IN THE INCOME TAX APPELLATE TRIBUNAL

'A' BENCH, CHENNAI

BEFORE Dr. O.K.NARAYANAN, VICE-PRESIDENT AND SHRI CHALLA NAGENDRA PRASAD, JUDICIAL MEMBER

ITA No.1842(Mds)/2011
Assessment Year : 2007-08

M/s. California Software Co. Ltd., Robert V Chandra Tower, 7th Floor, 149, Velachery-Tambaram Main Rd., Pallikaranai, Chennai-600 100. PAN AABCC8506B.	Vs.	The Assistant Commissioner of Income-tax, Company Circle I(3), Chennai.
(Appellant)		(Respondent)

Appellant by : Shri H.Padamchand Khincha, FCA.
Respondent by : Shri Shaji P Jacob, IRS, JCIT

Date of Hearing : 27th August, 2012
Date of Pronouncement : 27th August, 2012

O R D E R

PER Dr.O.K.NARAYANAN, VICE-PRESIDENT:

This is a Transfer Pricing (TP) appeal. The assessment year is 2007-08. It is filed by the assessee. It is directed against the order of the assessing authority passed under section

143(3), read with sections 92CA and 144C(5) of the Income-tax Act, 1961. The Transfer Pricing Officer (TPO) has passed her order on 29-10-2010 under section 92CA of the Income-tax Act, 1961. Directions of the Dispute Resolution Panel at Chennai are dated 8-9-2011in the proceedings concluded under section 144C(5) of the Income-tax Act, 1961.

2. The assessee is a hundred per cent exporter of computer software. Transactions were entered into with Associated Enterprise overseas and as such the matter was destined under the jurisdiction of transfer pricing regime. The Transfer Pricing Officer, after making an analysis of the transfer pricing study reported by the assessee, worked out an incremental adjustment of ₹ 5.84 crores to the income returned by the assessee as Arm's Length Price (ALP) adjustment. The Dispute Resolution Panel (DRP) upheld the upward revision made by the TPO and as such confirmed the draft assessment order passed by the Assessing Officer. Thus, the assessment was completed after making an addition of ₹ 5.84 crores to the income of the assessee-company.

3. The grounds raised by the assessee in the context of TP adjustment are as follows:-

"The lower authorities have erred in:

1. Not appreciating that the charging or computation provision relating to income under the head "Profits and Gains of Business or Profession do not refer to or include the amounts computed under Chapter X and therefore addition under Chapter X is bad in law.

2. In relying on information collected u/s 133(6) by other Directorates of Transfer Pricing without providing the information to the appellant.

3. Rejecting internal comparables selected by the appellant and rejecting transfer pricing analysis of the appellant.

4. Doing fresh transfer pricing analysis and adopting inappropriate filters in doing fresh transfer pricing analysis.

5. Selecting inappropriate comparables and rejecting appropriate comparables.

6. Inappropriately computing the operating margins of comparables and the appellant.

7. Not restricting the TP adjustment to AE transactions only.

8. Not making proper adjustment for enterprise level and transactional level differences between the appellant and the comparable companies.

9. Not allowing the benefit of the +/-5% range mentioned in the proviso to section 92C(2).”

4. The assessee has also raised grounds relating to additions made under section 14A, disallowance made under section 10A and also contention against the rate of depreciation adopted by the assessing authority on UPS and further grounds against levy of interest under section 234B of the Act.

5. We heard Shri H.Padamchand Khincha, the learned chartered accountant appearing for the assessee-company and Shri Shaji P Jacob, the learned Commissioner of Income-tax appearing for the Revenue.

6. On going through the orders of the lower authorities and the submissions made by the learned chartered accountant appearing for the assessee, we find that the transfer pricing analysis has been made by the assessee as well as the authorities below only on the basis of internal comparables. At the same time, there is no case that instances of external comparables are unavailable. External comparables are available in the industry carried on by the assessee company.

7. Therefore, at the outset itself we feel that the assessee as well as the lower authorities have erroneously overlooked the necessity of analyzing external comparables as well, while making the exercise of TP study. In an environment where sufficient number of external comparables are available, it is imperative to examine those external comparables also alongwith internal comparables so as to come to a balanced finding on the matters relating to deciding of ALP and consequential adjustment called for, if any.

8. This is more because from the materials placed before us it is not seen whether the assessee has made segmental analysis before exclusively relying on internal comparables available at its disposal. Internal comparables are also influenced by various factors, which may distort the acceptability norm, if not examined with the touchstone of unbiased conclusion generated out of a study of external comparables. Therefore, the approach of TP study made in this case is inappropriate. Even if the assessee as well as the authorities below agree that the internal comparables are

sufficient for the TP study in the present case, that does not justify the legal compulsion of examining the external comparables as well. An agreement, arrived at on the basis of incorrect premises between the contending parties, does not determine the legality or otherwise of the course of action opted by them. The course of action must be determined strictly on the basis of the words of the statute and not by the consensus of the contending parties.

9. Therefore, the fact that the authorities below also have by and large made the voyage over internal comparables is not a reason for us to accept the contention of the assessee that the internal comparables relied on by the assessee are unbiased.

10. At the end, there could be a chance that internal comparables might still hold good in assessee's case. But that should be the result of a lawful enquiry made on the basis of internal as well as external comparables.

11. Because of the above stated inherent dis-qualification of the impugned TP assessment, we find that this matter has to go back to the concerned authority for redoing of the TP analysis on the basis of external as well as internal comparables. The file is remitted back to the TPO for the above purpose. The TPO is directed to redo the exercise of TP analysis in the present case taking into consideration both external and internal comparables. While doing so, the TPO will consider all the objections raised by the assessee regarding the filtering process including the variables, risk factors involved and all other essential factors which would take care of the anxieties of the assessee while determining the ALP. The process of the re-exercise also permits to adopt any other most appropriate method to determine the ALP, if the circumstances so warrant.

12. Regarding the other grounds relating to additions under section 14A and disallowance under section 10A, the assessing authority shall adjudicate the matter afresh after considering the latest case laws available on the topics. This direction is equally applicable to the rate of depreciation

applicable to UPS as well. The levy of interest is consequential and as such does not call for any adjudication at this stage.

13. In result, this file is remitted to the TPO vis-a-vis to the Assessing Officer and the appeal is treated as partly allowed for statistical purposes.

Order pronounced in the open court at the time of hearing on Monday, the 27th of August, 2012 at Chennai.

Sd/-	Sd/-
(Challa Nagendra Prasad)	(Dr. O.K.Narayanan)
Judicial Member	Vice-President

Chennai,
Dated the 27th August, 2012.
V.A.P.

Copy to: (1) Appellant
(2) Respondent
(3) CIT
(4) CIT(A)
(5) D.R.
(6) G.F.