

INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH "I-1": NEW DELHI
BEFORE SHRI H.S.SIDHU, JUDICIAL MEMBER
AND
SHRI PRASHANT MAHARISHI, ACCOUNTANT MEMBER

ITA No. 1520/Del/2015
(Assessment Year: 2010-11)

Morningstar India Pvt. Ltd, 9 th Floor, Platinum Tech Park, Plot No. 17/18, Sector-30A, Vashi, Navi Mumbai PAN: AAACX0362K	Vs.	DCIT, Circle-17(1), Delhi
(Appellant)		(Respondent)

Assessee by :	Mr. Piyush Chawla, CA Ms. Shruti Khimta, CA
Revenue by:	Shri Sandeep Kr. Mishra, Sr. DR
Date of Hearing	07/02/2019
Date of pronouncement	06/05/2019

ORDER

PER PRASHANT MAHARISHI, A. M.

1. This appeal is filed by assessee, Morningstar India private limited for assessment year 2010 – 11 against the order of the learned Deputy Commissioner Of Income Tax, Circle 17 (1), New Delhi (the learned Assessing Officer) (AO) under section 143 (3) read with section 144C of The Income Tax Act [The Act] passed in pursuance to the direction of the learned Dispute Resolution Panel – III (the learned DRP), New Delhi dated 27/11/2014

against objection filed by the assessee in proposed draft of assessment dated 14/2/2014 wherein the order u/s 92 CA (3) of the Act passed by The Assistant Director Of Income Tax, Transfer Pricing Officer – I (6), New Delhi (the learned TPO) dated 28/1/2014 proposing an adjustment of INR 25575349/- as arm's-length price (ALP) of the International Transaction (IA) was upheld.

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

“That on the facts and circumstances of the case, and in law;

1. *The assessment order passed by the Learned Assessing Officer ('Ld. AO') pursuant to the directions of Learned Dispute Resolution Panel ('Ld. DRP') is bad in facts and law.*
2. *The Ld. AO (following the directions of the Ld. DRP), erred both on facts and in law in confirming the addition of Rs. 14,770,775/- to the income of the Appellant proposed by the Transfer Pricing Officer ('Ld. TPO') by holding that the related party international transactions pertaining to provision of IT Enabled back-office support ('ITES') services do not satisfy the arm's length principle envisaged under the Income-tax Act, 1961 ('the Act'). In doing so, the Ld. DRP and the Ld. AO have grossly erred in agreeing with and upholding the Ld. TPO's action of:*
 - 2.1 *not appreciating that none of the conditions set out in section 920(3) of the Act are satisfied in the instant case;*
 - 2.2 *disregarding the Arm's Length Price ('ALP') as determined by the Appellant in the Transfer Pricing (TP) documentation maintained as per section 92D of the Act read with Rule 10D of the Income-tax Rules, 1962 ('Rules') as well as fresh search; and in particular modifying/ rejecting the filters applied by the Appellant;*
 - 2.3 *rejecting the comparability analysis undertaken by the Appellant in the TP documentation and conducted a*

fresh comparability analysis based on application of the following additional/ revised filters in determining the ALP:

- 2.3.1 exclusion of companies with export sales that are less than 75% of their total revenue/ sales as a comparability criterion;*
- 2.3.2 exclusion of companies identified by the Appellant with employee cost less than 25% of their operating cost as a comparability criterion;*
- 2.3.3 applying sales filter of Rs. 5 crore on for selecting comparable companies, thereby rejecting the turnover filter of Rs. 1 crore, applied by Appellant; and*
- 2.3.4 exclusion of companies with diminishing revenues/ having persistent losses during the year under consideration as a comparability criterion.*
- 2.4 including companies having abnormal margins/volatile margins in the final comparables' set without appreciating the fact those abnormal/volatile margins are due to certain abnormal conditions like business restructuring, super normal growth in revenue/net profits etc. and on the other hand resorting to arbitrary rejection of low-profit/loss making companies based on erroneous and inconsistent reasons.*
- 2.5 including certain companies in the final set that are not comparable to the ITES segment of the Appellant in terms of functions performed, assets employed and risks assumed and excluding certain companies on arbitrary/ frivolous/inconsistent grounds even though they are comparable to the Appellant in terms of functions performed, assets employed and risks assumed;*
- 2.6 ignoring the business/ commercial reality that since the Appellant is remunerated on an arm's length cost plus basis, i.e. it is compensated for all its operating costs plus a pre-agreed mark-up based on a benchmarking*

analysis, the Appellant undertakes minimal business risks as against comparable companies that are full-fledged risk taking (which may include market risk, price risk, capacity utilization risk, etc.) entrepreneurs as is evident from the volatile margins earned over the period of years and by not allowing a risk adjustment to the Appellant on account of the fact.”

3. Brief facts of the case shows that assessee is a 100% subsidiary of Corporate Fundamentals Incorporation, USA engaged in the business of captive Data processing services provider to its group companies. The assessee is also involved in the sale of access to online databases in services of Morningstar incorporation USA. The assessee company filed its return of income (ROI) on 29/9/2010 declaring loss of INR 14666670/-. The assessment u/s 143 (3) of the act was taken up and it was found that assessee has entered into an international transaction amounting to INR 121476495/- with its associated enterprise. Case was referred to the learned transfer pricing officer for determining its arm's-length price. The learned transfer pricing officer found that assessee has entered into a transaction of provision of data processing and software services to its associated enterprise amounting to Rs. 116698529/- which was benchmarked by the assessee adopting the Transactional Net Margin Method (TNMM) is most appropriate method (MAM) using the profit level indicator (PLI) of operating profit/total cost (OP/TC) selecting 7 comparable wherein the comparable mean PLI was 12.19 percent and assessee has earned the margin of 14.04 %, assessee submitted that its international transaction is

carried out at arm's-length. The learned transfer pricing officer issued a show cause notice with respect to the several aspects of the benchmarking analysis of the assessee. After that he issued a show cause notice with respect to the selection of the comparables, use of current year data, the rejection of the certain filters et cetera. The learned TPO also referred to the cost allocation methodology adopted by the assessee for the login sale revenue of the assessee. Thereafter recording the objection of the assessee and considering reply of the assessee after giving the reasons for the rejection, the learned TPO finally selected 12 comparables whose average profit level indicator of operating profit/operating cost was found to be 31.47 percentage, compared it with the PLI of the assessee and determined arm's-length price of the transaction at Rs. 139444849/- against the transaction value of Rs. 113869500/-. Accordingly shortfall of transfer pricing adjustment of INR 25575349/- was determined. Consequently draft of proposed assessment was passed. Assessee objected it before the learned dispute resolution Panel. The learned dispute resolution passed the direction on 27/11/2014. As per the direction of the learned dispute resolution panel all the 12 comparables selected by the learned transfer pricing officer was approved and the authentic mean of operating profit/total cost of the comparable companies was computed at 28.83 percentages. Based on those directions order u/s 143 (3) read with section 144C of the act was passed. Subsequently an order u/s 154 of the income tax act was passed

by the learned Deputy Commissioner Of Income Tax, Transfer Pricing Officer – 2 (1) (1), New Delhi on 18/12/2014 wherein the proposed adjustment u/s 92CA of the act was restricted to INR 14770775/-. Assessee aggrieved with the assessment order passed u/s 143 (3) read with section 144C has preferred this appeal before us.

4. The learned authorised representative submitted that assessee challenges the transfer pricing adjustment made to the international transaction of the assessee of INR 147770775/- and is pressing for exclusion of following comparables:
 - a. Accentia technologies Ltd
 - b. E Clerx services Ltd
 - c. Infosys BPO Ltd
 - d. TCs E serve international Ltd
5. He submitted a detailed chart with respect to the each of the comparable. Over and above, this he also pressed for inclusion of the comparable Mphasis finsources Ltd.
6. The learned departmental representative vehemently supported the order of the learned transfer pricing officer and the learned dispute resolution panel.
7. We have carefully considered the rival contention and perused the orders of the lower authorities. The only dispute is with respect to the software development and maintenance and data processing services of the assessee. Assessee is performing the IT support services to its associated enterprise. It is an IT support and software development and maintenance service

provider to its associated enterprise whereas its associated enterprise are engaged in marketing and sales, quality control, invoicing on collection, client relationship, engagement control, execution of services and management support services for software development. Therefore according to the transfer pricing study report furnished by the assessee and not disputed by the learned assessing officer, Morningstar India, assessee provides, assistance in website and web application development of customers of associated enterprise, assistance in development and maintenance of STAR framework and Morningstar corporate website, assistance into tracking and data feeding, assistance in sales analysis and market research and assistance in quality testing of software developed by associated enterprises. Assessee is also involved in sale of online access of various databases of Morningstar group from its Mumbai office. It provided data processing and software services to its associated enterprise Morningstar incorporation of INR 58412756/- and to Corporate fundamental incorporation of INR 58285773/-. The only dispute rose before us is the selection of comparables.

8. The 1st comparable disputed by the assessee for its exclusion is Actentia technologies Ltd stating that it is functionally dissimilar as it is engaged in medical transcription services and further it has a significant amount of brands , IPRS and goodwill. Further due to non-availability of the segmental information and business restructuring resulting in extraordinary circumstances being amalgamation in the company, it should be excluded. The

assessee further relied upon several judicial precedents wherein the above comparable company was excluded.

9. The learned transfer pricing officer considered the argument of the assessee that it is functionally dissimilar and rejected that stating that annual report has been produced and it is seen that the company is into an healthcare receivable cycle management predominantly which is an ITeS segment. He further held that 86% of the receipt is from healthcare receivable field and a small portion is in the coding activity. He thereafter extracted the annual accounts and the reports of the above comparable company and stated that healthcare management receivable system is of one single operational segment consisting of various activities which are closely related and complementary and the services cannot be termed as diversified activity. He further held that SaaS (software as a service) is nothing but growing of all the services under one umbrella. He therefore held that the above comparable companies functionally similar and passes all the filters applied by the learned transfer pricing officer. He further held that there is no abnormal fluctuation in the profit earning capacity of the comparable for the year under this situation and it is showing good margin consistently over the years and therefore there is no issue of supernormal profits. Therefore he stated that the comparable is robust comparable in case of the taxpayer and is retained as a suitable comparable. The learned dispute resolution panel was also of the view that the FAR profile

of the company is essentially similar to that of the assessee hence it was retained as a comparable.

10. On careful consideration of the annual report of the above comparable company for financial year 2009 – 10 at page number 41 of the annual report it is stated that the comparable company provides healthcare and receivable management services involving medical transcription, medical coding, billing and receivables management (collections). At page number 42, description of the medical transcription services have been provided with shows brief process of the medical transcription giving the process flowchart and in the end it is stated that medical transcription profession is considered very much a skilled work which can be done only after undergoing 6 to 8 months of rigorous training as it involves the identifying the generic name and trade name of the various drugs. That can be done only after reference to the pharmacology reference books which should always be a part of the library of a medical transcription profession. Further at page number 43 medical coding has also been explained by way of a flowchart. The company says that it has a sizeable number of certified coders which is assigning codes to diagnosis and procedures which help in financial reimbursement from insurance companies and government companies et cetera. It is further stated that medical coders are specialized in coding after thorough training program and certification. Further the assessee has contended that it has a significant amount of brands and software for providing IT

services. For this proposition we look at page number 37 of the annual report wherein management discussion and analysis it is submitted that it is the 1st company to offer SaaS model MHRC area. It is also entering into the legal process outsourcing segment. It is also using Immaculate business process outsourcing management solutions for healthcare, financial and insurance sector and health the dox – cutting-edge offshore HRC solutions for healthcare sector are provided by this company. The assessee has also contested that it has undergone amalgamation of another company with the comparable company. The AR referred to page numbers 78 of the annual report wherein in ‘notes to accounts’ the reference has been made that pursuant to the scheme of amalgamation of accentia private limited with the company as approved by the shareholder in the court convened meeting held on 25th day of April 2009 and subsequently sanctioned by the honourable High Court of Mumbai vide order dated 21/08/2009 and the High Court of Karnataka vide order dated 06/02/2010, the assets and liability of the erstwhile company was transferred invested in this company with effect from 01/04/2008. On reading the above note it is apparently clear that amalgamation has happened with effect from 01/04/2008, and therefore it does not pertain to this year which is assessment year 2010 – 11. And therefore we reject the argument that there is an extraordinary event in the comparable company. However looking to the functions performed by the Accentia technology and the various kinds of

advanced assets in the form of software et cetera utilized, it is apparent that functionally the above company is not comparable with the assessee company. Hence we direct the learned transfer pricing officer /learned AO to exclude the above company from the comparability analysis.

11. The next comparable challenged for its exclusion is E Clerx services Ltd stating that it is functionally dissimilar as it is engaged in rendering knowledge process services focused on financial services and sales and marketing support services and TPO services. It is further stated that it provides end-to-end financial transaction support services with services that span both on the sale side and buy-side of the financial transaction. The comparable company also provides strategy process consulting services helping clients devise solution to improve efficiency, reduce risk and meet regulatory and market demands. In the sales and marketing support division, the comparable company provides services in all elements of products and services marketing. It is further argued that honourable Delhi High Court in Ramp green solutions private limited vs. CIT it is held that it is engaged in the knowledge process outsourcing business and therefore it cannot be compared with simple ITeS service provider.
12. Before the learned transfer pricing officer assessee contested for exclusion of the above comparable stating that it is functionally dissimilar and a very large company. The learned transfer pricing officer rejected the contention of the assessee and stated

that assessee itself has accepted that these companies into a BPO segment and therefore he rejected the contention of the assessee as the comparable company passed all the filters. The learned transfer pricing officer further stated that under the TNMM method the standard of comparability are relatively relaxed and only broad similarity of the functions are required to be compared. The learned dispute resolution panel also approved the contention of the learned transfer pricing officer.

13. We have carefully perused the annual accounts of E Clrex services for financial year 2009 – 10 placed at page number 109-212 of the paper book. On page number 4 of the annual report, it is mentioned that E Clrex services Ltd is a leading knowledge process outsourcing company supporting its clients. Therefore it is apparent that it is a knowledge process outsourcing company. It is also undisputed that the profile of the assessee company is not of knowledge process outsourcing company. The honourable Delhi High Court in Ramp green solutions private limited vs. CIT [2015] 60 taxmann.com 355 (Delhi)/ [2015] 234 Taxman 573 (Delhi)/ [2015] 377 ITR 533 (Delhi)/ [2015] 279 CTR 441 (Delhi) has held that expression 'KPO' indicates the involvement of domain knowledge in providing ITeS. Typically, KPO includes involvement of advanced skills; the services provided may include analytical services, market research, legal research, engineering and design services, intellectual management etc. It is further held that the KPO sector has been described as 'a value play'. The honourable High Court referred to in report and held that KPO services are likely to span activities such as 'patent advisory, high-end research

and analytics, online market research and legal advisory'. Therefore respectfully following the decision of Honourable Delhi High court as stated above, it is apparent that the E clerx services Ltd is not a comparable company with the ITeS segment of the assessee. Therefore, we direct the learned transfer pricing officer/AO to exclude this company.

14. The 3rd comparable contested is Infosys BPO Ltd. The learned authorised representative says that above company provides high-end integrated services in the nature of business transformation services, sourcing and procurement outsourcing et cetera and which has a significant intangible asset in the form of Infosys brand. It is further stated that it has acquired a company and therefore there is an extraordinary event hence it should be excluded. He further referred to page number 264 of the paper book wherein the amalgamation has taken place of PAN financial services India private limited with comparable company. Therefore it is stated that it should be excluded.
15. The learned transfer pricing officers considered the above objection of the assessee vide para number 15.5 page number 28 of his order. He held that as per the profit and loss account, significant accounting policies and notes on accounts of the above company, it is clear that this company is an ITeS company and fully comparable with the assessee. With respect to the presence of brand value the learned TPO noted that annual report of Infosys BPO does not mention anything regarding the brand deriving its profitability. He further stated that by

spending a meager amount of revenue Infosys BPO could not have generated brand value as suggested by the taxpayer. The learned dispute resolution panel also upheld reasoning given by the learned transfer pricing officer.

16. We have carefully considered the annual report of Infosys BPO Ltd for financial 2009 – 10 placed at page number 213 – 296 of the paper book. Undoubtedly the comparable company belongs to Infosys group and therefore it has the support and backing of the Infosys brand which will have its own impact on the profitability and price of this comparable company. It is also not necessary that the comparable company must have spent for the brand value. In the present case of comparable is not required to do so as it belongs to as such one of the largest group in the IT segment “Infosys”. As per page number 281 in schedule 12 selling and marketing expenses shows that comparable company has spent approximately INR 7,500,000 towards the brand building and advertisement expenditure. Coupled with the fact that the comparable company belongs to an Infosys group, has incurred the expenditure on the brand building and on the annual report itself shows the imprint of being part of the large IT segment group, it is apparent that the functional profile, the assets utilized by the comparable company are not comparable with the assessee company. Therefore, for this reason only, we direct the learned transfer pricing officer, AO to exclude the above comparable from comparability analysis.

17. With reference to the argument of the learned authorised representative that it has acquired one company MaCmish system LLC and therefore there is an extraordinary event in the company, deserves to be rejected at the threshold because it is merely a purchase of shares of the target company by this comparable. Purchasing shares of the company does not make any impact on the price of the margin of the comparable company. Therefore there is no extraordinary event when a company invest in some other company by purchase of shares. It is neither a case of amalgamation/merger. Hence on this ground the above comparable company cannot be excluded.
18. Further the authorised representative also stated that there is an amalgamation of PAN financial services India private limited with the company and therefore it should be excluded. We have carefully considered the contention and find that the board of directors in that meeting held on 06/10/2008 approved subject to the approval of the Karnataka and mothers High Court of scheme of amalgamation to amalgamate PAN financial services India private limited which is engaged in providing business process management services with the Infosys BPO Ltd with effect from 01/04/2008. Therefore even if there is an amalgamation or merger, it has happened in financial year 2008 – 09, and impugned financial year before us is financial year 2009 – 10 , hence it does not pertain to this year and therefore for this reason Infosys BPO cannot be excluded.

19. However for the reasons given by us above, we direct the learned TPO/AO to exclude the Infosys BPO Ltd from the comparability analysis for the reasons of having huge brand value.
20. The 4th comparable TCS E serve international Ltd challenged by the learned AR on functional dissimilarity stating that it is engaged in transaction processing and technical services like software testing, verification and validation of the software. It is further contended that segment information is not available. The AR further stated that there are extraordinary event in the form of acquisition by the comparable company from Citigroup of certain business. It was further stated that there is a payment for TATA brand equity, further the comparable became part of TATA group and has a huge scale and large client base which has enhanced its offerings and has also started servicing new clients during the year under review. Hence it was submitted that this company is not comparable with the assessee company. He also referred to several judicial precedents where the above company was held to be not comparable for the reason of the size and scale of its operation which makes it an inapposite comparable.
21. Before the learned transfer pricing officer assessee argued that it is a very large company which has been rejected by the learned transfer pricing officer in para number 15.6 of his order. The learned dispute resolution panel also rejected the contention of the assessee and upheld its inclusion by the TPO.

22. We have carefully considered the contentions and find the annual account of the above comparable company placed at page number 297 – 371 of the paper book. Apparently TCS E serve international is a subsidiary of Tata consultancy services Ltd. Behind the above comparable company, there is a Tata brand. On the perusal of schedule M of the profit and loss account there is a payment of 3738'000s towards the Tata brand equity contribution. For this reason that it belongs to Tata group and has also contributed to Tata brand which is one of the largest brand in the information technology segment, there is a definite impact on the pricing capacity of the comparable which the assessee lacks. Hence, we find that TCS E serve international Ltd deserves to be excluded. Accordingly we direct the learned TPO – AO to exclude the above comparable.
23. The last comparable challenged by the assessee is TCS E serve limited. The assessee challenged its exclusion for the reason of the functional dissimilarity as the comparable companies engaged in transaction processing and technical services like software testing, verification and validation of the software. The learned authorised representative also challenged it as it owns intangibles, pays for Tata brand equity and non availability of the segment information. Further it is also not comparable on the ground of incomparable scale of operations.
24. The learned transfer pricing officer in para number 15.7 of the order rejected the argument of the assessee similar to TCS E

serve international Ltd. The learned dispute resolution panel also rejected the objection of the assessee.

25. On identical facts and circumstances we have excluded TCS E serve international Ltd that it belongs to a Tata group and has paid contribution for Tata brand. We have also perused the annual report of the comparable company which is placed at page number 372 – 507 of the paper book on careful analysis of the annual report it is found that in schedule 'N', Tata brand equity contribution of this comparable companies is Rs 46065 thousands. Therefore we direct the learned transfer pricing officer to exclude the above comparable from the comparability analysis.
26. The next ground on the comparability analysis of the assessee is that one comparable selected by the assessee by the name of Mphasis Fincources Ltd has been rejected by the learned transfer pricing officer as it failed the employee cost filter. The learned authorised representative submitted that on perusal of the page number 13 of the annual report indicated that the total employee cost is INR 7 2651206 and the total expenditure incurred by the assessee is INR 1 63475456 and therefore the employee cost is only 44.44 percentage and thus meets the filter applied by the learned transfer pricing officer. He further stated that even if only salary cost is taken then also the employee cost to total cost comes to 40% approximately. It was further stated that the above companies also functionally comparable and therefore it should be included for the comparability analysis. With respect

to the financial result for FY 2009 – 10, he submitted a copy thereof.

27. The learned transfer pricing officer rejected the above comparable stating that that is not a suitable comparable as it has been selected by the assessee on the basis of the data for a financial year 2008 – 09 despite the fact that assessee has used companies with financial year for FY 2009 – 10 as a filter. Further according to the TPO the functional profile is also different and employee compensation is a percentage to total expenses is less than 25%. The learned dispute resolution panel also accepted the reasons recorded by the learned transfer pricing officer for its rejection.
28. We have carefully considered the contention of the assessee on this aspect. In the transfer pricing study report submitted before the learned transfer pricing officer the assessee did not submit the financial for Year 2009 – 10 of this comparable company. Further same were neither produced before the learned transfer pricing officer or before the learned dispute resolution panel and it is first-time produced before us. There is no application made by the assessee of admission of any additional evidences also. In view of this we do not find any merit in the case of the assessee for inclusion of the above comparable. Hence we reject the same.
29. In ground number 2.6 the assessee also contested that the claim for risk adjustment may be allowed as the appellant undertakes minimum business risk as against comparable companies that are full-fledged risk entrepreneurs. The learned transfer pricing

officer and the learned dispute resolution panel has rejected the argument of the assessee for the reason that assessee failed to demonstrate before them that the risk profile of the assessee is making a difference in the margins earned by the assessee and the comparables. Before us also assessee could not demonstrate that how the risk profile is making a difference in the margin of the comparable companies as well as the assessee. Therefore we do not find any reason to interfere in the decision of the learned transfer pricing officer and approved by the learned dispute resolution panel.

30. Accordingly we direct the learned transfer pricing officer to exclude Accentia technology Ltd, E Clerx services Ltd, Infosys BPO Ltd, TCS E serve international Ltd and TCS E serve limited. Accordingly ground number 2 of the appeal is partly allowed.
31. Ground number 1 and ground number 3 of the appeal is general in nature and therefore there dismissed.
32. Accordingly appeal of the assessee is partly allowed.
- Order pronounced in the open court on 06/05/2019.

-Sd/-
(H.S.SIDHU)
JUDICIAL MEMBER

-Sd/-
(PRASHANT MAHARISHI)
ACCOUNTANT MEMBER

Dated: 06/05/2019

Copy forwarded to

1. Applicant
2. Respondent
3. CIT
4. CIT (A)

5. DR:ITAT

ASSISTANT REGISTRAR
ITAT, New Delhi