

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI "I-2" BENCH, NEW DELHI**

[Coram: Diva Singh JM and Pramod Kumar AM]

ITA No.5023/Del/2012
Assessment year: 2007-08

**Dy. Commissioner of Income Tax,
Circle 3(1), Ahmedabad.**

.....**Appellant**

Vs.

Calance Software Pvt Ltd
201, Greenwood Plaza, Sector 25
Gurgaon 122 002 [PAN: AACCC5176A]

.....**Respondent**

Appearances by:

**B Ramanjaneyulu for the appellant
Manoj Kumar for the respondent**

Date of concluding the hearing : April 11, 2017
Date of pronouncing the order : May 30, 2017

O R D E R

Per Pramod Kumar, AM:

1. This appeal is directed against the learned CIT(A)'s order dated 23rd July 2012 in the matter of assessment under section 143(3) of the Income Tax Act, 1961, for the assessment year 2007-08.

2. Grievances raised by the appellant, which we will take up together, are as follows:

1. The Ld. CIT(A) erred on facts and in law in deleting the addition made on account of Arm's Length Price u/s 92CA(3) amounting to Rs.52,57,418/-.

2. That the Ld. CIT(A) has erred in not considering the arguments put forth by the TPO in his order that in so far as application of CUP to

the international transaction between assessee and Calance US for an independent contract is concerned.

3. That the Ld. CIT(A) has erred in not taking cognizance of the aberrations/differences between the agreement with Vision gain and that with Calance US, as pointed out by the TPO in para 6 on page 4 of the order while rejecting CUP method of the assessee.

4. That the Ld. CIT(A) has erred in his observation that under TNMM the margin between the comparables and the assessee is similar is also erroneous. The Ld. CIT(A) has taken the total cost at Rs.2,40,57,988/- on pro rata basis. However, the total cost figure submitted by the assessee and accepted by the TPO in the TP proceedings is Rs.2,82,29,264/-. This figure is arrived at after excluding certain non-operating expenses, as mentioned in detail by the TPO at para 12 on page 62 of his order. This has not been discussed or taken into cognized by the Ld. CIT(A).

3. The assessee is engaged, inter alia, engaged in providing services such as software development. During the relevant previous year, the assessee rendered software development services to its associated enterprises. There were three different transactions, values of which aggregated to Rs 3,01,19,496, and all these transactions were with Calance Corporation, United States. Two of these three transactions, as noted by the Transfer Pricing Officer, were back to back transactions in respect of contracts that Calance US had entered into independent entities by the name of Adjoined Consulting (US \$ 4,25,320) and Heritage Valley Health System (US \$ 85,000). There is no dispute that **these contracts were passed on to the assessee company (by Calance US) and the entire amount of US \$ 5,10,320 was passed on to the assessee**. The stand of the assessee was that since these are back to back transactions, these transactions are required to be taken as having been entered into at an arm's length price. As regards the third transaction, as noted by the TPO, **there were some direct software development services also worth US \$ 1,57,739 which was rendered by the assessee to Calance US**. It was also noted, in this context, that **the assessee has reported that identical services have been provided to a company (independent enterprise), namely Vision Gain (at a lower price), and, therefore, these services were also (stated to be) at an arm's length price**. It was also noted that the benchmarking has been done on the basis of Comparable Uncontrolled Price (CUP) method. The Transfer Pricing Officer, however, did not approve the stand so taken by the assessee. The TPO was of the view, inter alia, that the CUP is not the most appropriate method on the facts of this case as the functions of the assessee company vis-à-vis Calance US are different inasmuch as the assessee is simply a software developer whereas Calance US is a large scale business entity, suggesting that the price at which assessee should sell to Calance US cannot be compared with the price at which Calance US sells to its client. It was so observed in the context of

back to back contracts. As regards direct software development services of US \$ 1,57,739 to Calance US and its comparison with billing to UK based independent entity Vision Gain, it was observed that there is nothing to show that the skills employed in the case of services to Vision Gain vis-à-vis Calance assignment are similar or even comparable,. It was also noted that while Calance US was billed on the basis of INR 4,000 per day, billing basis for vision gain was comprehensive costing based on time and material model that there was no mention of 24 X 7 support model to Calance US, that the payment schedule was not specified in the case of Calance US whereas in Vision Gain case it was a phased payment after completion of work, and finally in the case Calance US market was USA, whereas Vision Gain related to UK market. It was in this backdrop that the TPO rejected application of CUP method on the facts of this case. He also observed that when reliable method viz TNMM is available, then there is no need to go to CUP especially when reliable data of the comparable cases is not available for ascertaining the man hourly charges for identical or near identical services in an uncontrolled transaction or by an independent enterprise+. He then proceeded to adopt TNMM, as the most appropriate method, for benchmarking these transactions. Based on the selection of comparables, which, for the reasons we will set out in a short while, we need not deal with in detail, an arm's length price margin of 25.32% was computed. Taking the cost base at Rs 2,82,29,264, the arm's length price of the software development services was computed at Rs 3,53,76,914- as against the price of Rs 3,01,19,496 on which the services were actually rendered. Accordingly, an ALP adjustment of Rs 52,57,418 was made. Aggrieved, assessee carried the matter in appeal before the CIT(A). Learned CIT(A) was of the view that when a reasonable CUP input, as in the present case, was available and particularly as the TPO himself, though in the immediately succeeding assessment year, has accepted the CUP as most appropriate method in respect of similar transactions, there is no good reason to reject the CUP as most appropriate method in this assessment year. It was also noted that the assessee had a modest turnover of less than Rs 4 crores. Learned CIT(A) also noted that if the segment relating to export turnover to AE is taken into account, the operating margin, i.e. OP/TC, of this segment will come to 25.20%. It was also noted that this margin is thus comparable with the arm's length margin computed by the TPO, and that the identified costs incurred by the assessee can be directly allocated and the overheads can be divided on pro rata basis. In effect, thus, according to the CIT(A), whichever way one looks at it- whether on the basis of CUP or TNMM, the transactions entered into by the assessee are at arms length price. The ALP adjustment was thus deleted. The Assessing Officer is aggrieved and is in appeal before us.

4. We have heard the rival contentions, perused the material on record and duly considered facts of the case as also the applicable legal position.

5. We find that, so far as the back to back transactions are concerned, the services rendered by the assessee to the AE are exactly the same as, in effect, rendered by the AE to the independent transaction. The price charged for the same service by the AE to the independent end customer is thus the best CUP input in respect of such a back to back transaction. If a unit sells a product to its AE for INR 100 and the AE sells the same product to an independent enterprise for INR 100, the intra AE transaction cannot but be termed as the arm's length transaction. The stand of the revenue however is that, as evident from FAR analysis, the functions performed by the Calance US are far more comprehensive, the assets employed Calance US are much more and risks assumed are much higher. What is, however, overlooked that this FAR analysis has to be with respect to the particular transaction, and when transaction is exactly the same, there cannot be any occasion for the FAR of the transaction being any different. In principle, thus, so far as back to back transactions at the same price are concerned- whether between the AEs or by the AE to the end customer independent enterprise, these are inherently arm's length transactions on the basis of CUP analysis. The distinction drawn by the TPO on the basis of FAR analysis of the enterprise rather than the transaction, which is sought to be justified before us by the learned Departmental Representative, is a distinction without any difference. It is also incorrect to proceed on the basis, as has been done by the TPO, that when TNMM inputs are available, the application of CUP can be rejected. CUP is not a residuary method. As a matter of fact, when perfect CUP inputs are available- as in this case in respect of back to back transaction, that is the best and inherently most suitable method, as it is a direct method and it hardly leaves any scope for distortion of results by extraneous factors. We reject the plea of the learned Departmental Representative on this point. However, so far as third transaction of rendering software development services for US \$ 1,57,739 to Calance US is concerned, we have noted that there is only one comparable available, and that too, as learned Departmental Representative rightly points out, was at an exceptionally lower rate as the assessee was trying to enter a new market. This solitary transaction, according to the learned Departmental Representative, cannot be said to be representative of the commercial transactions of this nature in the US market. Learned counsel for the assessee was also fair enough in not contesting these facts, particularly with respect to a single comparables of small size and in respect of a new market that the assessee was trying to enter, but he did state that even if this CUP input is ignored, there will not be any need of ALP adjustment because the margin on this transaction, when computed correctly, will be comparable with the arm's length margin computed by the TPO. However, we have noted that this aspect of the matter has not been dealt with by the CIT(A) in sufficient detail, by way of a speaking order, and all that the CIT(A) has stated that the total costs of software development comes to Rs 2,40,57,988. As evident from observations made by the TPO, at page 62 of his order, to the effect that "though it

is mentioned that at Annexure 7, it has attached a chart which shows costs related to revenues to international transaction, no such chart has been attached, the TPO had no occasion to examine this aspect of the matter and, therefore, examine assessee's claim for correct computation of its margins. We, therefore, consider it appropriate to remit this limited aspect of the matter for the verification by the TPO. In case he finds factual claim of the assessee to be correct, and that the right computation of assessee's margin within permissible range of deviation from the ALP computed by the TPO, the matter ends there, and the relief granted by the CIT(A) will stand confirmed on this transaction as well. In any other case, he will be at liberty to pass a fresh order, in respect of the last transaction of US \$ 1,57,739 only, after giving a reasonable opportunity of hearing to the assessee, in accordance with the law and by way of a speaking order.

6. In effect, the matter stands restored to the assessment stage, with directions as above, in respect of third transaction of software development services of US \$ 1,57,739, for verification and, if necessary, fresh adjudication.

7. In the result, the appeal is partly allowed for statistical purposes in the terms indicated above. Pronounced in the open court today on the 30th day of May, 2017.

Sd/xx
Diva Singh
(Judicial Member)

Sd/xx
Pramod Kumar
(Accountant Member)

New Delhi, the 30th day of May 2017

Copies to: (1) The appellant (2) The respondent
(3) Commissioner (4) CIT(A)
(5) Departmental Representative (6) Guard File

By order

Assistant Registrar
Income Tax Appellate Tribunal
Delhi benches, New Delhi