IN THE INCOME TAX APPELLATE TRIBUNAL
AHMEDABAD "D" BENCH

(BEFORE SHRI N.K. BILLAIYA, ACCOUNTANT MEMBER & SHRI MAHAVIR PRASAD, JUDICIAL MEMBER)

ITA. No: 2411/AHD/2014 (Assessment Year: 2009-10)

Effective Teleservices Pvt. Ltd. 1st Floor, IT Tower IV, Infocity, Nr. Indroda Circle Gandhinagar-382009	**V/S**	**Asst. Commissioner of Income Tax, Gandhinagar Circle, Gandhinagar**
(Appellant)		**(Respondent)**

PAN: AAACE9318E

Appellant by	**: Shri Dhinal Shah, AR**
Respondent by	**: Shri V.K. Singh, Sr. D.R.**

(आदेश)/ORDER

Date of hearing : 08 -01-2018
Date of Pronouncement : 16 -01-2018

PER N.K. BILLAIYA, ACCOUNTANT MEMBER:

1. This appeal by the Assessee is directed against the order of the Ld. CIT(A), Gandhinagar, Ahmedabad dated 02.06.2014 pertaining to A.Y. 2009-10.

2. The assessee is aggrieved by the Transfer Pricing Adjustment of Rs. 37,716,838/- made by the TPO and confirmed by the CIT(A). Alternatively, the assessee claims that Internal TNMM should have been considered as the most appropriate method.

3. Representatives of both sides were heard at length. Having heard the rival contentions, we have carefully perused the orders of the authorities below.

4. Briefly stated the facts of the case are that the appellant company is engaged in providing various call center services such as operations support staff services. TQM verification, data entry etc to its Associated Enterprises in USA and other unrelated parties both within and outside India.

5. The appellant company had benchmarked the said transactions in its transfer pricing study using internal comparable Uncontrolled Price (CUP) Price Method. As the average hourly rate from AE in USA was higher than that of the Non AEs in UK, the transactions were considered to be at arm's length.

6. During the course of the transfer pricing assessment proceedings, the appellant company also submitted additional analysis in the form of Internal Transaction Net Margin Method. The net margins derived from AE business was higher than that of Non AE business and hence again the transactions were considered to be at arm's length.

7. While framing the transfer pricing assessment order, the TPO rejected the Internal CUP and also rejected the Internal TNMM as submitted during the course of transfer pricing assessment proceedings. The TPO concluded the

proceedings by applying the external TNMM by adopting five comparables. The TPO rejected the search undertaken by the appellant company and the external comparable companies given by the appellant.

8. Assessee carried the matter before the ld. CIT(A) but without any success.

9. The ld. CIT(A) held that internal CUP as well as internal TNMM was not applicable to the facts of the case in hand. Though, the ld. CIT(A) rejected 3 out of the 5 comparables selected by the TPO but confirmed the upward adjustment. Rejecting all the comparables given by the assessee. The ld. CIT(A) held only 2 comparables companies comparable.

10. We have given thoughtful consideration to the orders of the authorities below. We find that the assessee is eligible for tax holiday u/s. 10A of the Act, therefore, we do not find any merit in holding that the assessee manipulated the prices and shifted the profits to the overseas jurisdiction for avoiding taxes in India. Moreover, the taxes rates in the USA are higher than the tax rates prevailing in India. Moreover, the AE of the appellant company has incurred losses in providing end to end services to third parties. If the assessee had directly undertaken contracts with the third parties in USA, it would also have incurred operating losses as against operating profits earned while undertaking transactions with AEs.

11. We find that the appellant company has earned average hourly rate from its AE business at Rs. 274.39 per hour. As against the same, the average hourly rate from Non AE business was Rs. 108.82 per hour. Thus, the average hourly rate earned from AE business was more than Non AE business. The only reason

for rejecting the assessee's contention is that the pricing mechanism in case of AE as well as Non AEs was different; therefore, CUP is not applicable. In our considered opinion, merely because pricing mechanism is different, internal CUP should not have been rejected.

12. We find that the TPO has mentioned in the order that the risk profile of AE and non AE is entirely different. In our considered opinion, reasonable accurate adjustment cannot be made for such risk differences and if the risk adjustment is made, the same would further reduce the average hourly rate charged from AE which is, as mentioned elsewhere, lower than the average hourly rate charged from AE. Therefore, in our understanding of the facts, internal CUP should have been accepted as most appropriate method.

13. For the sake of completeness of the adjudication, rejection of internal TNMM analysis undertaken by the appellant during the course of transfer pricing assessment should not have been rejected. We find that the appellant company has provided identical services to AE as well as non AEs and functions performed, assets used and risks assumed in AE as well as non AE business were similar. Therefore, in our considered opinion, even internal TNMM can be considered as most appropriate method. We find that the operating margin of the appellant from the AE segment was derived at 30.90% and the operating margins in the non AE segment was derived at Rs. 74.92%.

14. The TPO rejected the internal TNMM analysis on the basis that as the appellant has made operating loss in non AE business, the transactions with non AEs are not at independent rates and they have been undertaken only to increase capacity utilization. The total turnover of Non AE segment of Rs. 5.67

lacs as against the turnover of Rs. 1909.60 lacs in the case of international transactions with AE. The ld. CIT(A) confirmed the rejection by holding that the turnover of the third party segment is very much less compared to that with AE. The ld. CIT(A) further held that the appellant has not proved the allocation of the common cost between AE and non AEs and whether they are scientific and at arm's length. We find that the TPO has nowhere disputed the common cost allocation made by the appellant. We also find that the ld. CIT(A) has also never raised any doubt on the allocation. Insofar as the difference in the turnover, we find that the Tribunal Delhi Bench in the case of Lummus Technology Heat Transfer BV Vs. DCIT 42 taxmann.com 342 has held as under:-

> *5. Rule 10B(l)(e) of the Income Tax Rules, which deals with the Transactional Net Margin Method, provides requires that "the net profit margin realised by the enterprise (i.e. the assessee) from an international transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base" is compared with " the net profit margin realised by the enterprise (i.e. the assessee) or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base" - of course, subject to comparability adjustments which could affect the amount of net profit margin in uncontrolled conditions. It is not at all necessary, as the authorities below seem to suggest, that such net profit computations, in the case of internal comparables (i.e. assessee's transactions with independent enterprise), are based on the audited books of accounts or the books of accounts regularly maintained by the assessee. hi our considered view, all that is necessary for the purpose of computing arm's length price, under TNMM on the basis of internal comparables, is computation of net profit margin, subject to comparability adjustments affecting net profit margin of uncontrolled transactions, on the same parameters for the transactions with AEs as well as Non AEs, i.e. independent enterprises, and as long as the net profits earned from the controlled transactions are the same or higher than the net profits earned on uncontrolled transactions, no ALP adjustments are warranted. It is not at all necessary that such a computation should be based on segmental accounts in the books of accounts regularly*

maintained by the assessee and subjected to audit. We are, therefore, of the view that the authorities below were in error in rejecting the segmental results on the ground that the segmental accounts were not audited and that these segmental accounts were not maintained in the normal course of business. As regards vague generalizations by the TPO to the effect that these accounts are manipulated, that allocation basis of expenses is unfair and that these accounts conceal true profitability, we find that these observations are too sweeping and generalized the observations to have any merits. In any event, learned counsel for the assessee has painstakingly taken us through the segmental accounts, pointed out the basis of allocation of the expenses. We have noted that the allocation of expense is on the man hour basis, which is quite fair and reasonable, and that every person has to punch in hours on a specific project. We have also noted that all these details and expense allocation basis were also before the TPO and even then, no specific defects were pointed out by the TPO. Taking into account all these factors, as also entirety of the case, we are of the considered view that the TPO indeed erred in rejecting the segmental accounts and thus declining to accept the internal comparable. We are also of the view that the size of the uncontrolled transaction or transactions being smaller, by itself, does not make these transactions incomparable with the transactions in controlled conditions. Size of the comparable does matter in entity level comparison because scale of operations substantially vary and so does the underlying profitability factor, but in a transaction level comparison within the same entity, mere difference in size of the uncontrolled transactions does not render the transaction incomparable. If the size of uncontrolled transaction is too big, it may call for an adjustment for volume business. If the size of the uncontrolled transaction is too small, it may provoke an inquiry by the TPO to ensure that it is not a contrived transaction outside the normal course of business or with regard to other significant factors surrounding smallness of such transaction. However, in our considered view, in none of these cases, a comparable can be rejected on the basis of its size per se. In this view of the matter, the authorities below were clearly in error in rejecting the internal comparable, i.e. profitability of assessee's transactions with non AEs, on the ground that the volume of business with non AEs was too small vis-a-vis business with AEs. In view of these discussions, as also bearing in mind entirety of the case, the assessee was quite justified in adopting internal TNMM and comparing the profit earned on its transactions with AEs with profit earned with non-AEs. Accordingly, the ALP adjustment of Rs. 2,72,42,940/- deserves to be deleted. We order so. The assessee gets the relief accordingly.

15. The Tribunal Hyderabad Bench in the case of NTT Data Global Delivery Services Limited. 63 taxmann.com 92 had taken a similar view and followed the findings given in the case of Lummus Technology Heat Transfer BV (supra).

16. At this stage, it would be pertinent to refer to the financial analysis of comparable companies which is as under:-

Margin of Comparable companies

Sr. No.	*Name of Company*	*Unadjusted Operating Profit on Operating Cost*		
		OP	*OC*	*OP/OC*
1	*All sec Technologies Ltd.*	*(10,59,19,000)*	*1,16,96,95,000*	*-9.06%*
2	*CG-Vak Software and exports Ltd. (Segment)*	*3,44,058*	*89,50,183*	*3.84%*
3	*Cosmic Global Limited*	*2,52,49,856*	*5,23,89,737*	*53.17%*
4	*Informed Technologies India Ltd.*	*40,75,587*	*1,77,59,572*	*22.95%*
5	*R Systems India Limited (Segment)*	*1,23,65,000*	*25,11,72,000*	*4.92%*
	Average			*15.1%*

	ETPL (Tested Party)	*5,72,59,082*	*18,53,32,713*	*30.90%*

17. The ld. CIT(A) rejected Allsec Technologies Limited as comparable by observing as under:-

> *4.2.7.7 Allsec Technologies Limited is primarily engaged in the business of operating a call center, The services provided by the company include data verification, processing of orders received through telephone calls, telemarketing, monitoring quality of calls of other call centers, customer services and HR and payroll processing for domestic companies. For the period ended 31 March 2009, 31 March 2008 and 31 March 2007, 90 percent, 99 percent and 99 percent of the operating revenues respectively were derived from the above mentioned services. Therefore, this company is functionally comparable, however, because I have rejected all companies having export turnover less than 75%, the company should not be selected as comparable company.*
>
> *Accordingly, Allsec Technologies Ltd cannot be accepted as comparable.*

However without prejudice to the above, since the appellant has carried out the search during the assessment proceedings and not documented the same while maintaining the documents as prescribed under section 92D r.w Rule 10D, I am not inclined accepted such exercise as post facto analysis. The documents required to be prepared and maintained by the appellant has to be contemporaneous i.e. should be prepared and maintained at the time when the international transactions are entered into by the appellant and not during the course of the assessment proceedings. Accordingly in light of decision of UCB India (P) Ltd (supra) the entire exercise of the appellant should be discarded.

18. The other reason given by the First Appellate Authority is that the assessee carried out the search during the assessment proceedings and therefore such exercise was considered as post facto analysis. We do not find any merit in the observations/findings of the ld. CIT(A). The Tribunal Delhi Bench in the case of Mercer Consulting India Private Limited 47 taxmann.com 84. While considering Allsec Technologies Ltd. as comparable has observed as under:-

9.1 *This case was included by the assessee in the list of comparables which was excluded by the TPO on the ground of diminishing sales for the last three years and the export revenues less than 75% of the total turnover. Here, it is relevant to mention that the TPO adopted certain filters which have been mentioned on pages 13 and 14 of his order. One of such filters is the exclusion of companies whose export sales are less than 75% of the total sales from ITES. Another filter applied by the TPO is the exclusion of cases with diminishing revenues. The TPO recorded that this company has some peculiar problems and hence the same is not in line with the growth in software industry. However, he did not delve into the actual figures of diminishing revenues of this company. As against this, it is observed that Allsec's operating revenue has increased in the financial year 2008-09 over the previous year which is apparent from the Statement of facts given by the assessee. On a specific query, the Id. DR could not point out any material to indicate or support the TPO's assertion in his order about the diminishing of Allsec Technologies Ltd for the last*

three years. The second reason given by the TPO for discarding this case from the list of comparables is export less than 75% of the total turnover. We observe that albeit this contention of the TPO is correct that this case does not pass the filter or test laid down by the TPO, but the fact of the matter is that the actual ratio of export revenue to total turnover of Allsec Technologies stands at 74.45% as shown on page 84 of the paper book. If we literally consider the filter applied by the TPO, this case does not pass the test. However, it is seen that the assessee included this case in the list of comparables by applying the filter of excluding the cases in which export revenue was less than 25% of the total revenue. There can be no hard and fast rule for putting a specific ceiling in a particular filter. The filters are not sacrosanct as not statutorily prescribed. These are used or modified for selection or rejection of comparables as per the convenience of the concerned party. If an assessee wants to include a certain case in the list of comparables which suits its requirements, then, it will suitably modify the filter itself or the ceiling in such filter, so as to fit the bill. Position is no different when it comes to the turn of the Revenue. If it wants to include a particular case in the list of comparables, it will also modify the filter or ceiling in such filter to suit its interest. Equally, if both the sides want to exclude a case, they will modify the filter accordingly. The nutshell is that some sort of cherry-picking is done by both the sides.

***9.2** The exclusion of this case has been done by increasing the limit in filter to 75% as against 25% applied by the assessee because the percentage was 74.45%. If the actual ratio in this case had been more than 75%, and the Revenue hell bent on excluding this case, then it would have resorted to increasing the ceiling in the filter to 80% or still more so as to ensure that it remains outside the limit set by it. As the ratio of 75% is not something which is scientifically proven and the export revenue of Allsec Technologies is 74.45% as against the TPO's filter of 75%, we are of the considered opinion that the same cannot be excluded for such a minuscule difference if it is otherwise comparable. It is patent that the TPO has not disputed the otherwise functional comparability of this case with that of the assessee. If we consider the case of Allsec Technologies on a criteria of preponderance of comparability, we find that the same merits inclusion in the list of comparables. Not only the TPO's reasoning about the declining revenue of Allsec Technologies over a period of three years is incorrect, this case is also passing the test of the ratio of export turnover to total*

turnover on a pragmatic rational basis. We, therefore, hold that this case should be included in the list of comparables.

19. A similar view was taken by the Tribunal in Hyderabad Bench in the case of Capital IQ Informtion Systems (India) Pvt. Ltd. 49 taxmann.com 313 wherein the Co-ordinate Bench has followed the findings of the Tribunal Delhi Bench in the case of Mercer Consulting India Private Limited (supra). The Comparable CG-Vak Sofware &Exports Limited was rejected as the turnover of the company is less than 1 crore and hence does not qualify turnover filter. The turnover of the relevant segment of the company is 86.10 lacs but just because this company does not pass the turnover filter of 1 crore should not have been rejected as the business is exactly similar to that of the appellant company.

20. If the aforementioned two companies are accepted as comparable, as exhibited elsewhere, the average of the 5 comparables comes to 15.17% whereas that of the appellant company comes to 30.90%.

21. We further find that the appellant company has earned foreign exchange gain on revaluation of its outstanding revenue receivables which were not considered as part of operating profit by the TPO as well as CIT(A). We find that the foreign exchange gain earned by the appellant pertained towards revaluation of its debtors as on the balance sheet date which means that exchange fluctuation was towards revenue item. Further, Safe Harbour Rules are only applicable to those assessee who have opted for Safe Harbour Rules and the same is made effective from A.Y. 2013-14 onwards.

22. We find support from the decision of the Co-ordinate Bench in the case of Rajratna Metal Industries Ltd. Tribunal Ahmedabad Bench in ITA No. 1050/Ahd/2015. The relevant findings read as under:-

7. The Revenue's third and last substantive ground pleads that the lower appellate authority has erred in deleting arm's length price adjustment of Rs. 16,84,60,644/-; as proposed in Transfer Pricing Officer's order dated 21.01.2014 u/s.92CA(3) of the Act and accepted in the abovestated assessment order. Mr. Bidari strongly argues that the CIT(A) ought not to have reversed the impugned adjustment arising from exclusion of foreign exchange / loss; as done by the Assessing Officer. Mr. Dhinal Shah quotes a catina of case law that the issue of exclusion of foreign exchange gain/loss for the purpose of computing arm's length price in transfer pricing proceedings is no more res integra in view of the following judicial precedents:

"1. Fiserv India Pvt Ltd [TS-437-HC-2016(DEL)-TP]
2. Ameriprise India Pvt Ltd [TS-174-HC-2016(DEL)-TP]
3. NEC Technologies India Ltd [TS-221-ITAT-2016(DEL)-TP
4. Subex Ltd [TS-181 -ITAT-201 6(Bang)-TP]
5. Visa Consolidated Support & Services [TS-162-ITAT-2016(Bang)-TP]
6. SAP Labs India Private limited (145 TTJ 521) (Bangalore ITAT)
7. Four Soft Ltd. (ITA No. 1495/HYD/20 10) (Hyderabad ITAT)
8. Trilogy E Business Software India Private Limited vs. DCIT (23 ITR(T) 464) (Bangalore ITAT)
9. M/s Capital IQ Information Systems (India) Private Limited vs. DCIT (ITA No.1961/HYD/2011) (Hyderabad ITAT)
10. S. Narendra Vs. ACIT ([2013] 32 taxmann.com 196) (Mumbai ITAT)
11. Cordys R & D (India) (P.) Ltd. Vs. DCIT (ITA No. 1092/H YD/2010) (Hyderabad ITAT)
12. Techbooks International Pvt Ltd Vs. ACIT (ITA No. 722/Del/2014) (Delhi ITAT)"

The assessee's case therefore is that the CIT(A) has rightly treated foreign exchange fluctuation gain/loss as an operating item not to be excluded for the purpose of computing arm's length price. The Revenue fails to rebut application

of the above extracted judicial pronouncements holding identical foreign exchange fluctuation gains/losses as operating item under the transfer pricing parlance. We thus affirm CIT(A)'s findings on this third issue as well. The Revenue's last substantive ground as well as its appeal ITANo.l050/Ahd/2015 fails.

23. Our view is further fortified by the judgment of Hon'ble Delhi High Court in the case of Cashedge India Private Ltd. in Tax Appeal No. 279 of 2016. The relevant findings of the Hon'ble Court reads as under:-

> *7. As far as the question, i.e., foreign exchange fluctuation element is concerned, the records clearly reveal that the Safe Harbour Rules came into force later whereas the facts of this case pertain to the assessment year 2010-H (Financial year 2009-10). As a consequence, the impugned order cannot be interfered with. No question of law thus arises. The appeal is consequently dismissed.*

24. In the light of the above discussion, foreign exchange fluctuation should be considered as operating in nature for the purposes of computing the operating profit of the appellant as well as comparable companies.

25. Considering the facts in totality, the Upward Adjustment of Rs. 37,716,838/- is uncalled for and we direct the same to be deleted.

26. In the result, the appeal filed by the Assessee is allowed.

27. Before parting, we find that the revenue in its written submission has referred to three comparable companies provided by the TPO namely ;

(i) Accentia Technologies Ltd.

(ii) Acropetal Technologies Ltd.

(iii) Coral Hub Limited

28. The First Appellate Authority has held that these companies are incomparable to the business of the appellant and therefore the ld. CIT(A) has ruled in favour of the appellant The revenue is not in appeal before us. Therefore, no adjudication is required on these three companies.

Order pronounced in Open Court on 16 - 01- 2018

Sd/- Sd/-

(MAHAVIR PRASAD) **(N. K. BILLAIYA)**
JUDICIAL MEMBER **True Copy** **ACCOUNTANT MEMBER**

Ahmedabad: Dated 16 /01/2018

Rajesh

Copy of the Order forwarded to:-

1. The Appellant.
2. The Respondent.
3. The CIT (Appeals) –
4. The CIT concerned.
5. The DR., ITAT, Ahmedabad.
6. Guard File.

By ORDER

Deputy/Asstt.Registrar
ITAT,Ahmedabad