

IN THE INCOME TAX APPELLATE TRIBUNAL
“A” BENCH : BANGALORE

BEFORE SHRI A.K. GARODIA, ACCOUNTANT MEMBER
AND SHRI LALIET KUMAR, JUDICIAL MEMBER

IT(TP)A No.238/Bang/2016

Assessment year : 2011-12

M/s. Obopay Mobile Technology India Private Ltd., Enzyme JNC Business Center, 2 nd Floor, MPK Mansion, No.18, Guava Garden, 5 th Block, Koramangala, Bengaluru – 560 095. PAN: AAACO 9074H	Vs.	The Deputy Commissioner of Income Tax, Circle 5(1)(2), Bangalore.
APPELLANT		RESPONDENT

IT(TP)A No.553/Bang/2016

Assessment year : 2011-12

The Deputy Commissioner of Income Tax, Circle 5(1)(2), Bangalore.	Vs.	M/s. Obopay Mobile Technology India Private Ltd., Bengaluru – 560 095. PAN: AAACO 9704H
APPELLANT		RESPONDENT

Assessee by	:	Shri Padamchand Khincha, CA
Revenue by	:	Shri G.R. Reddy, CIT(DR)(ITAT)-1, Bengaluru

Date of hearing	:	22.02.2017
Date of Pronouncement	:	28.04.2017

ORDER

Per Laliet Kumar, Judicial Member

These are cross appeals preferred by the revenue and the assessee against the order of the Assessing Officer passed u/s. 143(3) r.w.s. 144C of the I.T. Act, 1961 consequent to the directions of the DRP.

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2. First we take up the revenue's appeal. Ground Nos.2 & 3 raised by the revenue is that the DRP erred in law in holding that the foreign exchange loss or gain is a part of operating expenses or operating income.

3. We have heard the rival contentions. The Id. AR has submitted that the foreign exchange gain/loss are part of operating revenue and therefore are required to be included. The Tribunal in the matter of SAP Labs has held that the foreign exchange fluctuation in respect of the assessee as well as comparables are operating in nature, therefore are to be taken into consideration while determining the ALP in the case of assessee. The Tribunal has held in various judgments that the foreign exchange loss/gain are operating in nature and therefore are required to be taken into consideration while calculating the ALP. However, the loss/gain of foreign exchange fluctuation are only required to be taken into consideration having direct co-relation of the transactions undertaken by the assessee as well as the comparable for the year under consideration i.e., if the dues remain unpayable after the export undertaken by the assessee or the

comparable company in the previous year and on that account some foreign exchange loss/gain was passed to the assessee/comparable as then said loss/gain is not required to be taken into consideration as operating in nature. U/s. 92C of the Act, the ALP is required to be determined in relation to the international transaction and the income arising from the international transaction shall be computed having regard to the ALP. The international transaction has been defined u/s. 92B and it clearly provides that the transaction entered between the assessee and AE in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, etc., having a bearing on the profits, income, losses or assets of such enterprises. Thus, it is the international transaction for the year under assessment, not the previous transaction entered between the assessee and its AE in the previous year. Therefore, the foreign exchange loss/gain is a part of operating expenses or operating income in respect of international transaction entered into between the assessee and its AE for the year under consideration and not for the previous year. In view of the above, ground Nos.2 &3 are set aside to the file of DRP with a direction to work out the actual basis in respect of foreign exchange with respect to loss/gain pertaining to the assessment year under consideration.

4. Ground No.4 pertains to risk adjustment. In this regard, attention of the Bench was drawn to para 4.8 of the DRP's order to the following effect:-

“4.8 The objection regarding adjustment on account of risk profile was raised by the assessee before DRP in relation to AY

2010-11 also and following the decision of the Hon'ble ITAT Bangalore in *Intellinet Technologies India Pvt. Ltd. vs ITO (ITA no, 1237/Bang/2007)* the TPO was directed to decide the percentage of risk adjustments to be calculated in that case. By means of guidance, it was mentioned that in the case of *DCIT vs. Hello Soft Pvt. Ltd. (2013) 32 taxmann.com 101 (ITAT, Hyd)* 1% adjustment to the average margin was provided towards risk differential. The DRP for AY 2010-11, after considering the submission of the assessee, has granted risk adjustment. Since the facts of the case remain the same, the TPO is directed to do the needful in above terms.”

5. The Id. DR has drawn our attention to the submissions made by the assessee before the TPO and it was submitted that no working in respect of comparable companies with respect to risk adjustment has been given and further in respect of assessee also no risk adjustment has been given. The Id. DR has submitted that no risk adjustment is required to be given to the assessee as there is no risk with the assessee for dealing with single customer i.e., with its AE and therefore risk adjustment granted by the DRP at 1% is unjustifiable.

6. We have gone through the record and applied our mind. In our view, the assessee is entitled to risk adjustment only when the assessee has given the detailed calculation of the risk adjustment in respect of comparable company as well as that of assessee. Since no detailed working has been given by the assessee in submission made before the DRP as well as before the TPO, in our view, grant of risk adjustment of 1% by the DRP to the assessee is without any basis and without any factual

foundation. In view thereof, we do not deem it appropriate to grant risk adjustment to the assessee. Accordingly, this ground of revenue is allowed.

7. The other grounds raised by the revenue are general in nature and therefore are not pressed.

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8. Now we will deal with the appeal filed by the assessee. The grounds raised are as follows:-

“Grounds relating to Transfer Pricing - Legal Issues

1. The Orders passed learned Deputy Commissioner of Income Tax, Circle-5(1)(2), Bengaluru (hereinafter referred as "AO" for brevity), learned Deputy Commissioner of Income Tax (Transfer Pricing) - 2(1)(2), Bengaluru (hereinafter referred as "TPO" for brevity) and the honourable DRP - II ("AO", "TPO" and DRP collectively referred as "lower authorities" for brevity) are bad in law and liable to be quashed.
2. The lower authorities have erred in:
 - a. Making transfer pricing adjustment of Rs. 4,73,19,859/-.
 - b. Re-computing the TP adjustment in the final assessment order without following all the directions of the honourable DRP and also not giving the basis of computation of TP adjustment arrived at in the final assessment order.
 - c. Making a reference to Transfer Pricing Officer for determining arm's length price.
 - d. Not appreciating that there is no amendment to the definition of "income" and charging or computation provision relating to income under the head "Profits & 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.

- e. Passing the order without demonstrating that the Appellant had motive of tax evasion.
3. Since the computation of TP adjustment, pursuant to DRP directions, has not been given in the final assessment order, the assessment order passed is bad in law.
4. Without prejudice, the lower authorities have erred in:
 - a. Rejecting some of the comparables selected by the Appellant in the TP study on unjustifiable grounds;
 - b. Ignoring the additional comparables proposed by the Appellant without giving any cogent reasons and on unjustifiable grounds;
 - c. Rejecting the transfer pricing analysis undertaken by the Appellant on unjustifiable grounds;
 - d. Conducting a fresh transfer pricing analysis despite absence of any defects in the transfer pricing analysis submitted by the Appellant;
 - e. Adopting inappropriate filters like one sided lower turnover filter, 25% RPT filter etc. in the process of selecting comparables;
 - f. Adopting companies as comparables even though they are not comparable in respect of functions performed, risks assumed, assets utilized, size, turnover having unusual business circumstance, high margins etc.
 - g. Inappropriately computing the operating margins of comparables;
 - h. Inappropriately computing the operating margin of the Appellant inter alia including loss on sale of asset and foreign exchange loss as part of operating cost;
 - i. Not making proper adjustment for enterprise level and transactional level differences between the Appellant and the comparable companies.

- j. Ignoring the business, commercial and industry realities and economic circumstances applicable to the Appellant vis a vis the comparables;
 - k. Not recognizing that the Appellant was insulated from risks, as against comparables, which assume these risks and therefore have to be credited with a risk premium on this account; and
 - l. Restricting working capital adjustment to 1.63%. Even otherwise not appropriately computing the working capital adjustment while computing the ALP
5. The lower authorities have erred in:
- a. Concluding that two deputed employees work for Obopay Inc without appreciating the facts and circumstances of the case;
 - b. Concluding that two deputed employees constitute service PE of Obopay Inc without appreciating that the jurisdiction of the TPO is only to compute ALP;
 - c. Treating salary paid to employees as international transaction without appreciating that salary was reimbursed to AE at cost basis; and
 - d. Considering 80% of salary paid to employees as TP adjustment by adopting flawed and arbitrary methodology, incorrect figures and assumptions, without selecting most appropriate method and comparables.
6. The lower income tax authorities have erred in not appreciating that the law does not compel adopting many (or any minimum) companies as comparables and that the Appellant could justify the price paid/charged on the basis of anyone comparable.
7. Assuming without admitting that the adjustment is to be made, the lower income tax authorities have erred in not allowing the benefit of the +/-5% range prescribed in the proviso to section 92C(2).

The Appellant submits that each of the above grounds/ sub-grounds are independent and without prejudice to one another.

The Appellant craves leave to add, alter, vary, omit, substitute or amend the above grounds of appeal, at any time before or at, the time of hearing, of the appeal, so as to enable the Income-tax Appellate Tribunal to decide the appeal according to law.

The Appellant prays accordingly.”

9. The assessee is engaged in two distinct business segments viz., (a) development and delivery of domain specific software for Obopay Inc.; and (b) establishing, deploying and maintaining a platform for making mobile payments and facilitating related services for users in India. The assessee during the assessment under consideration has derived income from software development services amounting to Rs.41,13,14,580 and the assessee has also undertaken international transactions in the form of reimbursement of expense paid to its AE amounting to Rs.2,17,76,409; purchase of fixed assets amounting to Rs.5,69,112, share application received amounting to Rs.14,35,51,141.

10. The assessee filed return of income and the case of assessee was selected for scrutiny assessment and thereafter the case was referred to the TPO as international transaction was involved. The assessee has selected 13 comparables for the year under consideration on the basis of middle year data and PLI was calculated at 15%. The arithmetic mean of the comparables was calculated by the assessee in the TP study at 13.66%. As the PLI of the comparables was within 5% range, therefore no adjustment was proposed by the assessee.

11. The TPO has rejected the TP study of the assessee and thereafter he has used the following filters:-

- a. Current year data
- b. Companies having software development income < Rs,1 crore were excluded
- c. Companies whose software development service and related services is less than 75% of the total operating revenues were excluded
- d. Companies who have more than 25% related party transactions of the sales were excluded
- e. Companies who have persistent losses for the last three years upto and including FY 2010-11 were excluded
- f. Companies having different financial year ending (i.e. not March 31, 2011) or data of the company does not fall within 12 month period i.e. 01-04-2-1- to 31-03-2011, were rejected
- g. Companies that are functionally different from the taxpayer were excluded
- h. Companies that are having peculiar economic circumstances were excluded
- i. Companies who have export sales less than 75% of the sales in software cases were excluded
- j. Companies with employee cost less than 25% of turnover in software cases were excluded.

12. On the basis of above filters and the objections raised by the assessee, the TPO has considered 13 comparables which are as under:-

Sl. No.	Name	Sales	Cost	PLI
1	Acropetal Technologies Ltd. (seg)	814,016,893	616,754,876	31.98%
2	e Zest Solutions (from Capitaline)	112,866,098	93,255,341	21.03%
3	E-infochips Ltd.	260,384,251	166,447,527	56.44%
4	Evoke (from Capitaline)	144,869,912	133,996,568	8.11%
5	I C R A Techno Analytics Ltd. (in 000)	158,401,000	126,894,000	24.83%
6	Infosys Ltd.	253,850,000,000	177,030,000,000	43.39%
7	Larsen & Toubro Infotech Ltd.	233,181,122,096	19,764,861,289	19.83%
8	Mindtree Ltd. (seg)	8,783,000,000	7,937,143,242	10.66%
9	Persistent Systems & Solutions Ltd.	189,490,457	155,172,089	22.12%
10	Persistent Systems Ltd.	6,101,270,000	4,971,860,000	22.84%
11	R S Software (India) Ltd.	1,882,638,741	1,617,804,170	16.37%
12	Sasken Communication Technologies Ltd.	3,941,962,000	3,175,616,000	24.13%
13	Tata Elxsi Ltd. (seg)	3,581,985,000	2,962,533,352	20.91%
	AVERAGE MARGIN			24.82%

13. On the basis of the said comparables, the TPO has made the adjustment to the extent of Rs.29,290,704.

14. The assessee challenged the direction issued by the TPO before the DRP. The DRP has adjudicated the issues raised by the assessee and thereafter pass an order. Feeling aggrieved by the order passed by the DRP, the assessee is before us.

15. Before us, the Id. AR of assessee has submitted that out of the 13 comparables finally retained by the TPO, the various comparables are required to be excluded by applying the turnover filter as the turnover of the assessee company is Rs.41,13,14,580.

16. It was submitted that the Tribunal is taking the turnover filter of 10 times of the turnover of assessee as well as $1/10^{\text{th}}$ of the turnover of assessee i.e., companies which are falling with $1/10^{\text{th}}$ and 10 times of the assessee's turnover are required to be retained and the companies which are falling less than $1/10^{\text{th}}$ and more than 10 times of the turnover are required to be excluded. By applying the above logic, if we look into the turnover given by the TPO in his order, then we can come to the conclusion that the following companies are required to be excluded by applying the turnover filter:-

	<u>Turnover (in Crores)</u>
1. Infosys Ltd.	25,385
2. Larsen & Toubro Infotech Ltd.	2,181
3. Mindtree Ltd.	878
4. Persistent Systems Ltd.	610

17. Since turnover of these companies are more than Rs.410 crores i.e., more than 10 times of the turnover of assessee, therefore these companies are required to be excluded as comparables in terms of size and therefore are directed to be excluded. The TPO/AO is directed to exclude these companies from the list of comparables.

18. After excluding the above 4 companies, now we will deal with the companies left behind one after the other.

19. Regarding the comparables viz., Acropetal Technologies Ltd., E-Zest Solutions Ltd., E-Infochips Ltd., Evoke Technologies Pvt. Ltd., I C R A Techno Analytics Ltd., Persistent Systems & Solutions Ltd., Sasken Communication Technologies and Tata Elxsi, our attention was drawn to para 4.3 of the DRP's order wherein the DRP has rejected the objection raised by the assessee without giving a reasoned order. The order of DRP is reproduced hereinbelow:-

“ It can be seen that the TPO has used appropriate and relevant filters to select the comparables which cannot be faulted. The comparables of the assessee that do not compare functionally or do not qualify filters are rejected. The TPO has given reasons to justify either selection or rejection of a company as comparable. In view of this, the objections of the assessee relating to selection/rejection of comparables cannot be accepted.”

20. In our view, once the assessee has raised the objection with respect to functional data, employee cost and application of RPT filters, it is the duty of the DRP to examine the objections of the assessee. Since the DRP has not decided the issue after detailed and elaborate examination of facts and law, we therefore deem it appropriate to remand the matter to the file of DRP to deal with the objections appropriately and pass a reasoned order on the issues raised by the assessee. In view thereof, these issues are decided in favour of assessee for statistical purposes.

21. The next ground raised by the assessee is with respect to ground No.5 which reads as follows:-

- “5. The lower authorities have erred in:
- a. Concluding that two deputed employees work for Obopay Inc without appreciating the facts and circumstances of the case;
 - b. Concluding that two deputed employees constitute service PE of Obopay Inc without appreciating that the jurisdiction of the TPO is only to compute ALP;
 - c. Treating salary paid to employees as international transaction without appreciating that salary was reimbursed to AE at cost basis; and
 - d. Considering 80% of salary paid to employees as TP adjustment by adopting flawed and arbitrary methodology, incorrect figures and assumptions, without selecting most appropriate method and comparables.

22. It is submitted that these two employees were working for the assessee as mentioned in the reply submitted by the assessee and reproduced by the AO in paras 13 to 13.6 and other pages from 19 to 32.

The Id. DRP dealt with the issue in para 5.1 & 5.2 as under:-

“5.1 This issue has been discussed by the TPO from Page 19 to Page 31 of his order. The TPO has verified the details of work done by two employees Raj Aji and Gary Singh engaged as VP (Business Development & Legal Affairs for Emerging Markets) and VP (Channels & Global Relationship) respectively: After verifications of the details of job profile of the seconded employees the TPO has observed that their job is to ensure that information relayed to Obopay Inc. is accurate and Sri Gary Singh has been seconded by Obopay Inc to further the interest of that company in assessee's business. He has been sent to maintain control over assessee's business by Obopay Inc. The TPO has further observed that "after consideration of submission of assessee, the functions of the two employees were restudied. It is clear that they were seconded by Obopay Inc. to oversee the deal with Nokia India and establish control over the Indian company

via monitoring and review. Raj Aji is not an Indian resident and has flimsy exposure to legal matters in India. Indian law is different from American law. A further evidence is that Obopay Inc has been a signatory to most agreements with Nokia India. Obopay Inc was engaged in the whole process of legal arbitration and negotiation. They can not do that without having their legal person in India. Raj Rai clearly worked on behalf of Obopay Inc in India. As such he is a "Service PE" of Obopay Inc in India. It is also interesting to see that the employment agreement is between Obopay Inc and Raj Rai. Scanned copy of agreement placed in this order after Para 13.8.

Clear evidence of Raj Rai's complicity is available in the form of an agreement submitted by assessee to this office in which Raj Rai has signed on behalf of Obopay Inc in 2011. The piece of incrementing evidence is scanned and reproduced as under".

5.2 The TPO has further mentioned that the service conditions, pay structure, pay conditions, etc. were established by Obopay Inc for both Gary Singh & Raj Rai. Assessee had no role to play in determination of pay structure or other benefits. These employees could also not be removed by the assessee. Thus, the TPO has finally concluded that it cannot be denied that while overseeing and performing business interest of Obopay Inc in India, they must have also performed some work for Obopay India. In view of non-compliance on part of assessee to supply data as regards list of employees, their designation, work profile and pay, etc. a reasonable ratio of 80% pay towards service PE of Obopay Inc and 20% pay towards service beneficial to assessee is adopted. Consequently, TPO has made an adjustment of Rs.1,74,21,127/-."

23. The Id. AR has ably submitted that the salary paid by the assessee to these employees were merely on the basis of reimbursement of the cost and therefore the apportionment of 80:20 given by the TPO is without any basis and it will amount to double addition. Para 6.15 was more particularly referred to by the Id. AR to the Bench and on the basis of that it was

submitted that Raj Rai was a part of support team and performed his services in legal department and 70% of the cost was allocated to SWD segment of assessee. This was marked up 15%. Therefore, effectively, 70% of salary on the mark up of 15% is already billed to AE. On the basis of the above, it was submitted that if the salary is apportioned to the extent of 80:20, that will result into double addition and therefore it is required to be excluded.

24. We have heard the rival contentions of the parties and perused the record. In our view, this issue is also required to be sent back to the file of DRP. The assessee called upon by the TPO vide notice dated 01.12.14 to provide the complete list of employees along with designation, work profile and pay. However, the assessee has failed to provide the details and in the absence of any particulars given by the assessee, the TPO had adjudicated the issue and estimated based on the material available in the ratio of 80:20 i.e., 80% pay is towards Service PE of Obopay and 20% towards services beneficial to assessee. Since the assessee has not provided the details as sought by the TPO, therefore the TPO has only decided this issue on the basis of material available. It is incumbent upon the assessee to render all possible help and provide all documents which are necessary and relevant for adjudication of the issues. As the assessee has not provided these details, therefore we direct the assessee to provide all the details as sought for by the TPO vide notice dated 01.12.2014. It is further directed that the Id. DRP on receipt of this information from the

assessee, shall decide the issue afresh. Accordingly, this issue is allowed in favour of assessee for statistical purposes.

25. In the result, the appeal of revenue is partly allowed and the appeal of assessee is allowed for statistical purposes.

Pronounced in the open court on this 28th day of April, 2017.

Sd/-

(A.K. GARODIA)
Accountant Member

Sd/-

(LALIET KUMAR)
Judicial Member

Bangalore,
Dated, the 28th April, 2017.

/ Desai Smurthy /

Copy to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.
6. Guard file

By order

Assistant Registrar,
ITAT, Bangalore.