

IN THE INCOME TAX APPELLATE TRIBUNAL  
BENGALURU BENCH 'A', BENGALURU

BEFORE SMT. ASHA VIJAYARAGHAVAN, JUDICIAL MEMBERS  
AND

SHRI. S. JAYARAMAN, ACCOUNTANT MEMBER

I.T(TP).A No.1256/Bang/2012  
(Assessment Year : 2008-09)

M/s. iSoft Health Services (I) P. Ltd,  
(Formerly M/s. IBA Health Services (India) P. Ltd,)  
Hafiz Court, New No.19 (Old No.8),  
Kodambakkam High Road,  
Nungambakkam, Chennai 600 034 .. Appellant  
PAN : AADCM5659D

v.

Income Tax Officer,  
Ward - 11(2), Bengaluru .. Respondent

Assessee by : Shri. Raghunathan P, CA  
Revenue by : Smt. Priscilla Singit, CIT - DR- I

Heard on : 25.07.2016  
Pronounced on : 30.09.2016

O R D E R

PER S. JAYARAMAN, ACCOUNTANT MEMBER :

This is an appeal filed by the assessee against the order of  
DRP dt.06.06.2012, for the assessment year 2008-09.

02. The assessee is engaged in the business of computer software development and consultancy in providing software services and maintenance to various clients engaged in running hospitals. During the year under consideration, it had entered into international transactions.

03. The TPO gave a show-cause notice dt.07.10.2011 to the assessee giving reasons for rejecting cost plus method and CUP method and proposing TNMM to arrive at the ALP. After considering the assessee's reply etc., the TPO substituted TNM method in the place of the Cost Pus Method (CPM) used by the assessee and consequently rejected the CUP method and then determined the ALP.

04. Aggrieved, the assessee approached the DRP and the DRP by its order dt.06.06.2012, inter alia, upheld the order of TPO. Being aggrieved with the order of ITO, Ward -11(2), Bengaluru, dt.31.07.2012, in pursuance of DRP order, the assessee is in appeal before this Tribunal. Its grounds of appeal are as under :

1. On the facts and in the circumstances of the case, the adjustments made to the arms length price (ALP) of software services by the learned assessing officer is opposed to law and accordingly the impugned addition of Rs.1,44,39,756/- is liable to be deleted, as such addition was just notional, **when no such income was earned by the Appellant.** Further the learned DRP has rejected all the grounds of objection in isolation **without considering the facts and circumstances of the case**, which was elaborated in detail.
2. The learned assessing officer ought to have refrained from referring the determination of ALP of Rs.1,77,19,075/- to the TPO in light of the instruction of the Board and the Appellant having not crossed the thresh-hold limit provided in the instruction of the Board and consequently the determination of ALP by the TPO is without jurisdiction and consequently the impugned addition of Rs.1,44,39,756/- as made was liable to be deleted.
3. The learned Assessing Officer having referred the matter to the TPO with regard to the various objections of the Appellant, had erred in accepting the opinion of the TPO without assigning any reason for accepting the same, though an opportunity was given to the appellant to make the representation, the order passed by the honorable DRP in rejecting the objections was not logical and convincing to the appellant.
4. The learned assessing officer as well as the DRP failed to consider the submissions of the Appellant, as they rely more on the data culled out from PROWESS and CAPITALINE without understanding the facts and circumstances and conceptual framework in which the assessee conducts its business and no comparable company engaged in the similar business of this scale.
5. **The revenue generation of the appellant depends on product sale which is cyclical. Hence during times of down turn the appellant would not able to make steady revenues, the fixed cost salary payables to technical staff has to be continually incurred to retain the talent pool** and also to continuously develop the product. The learned assessing officer as well as the DRP failed to consider the submissions of the Appellant with respect to the business always cannot run on profits, as the financial year 2007-08 saw the beginning of the Global Economic Crisis and onset of recession in the Global Market, thereby affecting the top line growth and consequent impact on profits margins hence **it is not proper for the TPO and the AO to take the AE transactions and apply a notional market margin and rework the same to arrive at notional profits.** These innovative methods of deriving profits are farfetched for reality.
6. Without prejudice, the DRP grossly erred in approving adjustments as suggested by the TPO blindly, without appreciating that in law, there cannot be any adjustments of notional margins and consequently, no adjustments could be made to ALP on such notional margins, especially after comparing with non-comparables wherein, even companies with manpower supply are compared in order arrive at notional profit.
7. Without prejudice, the impugned additions as made are arbitrary, excessive and ought to be reduced substantially.
8. For these and such other grounds that may be urged at the time of hearing, the Appellant prays that the appeal may be allowed.

05. Assessee has also filed an additional ground which is as follows:

“The Learned. TPO and DRP erred in rejecting the “comparable Uncontrolled Price” method adopted by the appellate (sic), correct one is appellant) as the most appropriate method of substantiating the arm’s length nature of the international transactions.”

06. Heard the AR and the DR. It is seen that this issue arose in the assessee’s case in a y 2007-08 which has been the subject matter before the DRP and the DRP has upheld the TNMM Method . The relevant portion of the DRP’s order for this A. Y is extracted as under:

6) **Ground of Objection-4: The order passed by the TPO reveal the lack of appreciation of the facts of the assessee’s case as they rely more on irrelevant case laws reproduced in a routine manner and a data culled out from ‘a dead and lifeless data bases’ bought out by Prowess and Capitaline without understanding the contextual framework in which assessee conducts its business. The TPO has worked out the ALP by working reverse direction, using TNM method and arrive at the ALP additions. The TPO has failed to appreciate that business always cannot run on profits. The assessee objects to these type of haphazard order passed in a routine manner.**

1. The assessee has stated that the Prowess and Capitaline data bases are dead and lifeless data bases. These allegations do not merit consideration, These data bases have been used in TP proceedings for several years The assessee has also not stated how it has arrived at such a conclusion. It appears that the main grievance arising to the assessee in this ground is the substitution of TNMM method in place of the Cost Pus Method (CPM) used by the assessee and the consequent rejection of the CUP method. This issue also arose for AY 2007-08 which has been the

subject matter before the DPP TNMM Method has been upheld by the DRP.

The reason why the CPM method cannot be applied to the assessee a case is as under:

- 1 The CPM method presents some practical difficulties in identifying the costs incurred for the provision of service like whether an indirect cost is towards rendering services or it is an enterprise level expense.
- 2 While applying CPM the taxpayer should have considered all direct and indirect costs incurred In respect of the services rendered by it. But, it is apparent from details given by the taxpayer that it did not include all the direct and indirect costs while computing gross mark up. The details of expense excluded were simply not available. Thus it was difficult to say whether the gross profit worked out in the case of the comparables is at the same level as that of the taxpayer.
- 3 As per the agreement, the taxpayer's cost of providing services included all costs that have been incurred by the taxpayer. All these expenses are reimbursed on cost plus basis. The tax payer is forgetting that it is also getting a percentage on other costs which have been excluded by the taxpayer in CPM So the cross margin shown by the taxpayer distorts the true picture of its financials for which TNMM method is the most appropriate method as It captures all expenses except interest, coinciding the cost base of the tax payer for reimbursement (as per the agreement and invoices raised by the tax payer).
4. The CPM method presents some difficulties in proper application, particularly in the determination of costs. Although it is true that an enterprise must cover its costs over a period of time to remain in business, those costs may not be the determinant of the appropriate profit in a specific case for any one year. While in many cases companies are driven by competition to scale

down prices by reference to the cost of creating the relevant goods or providing the relevant service, there are other circumstances where there is no discernible link between the level of costs incurred and a market price. So, when pricing of services is determined by market forces and it is almost constant across the industry, the cost plus method cannot be the most reliable or appropriate method.

2) Hence, for the above detailed reasons, CPM was rejected as the most appropriate method. And TNMM was utilized especially when the reliable data either in the taxpayer's case or in the comparable cases is not available for ascertaining the direct and indirect cost of production of services. The other methods such as CUP, Resale Price Method and Profit Split Method are also rejected due to the non availability of data and non applicability in the facts and circumstances of the case. Thus the TNMM was the most appropriate method in the facts and circumstances of the taxpayer's case. Accordingly objection no.4 is rejected.

7) Ground of Objection-5: The draft order passed without regard to the internal instructions issued by the Department that no ALP adjustment need to be made in a routine manner when the quantum of international transactions with the Associated Enterprises is less than Rs.15 crores, itself constitutes an arbitrariness in the passing of the order and the assessee objects on this ground also.

1) Before the DRP in its submission dated 02/06/2012 the assessee has stated that the total consideration involved which was proposed to be disallowed by the TPO was Rs. 1,77,19,075/- Which is far below the threshold limitation provided by the Board. Consequently it was submitted that the reference to the TPC was had and the order of the TPO suggesting adjustments to the declared

income was without jurisdiction and implementation of the same by the AC was again without jurisdiction. The assessee's submissions are not acceptable. The international transaction in terms of section 92CA was referred by the AO with the permission of the GT to the IPO. Once such expediency has been expressed by the AO and the CIT to refer a matter to the TPO nothing in the section 920A prohibits the making of such reference. The instruction to which the assessee refers is only an internal matter for guidance of Officers and there is no statutory prohibition to the making of such reference or the order of the TPO on such reference. Accordingly this ground is rejected.

- 8) Ground of Objection-6: The TPO / AO has arrived arbitrary margin of 23.65% and applied on the cost incurred to arrive at the proposed ALP & has made the arbitrary adjustment of Rs.1.44 crore, which the assessee vehemently objects as it is against the principles of natural justice and against the principles of practical business operations. This assumes the very impracticable possibility of business always on profit & assured profit which is incorrect.

Ground of Objection-7 : In view of the above, it is prayed before the Dispute Resolution Panel to consider the merits of the case. ground of appeal and the hardship to the assessee and drop the additions made by the TPO and AO and issue adequate directions to them accordingly u/s.144C and finalise the assessment.

- 1) Objections 6 & 7 are dealt with together, The TPO has arrived at the margin of 23.65% which is nothing but the average of OP/IC percentage. Such margin has been arrived at after considering the taxpayers objection, in this connection the adjustment was brought to the notice of taxpayer vide show cause notice dated 07/10/2011. Since the assessee has not specifically brought to the notice of this Panel its objections to the margin proposed by the TPO it

is not possible to deliberate on this matter further. It should also be noted that sufficient opportunity has been afforded to the assessee from the records of the TPO. Accordingly objection 6 & 7 are rejected.”

07. From the above, it is clear that the DRP considered all the issues raised by the assessee , including the rationale for TNMM, on which we could not find any infirmity. Thus, the assessee has not made out a case in its favour.

08. In the result, appeal of the assessee is dismissed.

Order pronounced in the open court on 30<sup>th</sup> day of September, 2016.

Sd/-

Sd/-

(SMT. ASHA VIJAYARAGHAVAN)  
JUDICIAL MEMBER

(S. JAYARAMAN)  
ACCOUNTANT MEMBER

MCN\*

Copy to:

1. The Assessee
2. The ITO Ward 11(2) , Bengaluru / The TPO -V , Bengaluru
3. The Principal Commissioner of Income Tax- I, Bengaluru
4. The DRP , Bengaluru.
5. The DR
6. GF, ITAT, Bangalore

By Order

Assistant Registrar