IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCH "A" : HYDERABAD

BEFORE SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER AND
SMT. ASHA VIJAYARAGHAVAN, JUDICIAL MEMBER

ITA.No.1846/Hyd/2012
Assessment Year 2008-2009

M/s. Patni Telecom Solutions Pvt. Ltd. Hyderabad. PAN AACCA4255G (Appellant)	vs.	ACIT, circle 16 (3) Hyderabad (Respondent)

Appellant by:	Shri A.V. Raghuram
Respondent by:	Shri Y.V.S.T. Sai

Date of hearing:	18.04.2013
Date of pronouncement:	25.04.2013

ORDER

PER SMT. ASHA VIJAYARAGHAVAN, J.M.

This appeal filed by the assessee against the Order of the Disputes Resolution Panel, Hyderabad dated 28.09.2012 for the assessment year 2008-2009.

2. Brief facts of the case are that the assessee-company is engaged in the business of software development services to its customers. The assessee also provides services to the Associated Enterprise "AE" namely Patni Telecom, U.S. and Patni Telecom, U.K. The assessee filed return of income for the assessment year 2008-2009 admitting total income of Rs.87,850/- under the normal provisions of the Income Tax Act, 1961 and book profit of Rs.14,75,22,331/- under section 115JB of the Act. The Assessing Officer passed draft assessment order under section 143 (3) read with section 144C of the Act on 26.12.2011 determining the total income under the normal provisions of the Act at

Rs.9,90,69,143/- after making addition of Rs.9,89,87,293/- to the returned income representing reference in transfer pricing value under section 92CA of the Act. The addition of Rs.9,89,81,293/- was determined by the TPO under section 92CA of the Act that reference made to him by the Assessing Officer. The assessee chose the TNMM method which was also accepted by the TPO. The assessee's transfer pricing study yielded 21 comparables after applying certain filters which yielded weighted average margin of 11.91% on cost. The mark up of total cost of the assessee was arrived at 7.19% at cost before working capital adjustment.

3. The Transfer Pricing Officer rejected the transfer pricing study done by the assessee. In addition to the filters employed by the assessee the TPO applied additional filters and further rejected 13 comparables out of 21 comparables submitted by the assessee. After various discussions the TPO finalised the list of comparables on 19 which included 6 comparables which were objected to by the assessee during the proceedings before the TPO.

4. On further appeal before the DRP, the DRP passed direction vide its order under section 144C(5) of the I.T. Act, 1961 dated 28.9.2012 by issuing the following directions to the Assessing Officer.

> *"Arithmetic Mean of all comparables is reduced from 26.20% to 21.25%"*
>
> *Based on these directions of the DRP, the arithmetic mean of the Profit Level Indicators is taken as the Arms Length margin (please see Annexure-B) for details of computation of PLI of the comparables). Based on this, the arms length price of the IT enabled services rendered by the tax payer to its AE(s) is computed as under :*

Arithmatic mean PLI	*21.25%*
Less: Working capital adjustment (annexure-C)	*-2.08%*
Adj: Arithmetic mean PLI	*23.33%*

Operating cost	*Rs.86,57,70,927/-*
Operating cost when aggregated with reimbursement received at Rs.1,76,99,840/-	*Rs.88,34,70,767/-*
Arms' Length Margin	*23.33%*
Arm's Length Price (ALP) @ 123.33% of operating cost	*Rs.108,95,84,496/-*

The price charged by the tax payer to its Associated Enterprises is compared to the Arms Length Price as under

Arm's Length Price (ALP) @ 123.33% of operating cost	*Rs.108,95,84,496/-*
Less: Sales with non-AE	*Rs. 49,17,64,426/-*
ALP of sales with AE	*Rs. 59,78,20,070/-*
Price received with reimbursements	*Rs. 54,05,38,598/-*
Shortfall being adjustment u/s 92CA	*Rs. 5,72,81,472/-*

The above short fall of Rs.5,72,81,472/- is treated as transfer pricing adjustment u/s. 92CA. The total income of the assessee is enhanced by the above amount of adjustment.

4. Subject to the above discussion, total income of assessee and tax payable thereon are computed as under :

A. ***Computation of tax under normal provisions*** *:*

Income returned	*87,850*
Add: Difference Transfer Pricing Value	*5,72,81,472*
Total Income Assessed	*5,73,69,322*
Tax thereon	*1,72,10,797*

6. Aggrieved by the Order of the Disputes Resolution Panel followed by the Assessing Officer in determining the income at Rs.5,73,69,322/- the assessee preferred appeal before us and has raised the following grounds.

"1. The Order of the Dispute Resolution Panel, Hyderabad that is followed by the Assessing Officer to determine the income at Rs.5,73,69,322 is erroneous both on facts and in law.

2. The DRP erred in rejecting the objections against comparables viz., Avani Cincom and Kais Information whose turnovers are miniscule compared to that of the appellant and thereby erred in considering their PLI to arrive at Arithmetic mean.

3. The DRP erred in rejecting the objections against comparables viz., Infosys Ltd. and Wipro Ltd. whose turnovers are multiple number of times higher compared to that of the appellant and thereby erred in considering their PLI to arrive at Arithmetic mean.

4. The DRP ought to have appreciated the fact that these companies are not comparables and are to be excluded while arriving at the Arithmetic Mean, and further ought to have appreciated the fact that the AM arrived at by excluding them is less than 5% and therefore ought to have directed for accepting the assessee's price as ALP.

5. The DRP erred in rejecting the ground against including sale with Non Associated Enterprises while applying Arithmetic Mean PLI for adjustment without appreciating the legal position that such sales cannot be included.

6. The DRP erred in rejecting the ground against including amount that is received as reimbursements of Rs.1,76,99,840/- while applying Arithmetic Mean

> *PLI for adjustment without appreciating the legal position that such amounts are not to be included."*

7. Ground No.1 is general in nature and therefore needs no adjudication. Ground No.2 is not pressed by the assessee and therefore, the same is dismissed as not pressed.

8. With regard to ground No.3 the learned Counsel appearing on behalf of the assessee Shri A.V.Raghuram argued that the case of the assessee is not comparable with Infosys Technologies Ltd. and Wipro Ltd. The learned Counsel pointed out that the segmental turnover of Infosys was at Rs.156,48,00,00,000/- and that of Wipro is at Rs.112,58,490,000/-. The learned Counsel relied on the decision of the Delhi ITAT Bench in the case of Agnity India Technologies ITA.No.3856/D/2010 for the assessment year 2006-2007 and submitted that assessee is not comparable with Infosys and Wipro Ltd. as can be seen from the financial data etc., mentioned with respect to the two companies.

9. Before us, the learned D.R. relied on the decision of the Capgemini India Pvt. Ltd. vs. ACIT vide ITA.No.7861/Mum/2011 A.Y. 2007-2008 for the proposition of the assessee that Infosys and Wipro which are cases of extremely high turnover should be excluded. The relevant portion of the Capgemini India Pvt. Ltd. is extracted below :

> *"5.3.5 . . . . The various reasons given for applying the turnover filter for comparison of margins are economy of scale, greater bargaining power, more skilled employees and higher risk taking capabilities in cases of high turnover companies, which increase the margins with rise in turnover. However, in the*

Tribunal decisions cited, no detailed examinations have been made as to how these factors increase the profitability with rising turnover. The concept of economy of scale is relevant to manufacturing concerns, which have high fixed assets and, therefore, with the rise in volume, cost per unit of the product decreases, which is the reason of increase in margin as scale of operations goes up because with the same fixed cost there is more output when the turnover is high. The same is not true in case of service companies, which do not require high fixed assets. In these cases employees are the main assets, who in the case of the assessee are software engineers, who are recruited from project to project depending upon the requirement. The revenue in these cases is directly related to manpower utilized. With rise in volume cost goes up proportionately. Therefore, as rightly pointed out by the ld. CIT-DR the concept of economy of scale could not be applied to service oriented companies. The ld. CIT-DR has also placed a graph plotted between margin and, turnover in case of the comparables selected by the assessee, which shows no linear relationship between margin and turnover. In fact, the graph shows that the margin has come down with the rise in turnover in some cases. Such detailed study was not available before the various Benches of the Tribunal mentioned earlier, who have applied the turnover filter. Therefore, in view of the fresh material, in our view, the decisions of the Tribunal cannot be followed."

10. We find that the coordinate Bench of the Tribunal in the case of Deloittee Consulting India Pvt. Ltd. vide ITA. No. 1082 and 1084/2010 has dealt with the issue as to whether the TPO was correct in selecting Wipro BPO having turnover multiple number of times more than the assessee-company as comparable or not. The relevant para of the Tribunal Order is reproduced as under :

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

11. Relying on the decision of the Coordinate Bench of the Tribunal we exclude the Giant Companies namely Wipro and Infosys which are taken as comparables as turnovers of these companies are multiple number of times higher compared to that of the assessee, we hold that the DRO erred in considering their PLI to arrive at the arithmetic mean.

12. Ground No. 4 and 5 have become infructuous since we have decided ground No.3.

13. Ground No.6 is against including the amount received as reimbursement of Rs.1,76,99,840/-. Before the DRP it was stated that assessee has reimbursed certain expenditure which was incurred on clients amounting to Rs.1,76,99,840/- which did not result in any profit or gain or income to it. It was requested that the same cannot be treated as consideration. The assessee relied on Abbey Business Services India Pvt. Ltd. vs. DCIT. The DRP panel noticed that the tax payer objected to the application of margin on reimbursement of expenses to its AE. The DRP observed that during the year the assessee had reimbuirsed a sum of Rs.1,76,99,840/- to the AE in respect of salary and other costs of the assessee paid by the AE. The DRP further observed that the tax payer cost was paid by its AE and subsequently, the tax payer had reimbursed it to its AE. However, observing that there is no clarity on the issue. The DRP held as follows :

> *"The assessee had reimbursed to AE while as per the additional ground submitted, client had reimbursed the expenses to the assessee. Nature of expenses forming part of this reimbursement of expenditure".*
>
> *. . . . . . The nature of expenses forming part of this "reimburse of expenditure", it is difficult to express our view on this issue agitated by the assessee. In the absence of clarity on the subject, as the assessee has not clearly explained its case, the Panel refused to interfere with the order of the TPO."*

14. In our view, the difficulty in adjudicating this issue agitated by the assessee is that there is absence of clarity on the subject. As the assessee has not clearly explained its case, the DRP refused to interfere with the Order of the TPO. The learned Counsel Shri A.V.Raghuram has not brought out any material in respect of the claim of the assessee against including the amount received as reimbursement while applying

arithmetic mean, PLI for adjustment. In the absence of any additional information on this issue, the CIT(A)'s order is upheld.

15. To sum-up, ground No.1 is general nature which needs no adjudication. Ground No.2 is dismissed as not pressed. Ground No. 4 and 5 have become infructuous and ground No.3 is allowed by excluding Wipro and Infosys as comparables.

16. In the result, assessee's appeal is partly allowed.

Order pronounced in the open Court on 25th April, 2013.

Sd/-	Sd/-
(CHANDRA POOJARI) **ACCOUNTANT MEMBER**	(ASHA VIJAYARAGHAVAN) **JUDICIAL MEMBER**

Hyderabad, Dated the 25th April, 2013

VBP/-

Copy to

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2. ACIT, circle 16 (3) Hyderabad
3. Disputes Resolution Panel (DRP) , 2nd Floor, Income Tax Towers, 10-2-3, A.C. Guards, Hyderabad – 500 004.
4. CIT(A)-1, Hyderabad
5. Director of Income Tax (TP) Chennai & Member, DRP, Hyd.
5. DR "A" Bench, ITAT, Hyderabad