

IN THE INCOME TAX APPELLATE TRIBUNAL 3C3 BENCH: KOLKATA

[Before Honøble Shri Mahavir Singh, JM & Honøble Shri B.P.Jain, AM]

I.T.A No.695/Kol/2011
Assessment Year: 2007-08

Acclaris Business Solutions Pvt.Ltd. Vs. I.T.O., Ward-2(2),
Kolkata Kolkata
(Appellant) (Respondent)
(PAN:AAECA 2366 E)

For the Appellant : Shri R.N.Bajoria, Sr.Advocate Shri Paras Shah &
Shri Akhilesh Gupta, Advocate

For the Respondent : Shri Vijay Kumar, CIT

Date of hearing : 23.04.2015.

Date of pronouncement: 11.06.2015.

ORDER

Per : B.P.Jain, AM

This appeal of the assessee arises from the order passed u/s 143(3) of the Act read with section 144C (5) of the Act passed by the Dispute Resolution Panel (DRP) dated 17th March, 2011. The DRP while dismissing the objections of the assessee, inter-alia, held that no interference was called for in respect of adjustment made by the TPO in the sales price of BPO services charged by the assessee to its Associated Enterprise (AE).

2. The assessee has raised the following 15 grounds of appeal :-

1. *“That on the facts and in the circumstances of the case, the Transfer Pricing Officer III, Kolkata (hereinafter referred to as “Ld TPO”), Dispute Resolution Panel, Kolkata (hereinafter referred to as “Ld. Panel”) and consequently the Income Tax Officer, Ward 2(2), Kolkata (hereinafter referred to “Ld AO”) has erred in making an adjustment of Rs.13,157,697 to the international transactions of the assessee with its Associated Enterprise (hereinafter referred to as ‘AE’).*
2. *That on the facts and in the circumstances of the case, the Ld. TPO, Ld.Panel and consequently the Ld. AO has erred by not considering the importance of functional comparability while selecting the comparables.*
3. *That on the facts and in the circumstances of the case,, the Ld. TPO, Ld.Panel and consequently the Ld. AO has erred by adopting a faulty and non-statistical approach for rejecting the abnormally high profit making companies and by applying a band of Profit Level Indicator (PLI) in the range of 10% to 50%.*
4. *That on the facts and in the circumstances of the case, the Ld. TPO, Ld.Panel and consequently the Ld. AO erred in undertaking fresh search for comparability analysis (FY 2006-07) as per the show cause notice dated 04-10-2010. By following the said approach the Ld. TPO himself travelled beyond the date of compliance i.e.*

October 31, 2007 resulting into impossibility of performance and against the premise of maintenance of “contemporaneous documentation”. Accordingly, the Ld.TPO has wrongly penalized the assessee with the use of such additional information and consequently claimed that the TP Study suffers from various infirmities.

5. That on the facts and in the circumstances of the case, the Ld. TPO, Ld.Panel and consequently the Ld. AO has erred in applying the turnover filter with a very small range of turnover thereby rendering the comparative study defective.
6. That on the facts and in the circumstances of the case, the Ld. TPO, Ld.Panel and consequently the Ld. AO has erred in rejecting the transfer pricing analysis of the assessee to justify the arm’s length nature of its international transactions on the ground that the assessee had used multiple year data while performing its benchmarking analysis and did not give consideration to the volume of sale.
7. That on the facts and in the circumstances of the case,, the Ld. TPO, Ld.Panel and consequently the Ld. AO has erred by determining the arm’s length mark-up based on the data for financial year 2006-2007 to the exclusion of prior year date [as contemplated under Rule 10B(4) of the Rules].
8. That on the facts and in the circumstances of the case, the Ld. TPO, Ld.Panel and consequently the Ld. AO held that proviso to section 92C(2) of the Act (as per Finance Act 2001) is not applicable to the assessee, instead proviso to section 92C (2) of the Act (as per Finance Act 2009) is applicable to the case of the assessee and further, erred in not providing benefit of 5% tolerance in determining the arm’s length price of international transactions of the assessee with the AE.
9. That on the facts and in the circumstances of the case, the Ld. TPO, Ld.Panel failed to adhere to the principles of natural justice by not addressing to the submission of the assessee and had conducted the proceedings on a complete misunderstanding and wrong interpretation of the facts.
10. That on the facts and in the circumstances of the case, the Ld. AO has erred in deducting Rs.39,451/- from the export turnover as expenses in foreign currency, although, the expenses had not been incurred in providing the technical services outside India.
11. That on the facts and in the circumstances of the case, the Ld. AO has erred in deducting Rs.14839/- as overseas insurance expenses, although, not attributable to the delivery of the articles or things or computer software outside India.
12. That on the facts and in the circumstances of the case, the Ld. AO has erred in disallowing the exemption under section 10A and 10B totaling to Rs.4,54,183/-, by deducting expenses amounting to Rs.48,84,548/- , from the export turnover which were incurred on account of expenses in foreign currency, bandwidth and connectivity charges, overseas insurance and World Interner Charges (Vonnage)ISD lease line.
13. That on the facts and in the circumstances of the case, the Ld. AO has erred by deducting the relevant expenses from the export turnover only and not from the total turnover of the assessee.
14. That on the facts and in the circumstances of the case, the Ld. AO has erred in disregarding the principle of erstwhile section 80HHC in section 10A and 10B case.
15. That the assessee craves leave to add to and to alter, amend, rescind or modify the grounds raised hereinabove before or at the time of hearing of the appeal.”

3. The assessee is a 99.99% subsidiary of Acclaris Inc. and was incorporated on 6th June, 2003. The assessee provides Back Office Processing services (BPO) to Acclaris Inc., as a captive service provider in relation to some of Acclaris Inc's clients. The BPO services include various types of services including recruitment services, financial services and routine back office services like indexing and enrollment for clients. The assessee works as an IT enabled back office services provider which provides back office services to the client. The assessee does not own any intangibles interest in the intangibles owned by Acclaris Inc. and is only a service provider. Acclaris Inc., on the other hand, provides a range of BPO services to its clients with significant experience in managing people, process and technology, Acclaris Inc. owns the intellectual property rights (know-how copyrights etc.) and other commercial and marketing intangibles (brand names, trade marks etc.) and is involved in complex operations of developing proprietary technologies and marketing of the same. Acclaris Inc. also bears all the significant business and entrepreneurial risks of product acceptability and performance in the market. The assessee is entitled to seek compensation appropriate to the functional performance and capital employed in the business.

3.1. During the Assessment Yr. 2007-08, the assessee filed its return of income, declaring a taxable income of Rs.1,08,583/-, on 16.01.2007. The return was duly processed u/s 143(1) of the Act and the case was selected for scrutiny for assessment by issuing notice u/s 143(2) of the Act and section 142(1) of the Act. As the assessee had made international transactions during the year with its AE, reference u/s 92CA of the Act was made by the AO to the TPO on 7th October, 2009. The assessee in its Form No.3CEB declared the following international transactions

Particulars	Amount (INR)
Receipts for BPO Services	10.73 crores
Recovery of expenses incurred on behalf of the AEs	0.12 crore
Receipt of interest free loan	0.34 crore

3.2. In the TP study the assessee selected itself as a tested party and its profitability (operating profit/total cost) was benchmarked by Transactional Net Margin Method.

(TNMM). According to the assessee, it had earned a profit of 15.02% for the relevant assessment year and as per the 14 comparables selected by the assessee with TP study, the average margin determined was 11.28%. Therefore, it was the case of the assessee that international transactions entered into by the assessee with its AE were at arms length. The TPO vide its order dated 29th October, 2010 u/s 92CA(3) of the Act, made an upward adjustment of Rs.1,31,57,697/- to the international transaction of the assessee with respect to rendering of services to AE. The TPO accepted all other international transactions of the assessee with its AE, to be at arms length.

3.3. The TPO had rejected the comparables chosen by the assessee and selected the comparables by applying the following filters :

- (i) All companies having account of the year 2006-07
- (ii) Company engaged in IT enabled services
- (iii) Sales between Rs.5.0 crores to Rs.15 crores.
- (iv) Operating profit more than zero, so as to exclude the loss making companies.

3.4. Some of the comparables having related party transactions as a percentage of sales of more than 10% were rejected. Thereafter the TPO chose a band of Profit Level Indicator (PLI) with the range of 10-50% to be applicable to the business of the assessee and finally proceeded to benchmark the international transaction by selecting the following five comparables :

Sl.No.	Name of the Company	OP/TC	Final OP/TC
1.	Galaxy Commercials Ltd.	23.53%	23.53
2.	ICRA Online Ltd.	30.35%	30.35%
3.	Maple Esolutions Ltd.	34.92%	34.92%
4.	Professional Management Consultants Pvt. Ltd.	13.59%	13.59%
5.	<u>Indusind Information Technology Ltd.</u>	<u>43.22%</u>	<u>43.22%</u>
	<u>Average</u>		<u>29.12%</u>

3.5. The TPO on the basis of the aforesaid comparison calculated the arms length price of international transactions of the assessee for rendering services to its AE for

BPO services to be at Rs.12,04,93,962 instead of Rs.10,73,26,265 declared by the assessee. Thus the upward adjustment made was Rs.1,31,57,697.

3.6. AO relied upon the TPO's order and passed a Draft assessment order by making Transfer price adjustment of Rs.1,31,57,697/-. The second addition made by AO was with respect to disallowance of exemption u/s 10A and 10B of the Act totaling to Rs.4,54,183/- by deducting expenses amounting to Rs.48,84,548/- which was incurred on account of expenses in foreign currency and connectivity charges, overseas insurance and world Internet charges (Vonnage) ISD lease line. With respect to the Transfer Pricing addition made, the assessee had raised grounds No.1 to 9. However during the course of hearing, the ld. Sr.counsel appearing on behalf of the assessee limited his submissions to only following two arguments. First, out of the five comparables selected by the TPO, two comparables namely Maple Eolutions Ltd. and Indusind Information Technology Ltd. were having different functional profile and cannot be compared with the assessee. The objection regarding the same is taken in ground no.2. Secondly, the two other comparables namely Galaxy Commercials Ltd. and ICRA Online Ltd. were of a very high profit margin of 23.53% and 30.35% and should be excluded. The aforesaid objections are referred to in grounds 2 and 3. The ld. Sr. Counsel submits if these comparables are excluded, the assessee's international transactions would be at arm length and no upward revisions would be required.

4. The ld. DR, on the other hand, submits that functional analysis and profitability of the comparables, objected to by the assessee, are highly technical in nature and the matter should be remanded to the file of the AO.

5. As regards the functional comparability of one of the comparables i.e. **Maple E-solutions Ltd.**, the ld. AR has submitted that the TPO did not differentiate between voice-based and non-voice based BPO units. The case of the assessee is that the assessee being a non voiced based BPO company cannot be compared to voice based companies while applying the TNMM method.

6. We have considered the facts of the case and submissions made before us. We are in agreement with the submissions made by the assessee that the aforesaid comparables i.e. Maple Esolutions Ltd. cannot be selected for the purpose of benchmarking in the case of the assessee while applying TNMM method.. The TPO failed to appreciate that the aforesaid comparable company and the assessee are engaged in different businesses altogether. As the business model of voice based companies is of totally different nature than that of non voice based companies, we have no option but to exclude the comparable Maple E-solutions Ltd. for the purpose of benchmarking.. It is pertinent to mention here that the aforesaid comparable company was also involved in fraud and the business reputation came under serious indictment. For this reason also the comparable must be excluded.

6.1. It shall be apposite to refer to judicial precedents on the aforesaid issue to fortify our reasons to exclude the comparable stated above. In the case of Pentair Water India (P) Ltd vs ACIT (2014)47 Taxmann.com 132 (Panaji), the ITAT Panaji Bench has held as under :-

“Maple Solutions Ltd :- While deciding the appeal of the assessee for A.Y.2006-07 in ITA Nos.2&5/PNJ/2013, this tribunal has excluded this company out of the comparables by holding as under vide its order dt.17.4.2014 :
Maple esolutions Ltd. : TPO has considered Maple eSolutions Ltd. as a comparable and computed the margin in respect of this company @33.66%. We noted that the Hon'ble Delhi Tribunal in the case of ACIT vs CRM Services India Pvt. Ltd., 14 taxmann. Com 96 has held that this company could not be selected as comparable for ITES companies as the management of this company was tainted one as the Directors of the company were involved in a fraud. The business reputation of the Rastogi group which owns Maple eSolutions was in serious indictment. In view of the question mark on the reputation of its owners, albeit for earlier years, it would be unsafe to take their results for comparison of profitability of the assessee. In A.Y. 2006-07 we noted that the profit margin has been taken by the TPO at 28.75%. When the assessee went in appeal before CIT(A), CIT(A) has excluded this company for the purpose of comparison. No cogent material or evidence was brought to our knowledge by the Id.DR how this company is not tainted one. The decision of the co-ordinate Bench is binding on us. We, therefore, respectfully following the decision of the co-ordinate Bench exclude this company from the comparables.”

6.2. The ITAT Delhi Bench had the occasion to appreciate the difference between business model of voice based and non voice based companies in ITO vs CRM Services India (P) Ltd in ITA No.4069/Del/2009. The Tribunal held as under :-

“Coming to the inclusion of six more comparable cases, it was submitted that these cases, namely, C.S.Software Enterprises Ltd., Carborundum Universal Ltd., Mukand Engineers Ltd., Tricom India Ltd., Ultramarine and Pigment Ltd and Tata Services were included as comparables as these companies were engaged in ITES activities. While doing so, the TPO did not differentiate between voice based and non-voice based BPO units on the ground, inter-alia that such a classification has not been demonstrated and in any case TNMM irons out difference in functions. It was further submitted that the functions performed were crucially different. It was also submitted that the finding to the fact that the assessee was also performing non-voice based services is not correct as it is based on the functions performed by TP USA. It was also submitted that the assessee was a start-up company with this year being the first year of full operations while the companies identified were old and established companies. They were performing different functions. The points of divergence have been tabulated by the Id.CIT(Appeals) on page nos. 40 and 41.”

Coming to the rejection of six comparables chosen by the TPO, our attention has been drawn towards the findings of the Id. CIT(A) that for the purpose of comparability between the tested party and the uncontrolled party, the nature and line of business, product or service market, the size and scope of operation and the stage of business are required to be seen. From the submissions made by the assessee and the perusal of annual report, it is found that the comparables taken by the TPO are engaged in totally different businesses. The details have been mentioned in a tabular form on page nos.47 and 48 of the impugned order. The table is reproduced below :-

Sl.No.	Name	Nature of Business	Remarks
1.	C.S.Software Enterprises Ltd.	Software Development	Not engaged in voice based call centre service, hence rejected
2.	Carborundum Universal Ltd.	Manufacturer of coated and bonded abrasive	-do-
3.	Mukand Engineers	Mainly into steel	-do-
4.	Tricom India Ltd.	Non-voice based BPO as part of the business	-do-
5.	Ultramarine & Pigments Ltd.	Non-voice based BPO as part of the business	-do-
6.	Tata Services	Tata Management Training Center and other services to Tata group companies	-do-

“9.3. When we examine the facts of the case in the light of aforesaid conclusion, it is seen that none of the comparables selected by the TPO is shown to have the same

business of voice based BPO as in the case of the assessee. C.S. Software Enterprises Ltd. is conducting the business of software. Carborundum Universal Ltd., is mainly in the line of manufacture of coated and bonded abrasive. The main business of Mukand Engineers Ltd. is production of steel. Tricom India, apart from other businesses is also carrying on the business of non-voice based BPO. Such is also the case of Ultramarine & Pigments Ltd. We have already mentioned about the business of Tata Services Ltd. All these companies have been carrying on their main businesses for a long period. The business models are not comparable. Therefore, we do not find any reason to disturb the order of the ld. CIT(A) in this matter.”

In view of the reasons stated above and judgments referred to above, we have no hesitation to exclude the comparable i.e. Maple E-solutions from the list of comparables chosen by the TPO.

6.3. As regards **Indusind Information Technological Limited**, it is the case of the assessee that the business model of the comparable chosen by the TPO is that of software development unlike that of the assessee company which is engaged in the business of BPO services.

6.4. After considering the submissions made by the parties and the judgments relied upon, we are in agreement with the averments made by the Ld Sr. Counsel for the assessee that the aforesaid comparable may be excluded for the purpose of benchmarking the arm's length price of the international transactions entered into by the assessee. The software development company has a completely different functional profile as compared to a company engaged in BPO services. The risk undertaken and the assets employed by a software development company cannot be compared to a BPO company.

6.5. A similar issue arose for consideration before the ITAT Chennai Bench in the case of S.R.A. Systems Ltd. vs ACIT (2014) 147 ITD 353 wherein the Tribunal has held as under :-

“7. We considered this issue in detail. It is the case of the assessee before the lower authorities that the turnover of the assessee for the past five years averaged to Rs.25 crores and therefore its turnover base for the purpose of arriving at comparables should be taken in the range of Rs.15 to 25 crores after eliminating related party transactions. On the above basis, the assessee stated that the PLI came to 2.53% as against the PLI reported by the assessee at 3.33%. Even when the turnover criterion is adopted at Rs.50

crores, the PLI came to 3.18%, which is much higher than the PLI criterion of 2.53%. It was the contention of the assessee that the business model of the assessee is based more on turnkey projects, where cost overruns were borne by the assessee that actual bench costs were much more than that estimated by the assessee, that the assessee had to incur considerable expenditure on research and development and that the assessee's financials should be compared to software development companies and not with companies in the area of BPO, KPO etc.

8. It is seen that it is against the above objections raised by the assessee that the TPO has worked out the PLI at 25.44% as against the PLI at 3.5%, resulting an upward adjustment of Rs.4,33,80,146/-. There is no justification on the part of the TPO to compare the financials of the assessee-company to those of BPO and KPO companies. The financials of the assessee should be compared only with software development companies. When a general comparison is made, huge expenditure incurred on research and development should be considered. It is also to be seen that the business model of the assessee was based more on turnkey projects, in which case cost overruns would have to be borne by the assessee-company. In the facts and circumstances of the case, we are not in a position to accept the PLI at 25.44% determined by the TPO on the ratio of operating profit to operating cost. This against the PLI returned by the assessee company at 3.5%. Therefore, we do not approve the upward adjustment of Rs.4,33,80,146/- made by the Assessing Officer to its full extent. On same set of facts, the issue of ALP determination was considered by Dispute Resolution Panel at Chennai in assessee's own case for the assessment year 2008-09. In their direction dated 4-6-2012 issued under section 144C(5), the Panel has directed the Assessing Officer to adopt the PLI at 13.35% as against the PLI of 21.86% adopted in the assessment. This shows that the upward adjustment made in the impugned assessment is quite arbitrary."

6.6. In the case of ACIT vs M/s.Maersk Global Service Centers (India)Pvt.Ltd. in ITA No.3774/Mum/2011 vide order dated 09.11.2011 the ITAT Mumbai Bench has held as under :-

"30. The assessee in its transfer pricing study considered transactional net margin method (hereinafter called "TNMM") as the most appropriate method with NCP margin as the profit level indicator to benchmark its international transactions with AEs. The assessee conducted analysis for determining the ALP of international transactions pertaining to the provisions of back office support services. Based on data available, the weighted average Arithmetical Mean of NCP margins earned by the comparable independent companies performing similar functions, was determined at 7.62%. As the assessee earned NCP of 7.90% from its international transactions, it was concluded that such transactions with AEs were at ALP. The Assessing Officer made reference to TPO for computation of ALP in respect of international transactions. The TPO, vide his order dated 31.10.2008, computed the adjustments to the ALP amounting to Rs.10,49,07,225. In such computation the TPO noted in para 4 of his order that "No companies were identified as comparables". He selected twelve companies as comparable with the assessee's international transactions, depicting the NCPs as under:-

Table B

Sr.No.	Comparable companies	OP/T %
1.	Allsec Technologies Limited	30.49
2.	Tulsyan Technologies Ltd. (Cosmic Global)	19.08

3.	Saffron Global	24.89
4.	WIPRO BPO Solutions Ltd.	27.60
5.	Vishal Information Technologies Ltd.	45.65
6.	Ace Software Exports Ltd.	15.46
7.	Nucleus Netsoft & GIS India Ltd.	40.60
8.	Asian Cerc Information Technology Ltd.	37.40
9.	Airline Financial Support Services (I) Ltd. (Seg)	26.54
10.	Goldstone Teleservices Ltd. (Seg)	15.95
11	Transworks Information Services Ltd.	2.87
12	Cepha Imaging Pvt. Ltd.	47.70
	Mean	27.80”

“48. Insofar as the cases of Tulsyan Technologies Limited and Vishal Information Technologies Limited are concerned, it is noticed from their annual accounts that these companies outsourced a considerable portion of their business. As the assessee carried out entire operations by itself, in our considered opinion, these two cases were rightly excluded. Coming to the cases of Cepha Imaging Private Limited and Asian Cerc Information Technology Ltd. (Seg.), we find that these companies are engaged in providing software development services as is evident from their annual reports available on pages 52 onwards and 64 onwards of the paper book. Thus these companies become functionally different. Insofar as WIPRO BPO Solutions Limited is concerned, we find that their turnover is eleven times greater than that of the assessee. This company having such a high brand value along with much higher turnover, in our considered opinion, has been rightly excluded by the ld. CIT(A). The last case being that of Airline Financial Support Services (I) Ltd. has 31.76% of the total service fees received from the controlled transactions with the related parties. This fact is evident from pages 62 of the paper book, which makes it incomparable with the assessee.”

6.7. In ACIT vs M/s. Hapag Lloyd Global Services Private Limited in ITA No.8499/Mum/2010 vide order dated 28.02.2013 similar issue arose wherein ITAT, Mumbai Bench has held as under :-

“4.1. The TPO observed that this company was in ITES both as per Board’s Notification and also D&B Websites. As the assessee had not considered this case, the TPO held it as comparable and included it in the list of comparables. The assessee contended before the learned CIT(A) that the said company was functionally incomparable as it was mainly engaged in software and application development. The learned CIT(A) considered the Annual report of this company and observed that it referred mainly to the income from export sales of software as against the assessee’s business of ITES. Accordingly this case was excluded from the list of comparables.

4.2. The ld. AR mainly relied on the decision of the Mumbai Bench of the tribunal in the case of ACIT v. Mearsk Global Service Centres (India) Private Limited [(2011) 133 ITD 543 (Mum)] to bring home the point that the case of Cepha Imaging Private Limited should be excluded as the same has been held by the tribunal in that case as incomparable.”

“4.4. Adverting to the facts of the instant case we find that the assessee in Mearsk Global Service Centres (India) Private Limited (supra) was a service provider rendering back office support service to its Associated Enterprises (AEs). In para 29 of this order, it has been recorded by the tribunal that the activities undertaken by the assessee were

essentially ITES, such as, data entry, transcription and data of shipping documents such as bill of lading etc. The instant assessee before us is also in the same line of business providing similar services as were rendered in the case of Mearsk Global Service Centres (India)Private Limited (supra). Further the A.Y. in both the cases is also similar, that is, 2005-2006. In that case also, the TPO introduced Cepha Imaging Private Limited as comparable. However, the Tribunal vide para 48 of its order observed that this company is “engaged in providing software development service as its evident from their annual report available on pages 52 onwards and 64 onwards of the paper book.” We find that the finding recorded by the learned CIT(A) in the impugned order that Cepha Imaging Private Limited was mainly engaged in export of software tallies with that recorded by the tribunal in the case of Maersk. As the assessee is engaged in ITES, any company engaged in exporting software, cannot be considered as comparable. We, therefore, hold that this case was rightly excluded by the learned CIT(A). “

6.8. In view thereof, the aforesaid comparable i.e. Indusind Information Technology is excluded for the purpose of bench marking the international transactions of the assessee. Accordingly ground no.2 raised by the assessee is allowed.

7. As far as the second limb of the arguments of the Id. Sr.counsel for the assessee is concerned, it is contended that the two comparables out of the five comparables chosen namely Galaxy Commercial Ltd. And ICRA Online Limited are of high profit margin (OP/TC) and therefore should be excluded from the list of comparables. The profit margin declared by the assessee in its TP study is 15.2% and these two comparables objected to by the assessee have a profitability of 23.53% and 30.35% respectively.

8. Before adverting to decide the aforesaid issue raised by the assessee, it is pertinent to refer to Rule 10B(2) of IT Rules, 1962 which provides for parameter for comparing international transactions with uncontrolled transactions. Rule 10B(2) is extracted herein below :-

“10B (2) : *For the purposes of sub-rule (1), the comparability of an international transaction [or a specified domestic 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.”*

8.1. A bare perusal of the aforesaid rule goes to show that there is no prohibition in considering companies with high profit or high losses as comparables for benchmarking international transactions to the arm length price. However, if there are specific and particular reasons evidencing abnormal profits or losses margin of the comparable, only then the comparable can be excluded. The burden to demonstrate the same is on the assessee. In the present case, no such particular facts have been brought on record to substantiate the reasons for high profitability of these comparables. In any case, comparables cannot be excluded for the sole reason that they are of high profitability margin. Such cases of high profitability or losses only invite further scrutiny as to the specific and particular reasons demonstrating abnormal profits/losses.

8.2. Even otherwise, the Indian Transfer Pricing Regulations differ from OECD Guidelines and US Transfer Pricing Regulations in this respect. The Indian Transfer pricing Regulations provide for arithmetic mean of the comparables for determining ALP of international transactions. The OECD guidelines, on the other hand, have enunciated the principle of quartile method for calculation of ALP, wherein the comparables that fall in the extreme quartiles get excluded and the middle quartiles are considered for benchmarking the transactions. The approach of the TPO by selecting the band of PLI between 10% and 50% is completely arbitrary and has no basis for reasons stated above. The selection of comparables by the TPO has led to arbitrariness wherein the loss making companies are excluded and comparables only in the range of 10% to 50% are selected. The benchmarking made by the TPO is not as per the principles governing Indian Transfer Pricing guidelines regulations or even the OECD guidelines.

8.3. Similar issue arose for consideration before the ITAT Bangalore Bench in the case of Trilogy E Business Software India Pvt. Ltd. Vs DCIT (2013) 140 ITD 540 wherein the ITAT Bangalore Bench held as under :-

30. Alternatively it was submitted that the profit margin of 60.23 percent was abnormally high and deserves to be rejected on this ground, as not within the parameters of comparability. In this regard, reference was made to the decision of Special Bench of ITAT Chandigarh in the case of Quark Systems Pvt. Ltd. (supra) besides several other tribunal decisions laying down identical proposition. Further it was submitted that Visual Soft Technologies Ltd. merged with Megasoft Ltd. w.e.f. 01.10.2006. Therefore the book results in the year in which the merger has taken place cannot be taken as a comparable. In this regard, reliance was placed on the decision of the Mumbai Bench of the ITAT in the case of Emersons & Process Management India Pvt. Ltd. v. Addl. CIT 13 Taxmann.com 149.

31. The learned DR relied on the order of the TPO and the DRP on this aspect. ~

32. We have considered the rival submissions. First we will consider the submission of the Assessee that companies with abnormal margins should not be regarded as comparable. In the case of Quark Systems Pvt. Ltd. (supra), the Special Bench had to deal with cases where the results were abnormal. The special Bench observed as follows:

"Even if the taxpayer or its counsel had taken Datamatics as comparable in its T.P. audit, the taxpayer is entitled to point out to the Tribunal that above enterprise has wrongly been taken as comparable. In fact there are vast differences between tested party and the Datamatics. The case of Datamatics is like that of "Imercius Technologies" representing extreme positions. If Imercius Technologies has suffered heavy losses and, therefore, it is not treated as comparable by the tax authorities, they also have to consider that the Datamatics has earned extraordinary profit and has a huge turnover, besides differences in assets and other characteristics referred to by Shri Aggarwal."

The above observations of the special Bench is a pointer to the fact that where there are extraordinary profits and those companies are considered by the TPO for comparability but loss making companies are not considered as comparable, that would improper. The Tribunal found that such contradiction in approach should not be permitted. Similarly in the case of M/S. Sap Labs India Pvt. Ltd. 2010-TII-44-ITAT Bang-TP had observed as follows:

"86. At the than 10 or 5, even below that. We have already considered that the agreement entered into by the assessee with its German associate concern has contemplated a compensation of cost plus 6 per cent, or 1.5 times of the total wages bill, whichever is higher. This point we have to consider in the light of the fact that the assessee is working in a risk mitigated environment. That is why we have agreed with the argument of the assessee-company that there may not be extreme profits in the case of the assessee. When extremes are excluded from the samples, all sorts of extremes should be avoided. otherwise, samples selected for comparative study may not be representative."

33. Even in the aforesaid decision the point that has been emphasized is that when the margins of comparable companies are either extremely low or high, the approach should be to eliminate both and not consider only the high or low margin comparables as it suits either the TPO or the Assessee.

34. *As far as the provisions of the Act are concerned, they lay down that the comparable companies should be functionally comparable to the tested party. There are no specific standards of comparability on the basis of abnormal profits or loss. Rule 10B(2) provides that 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.

35. *There is therefore no bar to considering companies with either abnormal profits or abnormal losses as comparable to the tested party, as long as they are functionally comparable. The OECD guidelines and in US TP regulations, this question may not arise at all because those regulations advocate the quartile method for determining ALP. Indian regulations specifically deviate from OECD guidelines and provide Arithmetic Mean method for determining ALP. In the quartile method, companies that fall in the extreme quartiles get excluded and only those that fall in the middle quartiles are reckoned for comparability. Hence, cases of either abnormal profits or losses (which are referred to as outliers) get automatically excluded. In the arithmetic mean method, all companies that are in the sample are considered, without exception and the average of all the companies are considered as the ALP. Hence, a general rule that companies with abnormal profits should be excluded may be in tune with the principles enunciated in OECD guidelines but cannot be said to be in tune with Indian TP regulations. However, if there are specific reasons for abnormal profits or losses or other general reasons as to why they should not be regarded as comparables, then they can be excluded for comparability. It is for the Assessee to demonstrate existence of abnormal factors.*

36. *In the present case factors for abnormal profits have not been highlighted by the Assessee. In such circumstances it is not possible to accept the submission of the Assessee to exclude this company for the purpose of comparison.-*

8.4. In view thereof the matter is restored to the file of the AO for making fresh search of comparables in view of the position of law enunciated in the present decision. Accordingly ground 1 and 3 are allowed for statistical purposes.

8.5. No submissions in support of ground no.4 to 9 were made by the Id. Sr. Counsel for the assessee. The same are deemed to be not pressed. Even otherwise as

we have remanded the issue of determining the arm's length price to the file of AO. Ground nos. 4 to 9 of the assessee do not require any adjudication at this stage.

9. With reference to ground nos. 10 to 14, both the parties have agreed that the issue to be restored to the file of AO for fresh adjudication. We have considered the arguments put forth by both the parties and perused the records. We feel it appropriate to restore the issues to the file of AO for denovo consideration. Accordingly ground nos. 10 to 14 are allowed for statistical purposes.

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

Order pronounced in the court on 11.06.2015.

Sd/-

[Mahavir Singh]
Judicial Member

Sd/-

[B.P.Jain]
Accountant Member

Date: 11.06.2015.

R.G.(P.S.)

Copy of the order forwarded to:

1. M/s. Acclaris Business Solutions Pvt. Ltd., 201, Ecospace, 2nd floor, Tower 2B, New Town Rajarhat, Kolkata-700156.
- 2 I.T.O., Ward-2(2), Kolkata.
3. C.I.T.- (A)- Kolkata.
4. CIT Kolkata
5. CIT(DR), Kolkata Benches, Kolkata.

True Copy,

By order,

Asst. Registrar, ITAT, Kolkata Benches

ITA No.695/Kol/2011
Acclaris Business Solutions Pvt.Ltd.
A.Yr.2007-08