issue Management.

Equity Research out of the above service can be compared with that of the Assessee's activity but segmental data is not available. The company's segment as reported are services, dealing in shares and other income. In the absence of specific data it is not possible to make comparison.

It can therefore be safely said that that above is into Merchant Banking and cannot be considered as a comparable.

#### **(7) L&T Capital Company Ltd. (LTCC)**

LTCC is the investment banking outfit of "L & T Group of companies". It has a Project Advisory Team, which has been providing value added services to State Governments, Public Sector organisations, L&T and other corporate on financing of Infrastructure projects. Financial advisory services in respect of projects offered include Syndication of finance, cash flow modeling, strategic

financial planning, assisting in bank negotiations etc. The analysis of income from operations in Profit and Loss account indicates that income from consultancy account 6.34% of the total income whereas the major income comprises of Arranger's fee, portfolio management services fees, syndication fees - money markets. The above mentioned facts highlights that the company is primarily into Portfolio Management, Mutual fund Distribution and Merchant Banking. Further, it has substantial related party actions. Hence, the said company cannot be considered as a comparable.

**(8)S.R.E.I Capital Markets Ltd., (SREI CAPS)**

SREI Caps, a wholly owned subsidiary of SREI Infrastructure Finance Limited (SREI). SREI Caps is a full-scale Investment Banking, Corporate Advisory and Project Management Consulting Firm ranging from managing equity & Debt offerings, Private Equity & Institutional Placements, Debt Syndication, Mergers & Acquisitions and valuations, Disinvestment related services and Infrastructure Advisory Services. The Income stream mainly consists of Consultancy Fees, Lead Manager's Fees, Underwriting Fees and Brokerage Received Fee. Out of above, the consultancy income accounts for only 0.27% of the total income of the company. From the above, it is noted that the company's core business is that of merchant banking, whereas consultancy accounts for only 0.27% of the total income and hence the said company cannot be considered as a comparable.

28. The TPO in his order has not considered any of these objections raised by the assessee with regard to functional comparability of the comparables relied upon by the TPO. The TPO has proceeded on the basis that the assessee while comparing its TP Study has rejected 274 comparables out of 275 selected by it but had not given any reason as to why comparables were rejected. It has further been the TPO's observation that out of segmental search of 424 companies (Prowess) and 136 Companies ( Capital Line) only one company was

selected by the assessee and no reasons were assigned for rejecting the rest. This is factually incorrect because in the chart given in the earlier part of this order, we have extracted the summary of the reasons given in the TP study carried out by the Assessee, as to why the broader search data was narrowed down to only 2 comparables. The TPO has also found fault with the other methodology adopted by the assessee which are not germane to the issue before the TPO. The TPO has thereafter referred to the show-cause notice dated 15/10/2010, wherein the TPO confronted the assessee with 8 comparables. The TPO has also referred to the reply given by the assessee. The objections of the assessee are summarized by the TPO in his order as follows:

(iii) The key differences between companies engaged in the business of investment banking /merchant banking ('IB/MB') and Carlyle India was submitted as under:

Investment banking assists in Initial Public Offerings, private placement and bond offerings, acts as broker and carries through mergers and acquisitions as against Carlyle India who does not finance capital requirements of an enterprise.

Investment bankers provide a wide array of services, including underwriting the issuance of equity or debt to aid a company having financial difficulties. In view of the risk undertaken by the underwriter, they are compensated a specified premium. The said activity is much riskier than simply advising clients, an activity which involves considerably less risk. The underwriting activity would follow the principle of "Higher the risk. Higher the return"

Further, in certain cases, for large or risky issues a number of investment bankers get together as a group, they are referred to as syndicate which means a temporary association of investment bankers brought together for the purpose of selling new securities. Carlyle India does not perform the said act.

Merchant banking also includes loan syndication, providing venture capital and mezzanine financing, corporate advisory services (includes exploring the refinancing alternatives of the client and evaluate cheaper sources of funds; advise clients on rehabilitation and turnaround



management, different hedging strategies and suggests the appropriate strategy, etc.) as against Carlyle India who does pure research activity.

Based on the above, it was submitted that functions performed by an IB/MB are different in nature than that performed by Carlyle India whose role is limited to providing research reports to the AE for their further evaluation.

7. I have considered the assessee's submission. I have taken the comparable companies not on the base of their main investment banking but a segments of those companies have been taken. Segments like Agency Business, Services, Fee Based Operations, Consultancy which are akin to investment advisory have been taken. Comparable Companies like S R E I Capital Markets Ltd., L & T Capital Co. Ltd. and Chartered Capital & Investment Ltd. are actually into investment advisory. Therefore, they are comparable companies. Just to support my view, I have also checked the data submitted by various assessees for investment advisory segments and I have found that assessees have reported operating profit margin ranging from 50% upto 500% for investment advisory segment. However, I have not taken those companies as comparable because not all those comparable companies' data are available in public domain."

29. We have already given the functional comparability of the various comparables selected by the TPO and we have also highlighted the absence of segmental data in so far as the investment advisory service provided by the comparables. In fact some of the comparables chosen by the TPO are not engaged in rendering investment advisory services. In fact three of the comparables cited by the TPO in the final order has been rejected by the TPO himself in the course of proceedings before him. We are, therefore, of the view that the comparables chosen by the TPO were functionally not comparable.

30. The only comparable chosen by the assessee viz., M/S.IDC India Ltd., which has also been relied upon by the TPO now survives for consideration. The comparables chosen by the assessee on the basis of the contemporaneous data for A.Y 2006-07 gives an arithmetic mean of 18.97% which we have already mentioned. This is the highest arithmetic mean of the comparable

chosen by the assessee. Even if this arithmetic mean is taken to be reflecting the operating margin of the comparable companies, the same is within 5% range of the operating margin of the assessee. We find that the TPO has not given any reason whatsoever for rejecting these comparables. As we have already explained the reasons given by the TPO does not any where mentioned as to how the comparables selected by the assessee were not functionally comparable. This Tribunal in the case of Maeserks Global Service Centre India Pvt. Ltd., in ITA No.3774/M/11, has taken the view that if TPO does not reject a comparable on the ground of functional incomparability then neither the AO or the revenue can take a plea of functional incomparability of the comparables chosen by the assessee in its TP Study. We are, therefore, of the view that the assessee's operative margin has to be held as within the range of 5% of the arithmetic mean of 18.97% of comparable companies and the same has to be accepted as ALP. For the reasons given above, the addition made by the AO and confirmed by the DRP is directed to be deleted.

31. In the result, the appeal of the assessee is allowed.

Order pronounced in the open court on the 4<sup>th</sup> day of April .2012

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

Sd/-  
(N.V.VASUDEVAN)  
JUDICIAL MEMBER

Mumbai, Dated. 4<sup>th</sup> April,2012

Copy to: 1. The Appellant 2. The Respondent 3. The CIT City –concerned  
4. The CIT(A)- concerned 5. The D.R”C” Bench.

(True copy)

By Order

Asst. Registrar, ITAT, Mumbai Benches

MUMBAI.

Vm.

	Details	Date	Initials	Designation
1	Draft dictated on	29/03/2012		Sr.PS/PS
2	Draft Placed before author	02/04/2012		Sr.PS/PS
3	Draft proposed & placed before the Second Member	02/04/2012		JM/AM
4	Draft discussed/approved by Second Member			JM/AM
5.	Approved Draft comes to the Sr.PS/PS			Sr.PS/PS
6.	Kept for pronouncement on			Sr.PS/PS
7.	File sent to the Bench Clerk			Sr.PS/PS
8	Date on which the file goes to the Head clerk			
9	Date of Dispatch of order			