

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

**BEFORE SHRI N.S. SAINI, ACCOUNTANT MEMBER
AND
SHRI SUDHANSHU SRIVASTAVA, JUDICIAL MEMBER**

**ITA NO 3680/DEL/2013
AY: 2004-05**

**ACIT, vs M/s Comverse Network Systems India Pvt. Ltd.,
Circle-1(1), 6th Floor, Vatika Triangle, Block-A,
Gurgaon. Sushant Lok, Phase-I, Gurgaon.
(PAN: AABCC3425B)
(Appellant) (Respondent)**

**C.O. No. 94/Del/2016
(IN ITA NO. 3680/DEL/2013)
AY: 2004-05**

**M/s Comverse Network Systems India Pvt. Ltd., vs ACIT,
DLF Building No. 14, Tower D, Circle 1(1),
18th Floor, Sector-25 & 25A, Gurgaon.
DLF Cyber City,
Gurgaon-122002**

**Assessee by: Shri G.C. Srivastava, Adv.
Shri Parichay Solanki, Adv.**

Respondent by: Ms Saweta Nakra, Sr. DR

Date of hearing : 14.06.2019

Date of Pronouncement : 19.06.2019

ORDER

PER SUDHANSHU SRIVASTAVA, JM

This appeal by the revenue is preferred against the order of the Ld. Commissioner of Income Tax (Appeals), Rohtak {CIT (A)} dated 28.3.2013 and pertains to assessment year 2004-05 and the C.O. has been preferred by the assessee.

2.0 Brief facts of the case are that, as per the assessment records, Comverse Technology Inc., which is the ultimate holding company of the group, was incorporated in the year 1984 and is engaged in designing, developing, manufacturing, marketing and supporting telecommunication systems and software for multimedia, communications and information processing applications. The holding company through its various subsidiaries primarily makes communication systems and software that telecom companies use to offer call answering, voice/fax mail, communications surveillance and recording etc. The assessee i.e. Comverse Network Systems India (P) Ltd. is a subsidiary of Comverse Technology Inc. USA which holds 99.90% of the capital. The assessee was incorporated in the year 1999 to provide pre-sales support and post-sales support services primarily to the customers of Comverse Network Systems Ltd., Tel Aviv and also to the Indian customers of Verint Systems Inc (another subsidiary of the holding company) which are the Associated Enterprises (AE).

2.1 During the captioned year, the return of income was filed declaring income of Rs. 61,18,410/-. Subsequently, the case was selected for scrutiny. During the year under

consideration, the assessee had shown total service income of Rs. 9,88,99,921/-. In view of the international transactions entered into by the assessee during the year under consideration, the Assessing Officer (AO) made a reference to the Transfer Pricing Officer (TPO) u/s 92CA(3) of the Income Tax Act, 1961 (hereinafter called 'the Act') to determine the Arm's Length Price (ALP) with respect to the two transactions as under:-

- i) Sales and post sales support – Rs. 9,00,08,187/-
- ii) Payment of medical insurance fee – Rs. 1,63,705/-

2.2 The assessee had adopted Transactional Net Margin Method (TNMM) to compute the Profit Level Indicator (PLI). The assessee computed its operating profit margin at 6.58% whereas the mean Net Operating Profit of the four comparables selected by the assessee was computed at 3.08%. However, the Transfer Pricing Officer (TPO) determined the Arm's Length Price (ALP) of the international transactions related to providing services to the AEs at Rs. 10,86,91,099/- and proposed an addition of Rs. 18,682,912/- as transfer pricing adjustment in terms of the provisions of section 92CA(4) of the Act. Apart from this, the Assessing Officer also made addition of Rs. 8,55,136/- on account of disallowance of provision for gratuity and a further

disallowance of Rs. 40,500/- being disallowance of payment made to Golf Club. The total income of the assessee was computed at Rs. 2,56,96,958/-.

2.3 Aggrieved, the assessee approached the Ld. First Appellate Authority. The Ld. Commissioner of Income Tax (Appeals) partly allowed the assessee's appeal by deleting five out of the six comparables introduced by the TPO for determining the ALP. The Ld. Commissioner of Income Tax (Appeals) also deleted the partial disallowance of the Golf Club expenses and also gave relief to the assessee with respect to the disallowance of the provision for gratuity.

2.4 Aggrieved by the order of the Ld. Commissioner of Income Tax (Appeals), the department is now in appeal before this Tribunal (ITAT) and has raised the following grounds of appeal:-

"1. Whether the Ld. CIT has erred in rejecting 5 of the 6 comparables taken by the AO/TPO for determining Arms Length Price.

2. Whether the Ld CIT has erred in deleting the part disallowance of club expenses, despite the fact that the assessee could not submit any evidence either during assessment proceedings or during appellate proceedings in favour of these expenses being 'wholly and exclusively' for the purpose of business.

3. *Whether the Ld CIT (A) erred in admitting additional evidence pertaining to approval status of the assessee's gratuity fund without calling for the remand report from the AO.*

4. *Whether the Ld CIT (A) erred in treating the provision for gratuity and provision for leave encashment as ascertained liabilities for the purpose of book profit calculation u/s 115JB without any basis.*

Keeping in view the above facts & the tax effect i.e. 62,18,019/- which is more than the prescribed monetary limit of Rs. 3,00,000/- for appeal before the Hon'ble ITAT & as also suggested by the Range Head, further appeal to the ITAT is recommended in this case on the below mentioned issues.”

2.5 The assessee is also before the ITAT by means of a Cross Objection (CO) and the grounds raised in the CO are as under:-

“1. That the learned Commissioner of Income Tax [Appeals], Rohtak (“CIT-A”) erred in not holding the order passed by the learned Assistant Commissioner of Income tax, Circle 1(1), Gurgaon (“AO”) and the learned Assistant Commissioner of Income tax, Transfer Pricing Officer - IV, New Delhi (“TPO”) as being contrary to the facts, law and the principles of natural justice.

2. That the learned CIT-A erred in law in not holding that the learned AO did not meet the preconditions for making reference to the learned TPO under section 92CA(1) of the Act and erred in not providing an opportunity of 'being heard' to the Respondent before referring the transfer pricing issues to the learned TPO.

3. That the CIT-A erred in law in not holding that the order of the learned TPO is bad in law and contrary to the

principles of natural justice since 'no sufficient opportunity' was provided to the Respondent while concluding the assessment under section 92CA(3) of the Act in respect of determination of arm's length price.

4. The learned CIT-A erred in law and in facts by upholding the following erroneous approach taken by the learned AO and the learned TPO:

4.1 Rejecting 3 out of 4 comparables selected by the Respondent at the time of maintaining TP documentation and not accepting the economic analysis undertaken by the Respondent.

4.2 Failing to make appropriate adjustments as prescribed under the Rules for differences in the functions performed, risks undertaken and assets employed by the Respondent vis-a-vis the comparables.

4.3 Adopting a flawed approach by using single year dataas against the multiple year data used by the Respondent in accordance with law, to compute the arm's length price of the international transactions entered by the Respondent, using Transaction Net Margin Method ("TNMM").

5. Without prejudice to above, the learned CIT-A has erred in holding that the benefits given by Proviso to section 92C of the Act is not available to the Respondent."

3.0 The Ld. Senior Departmental Representative (Sr. DR) submitted that the assessee had selected four comparables in the Transfer Pricing study viz. Enviro Technologies Ltd., Intelligent Communication System (India) Limited, Yashmun Engineers Limited and Vaibhav Heavy Vehicles Limited. The Ld. Sr. DR

submitted that with respect to all these comparables the TPO had made observations in his order. It was submitted that the TPO observed that no data about product or services being provided by M/s Vaibhav Heavy Vehicles Limited was available. Similarly, no data for the products or services being provided by M/s Yashmun Engineers Ltd. was available. It was further submitted that as per the TPO, Intelligent Communication System (India) Limited was engaged in diverse activities ranging from sale of cables, computer accessories, personal computers and printers etc and repair and AMC was only one of the activities of the company and no segmental data was available with respect to the service activity. It was submitted that the TPO had no other option but to select seven comparables which was based on the Transfer Pricing study report in assessment year 2002-03. These comparables were Hindustan Housing Co. Ltd., Scal Services Ltd., Wartsila Operations & Maintenance India Ltd., Choksi Laboratories Ltd., Artson Engineering Ltd., Isgec Coverma Ltd., Enviro Technology Ltd. and Vimta Labs Ltd. It was submitted by the Ld. Sr. DR that the final set of comparables selected by the TPO had an average PLI of 17.2%. The Ld. Sr. DR drew our attention to the observations and comments of the TPO with

respect to each of the comparables selected by the TPO and submitted that all these comparables were functionally comparable to the assessee company and had been rightly selected.

3.1 The Ld. Sr. DR drew our attention to the impugned order and submitted that the Ld. Commissioner of Income Tax (Appeals) had rejected five out of the six comparables selected by the TPO which was incorrect inasmuch as the five comparables viz. Hindustan Housing Co. Ltd., Scal Services Ltd., Choksi Laboratories Ltd., Isgec Coverma Ltd. and Vimta Labs Ltd. were assessee's own comparables in assessment year 2002-03 and, therefore, they could not be taken as being functionally different in the year under consideration when the nature of assessee's business has remained the same. It was submitted that the Ld. Commissioner of Income Tax (Appeals) had completely disregarded the reasons recorded by the Transfer Pricing Officer for inclusion of these comparables. It was vehemently argued that the Ld. Commissioner of Income Tax (Appeals) had erred greatly in rejecting these five comparables.

3.2 With respect to ground no. 2 relating to disallowance pertaining to Golf Club expenses, it was submitted that the assessee had debited an amount of Rs. 81,000/- in the profit and loss account being payment made to DLF Golf Resort Ltd. and since personal element could not be ruled out in the expenditure of this nature, 50% of the expenditure had rightly been disallowed by the Assessing Officer but the Ld. Commissioner of Income Tax (Appeals) had erred in deleting the disallowance.

3.3 With respect to ground no. 3 pertaining to the relief granted to the assessee with respect to the disallowance pertaining to provision of gratuity, it was submitted that the Ld. Commissioner of Income Tax (Appeals) had erred in admitting additional evidence pertaining to the approval of the gratuity fund without calling for a remand report from the Assessing Officer.

3.4 With respect to ground no. 4 pertaining to the adjustment of book profits u/s 115JB of the Act with respect to provision of gratuity and provision for leave encashment, the Ld. Sr. DR submitted that the Ld. Commissioner of Income Tax (Appeals) had erred in treating these two provisions as

ascertained liability whereas these two provisions were based on assumptions and were not based on any actuarial valuation.

4.0 In response, the Ld. Authorised Representative (AR) put forth his arguments on the issue of various comparables as under:

(i) M/s Hindustan Housing Co. Ltd.

The Ld. AR submitted that Hindustan Housing Co. Ltd. did not exist in the data base list generated using the comprehensive search process generated through comprehensive search process adopted by the assessee at the time of undertaking the economic analysis and hence was not accepted by the assessee as a comparable. It was further submitted that this company was not functionally comparable to the assessee company as it was primarily engaged in providing air conditioning, lift and intercom services which typically included operating and service maintenance services thereof. The Ld. AR further submitted that there were certain Related Party Transactions undertaken by this company during the year under consideration and which constituted 38.86% of its operating revenue. For this, a reference was made to the annual report of this company (which was placed

at pages 263-267 of the paper book filed by the assessee company). The Ld. AR argued that this company could not be compared to the assessee company for the above reasons.

(ii) M/s Choksi Laboratories Ltd.

With respect to this company, the Ld. AR submitted that this company was also not functionally comparable as this is a commercial testing and analysis laboratory engaged in testing of various products which included food and agricultural products, cement and building materials, chemicals, drugs and paints. It was submitted that the other services rendered by the company are calibration services, consultancy and pollution control. Our attention was drawn to page 9 of the TPO's order wherein the TPO himself has observed that the core activity of this company was providing analytical and testing services. It was further submitted that this company had a significantly high proportion of testing instruments which was approximately 58% of its total net assets which implied that the functions performed by the company were more capital intensive than the functions of a service provider. Our attention was drawn to page 315 of the paper book of the assessee which contained the annual report to

highlight this fact. It was submitted that the high proportion of investment of this company would suggest that this company was engaged in a significantly different business function than that of the assessee which was only a sales support and post sales support service provider.

(iii) Vimta Labs Ltd.

With respect to this company, the Ld. AR submitted that this company was a leading provider of multi-disciplinary contract-research and testing services in India. It was submitted that this company is mainly engaged in providing testing services in India in areas of clinical research, environmental assessments, pre-clinical animal studies, clinical reference lab services and analytical testing of a wide variety of products. Our attention was drawn to page 340 of the paper book containing the annual report of this company wherein these functions were mentioned. It was also highlighted that this company had incurred huge expenditure on testing and analysis whereas the assessee company did not incur any expenditure on testing services. It was also submitted that the assets employed by the assessee in terms of plant and machinery were approximately 70% of its total

net assets which implied that the functions performed by this company were more capital intensive than the assessee company which was a mere service provider and, therefore, this company was also not comparable to the assessee company.

4.0.1 With respect to the other two comparables viz. Scal Services Ltd. and Isgec Coverma Ltd., whose exclusion by the Ld. CIT (A) was being challenged, the Ld. AR submitted that the assessee had no objection if these two comparables were included in the final set of comparables.

4.1 With respect to the disallowance deleted by the Ld. Commissioner of Income Tax (Appeals) with respect to the Golf Club expenses, the Ld. AR drew our attention to the nature of the expenditure which was duly reflected in page 371 of the paper book and it was submitted that the nature of expenditure was membership fee which was an allowable expenditure. Reliance was placed on the judgment of the Hon'ble Bombay High Court in the case of C.I.T. (Large Tax Payer Unit, Mumbai) vs. Lubrizol India Ltd. reported in (2013) 37 taxmann.com 294 (Bombay) wherein it had been held that entrance fee for membership of a club would be considered as revenue expenditure. It was

submitted that the Ld. CIT (A) had rightly deleted the disallowance.

4.2 With respect to ground no. 3 pertaining to the contention of the department that the Ld. Commissioner of Income Tax (Appeals) had erred in admitting additional evidence pertaining to the approval of the assessee's gratuity fund without calling for the remand report from the Assessing Officer, the Ld. AR submitted that no fresh evidence had been admitted by the Ld. Commissioner of Income Tax (Appeals) in this respect and the approval of the gratuity fund w.e.f. 29.03.2004 was a matter of record.

4.3.0 With respect to ground no. 4, wherein the department has challenged the action of the Ld. Commissioner of Income Tax (Appeals) in treating the provisions of gratuity and provision for leave encashment as ascertained liabilities for the purpose of book profit calculation u/s 115JB of the Act, the Ld. AR submitted that as far as provision for gratuity was concerned, a provision of Rs. 5,13,162/- had been made for the year under consideration whereas the corresponding provision was of Rs. 3,41,974/- in the immediately preceding year and the

accumulated provision as on 29.03.2004 was of Rs. 8,55,136/-. The Ld. AR further submitted that against this accumulated provision, a payment of Rs. 8,50,000/- was made by the assessee company during the year under consideration and, thus, it was not a provision since the payment against the same had been made during the year. Our attention was drawn to pages 373-374 of the paper book containing the chart pertaining to gratuity and notes on account wherein these figures had been duly mentioned.

4.3.1 With respect to provision of leave encashment amounting to Rs. 4,21,697/- our attention was drawn to the notes on account wherein in Para (e) it had been mentioned that this provision was based on actuarial valuation of assessee's liability. Reliance was placed on the judgment of the Hon'ble Bombay High Court in the case of C.I.T. vs. Echjay Forgings (P) Ltd. reported in (2001) 116 Taxmann 322 (Bombay) wherein it has been held that where the assessee had made a provision for doubtful debts, gratuity etc. on the basis of actuarial valuation, such provisions would have to be excluded from net profit for working out the book profit u/s 115J of the Act.

5.0 The Ld. AR submitted that the C.O. of the assessee was not being pressed.

6.0 We have heard the rival submissions and perused the material available on record. We take up the issue relating to the comparables first. Our adjudication on the comparables is as under:-

(i) Hindustan Housing Co. Ltd.

It has been submitted that this company was not functionally comparable to the assessee company as it was primarily engaged in providing air conditioning, lift and intercom services which typically included operating and service maintenance services thereof. It has also been submitted that there were certain Related Party Transactions undertaken by this company during the year under consideration and which constituted 38.86% of its operating revenue. A perusal of the Directors' Report and the Annual Financial Statements shows that the contentions of the Ld. AR are correct on both the counts. Undisputedly, the assessee company is engaged in providing pre-sales support and post-sales support services primarily to the customers of Comverse Network Systems Ltd., Tel Aviv and also to the Indian

customers of Verint Systems Inc (another subsidiary of the holding company) which are the Associated Enterprises (AE). On the other hand, Hindustan Housing Co. Ltd. undertakes a wider variety of activities like providing air conditioning, lift and intercom services which typically included operating and service maintenance services thereof. Thus, although providing post sales services is a part of the activities of Hindustan Housing Co. Ltd., its spectrum includes providing air conditioning, lifts and intercoms also. Thus, it cannot be considered as a company which is functionally comparable to the assessee company. Also, the company fails the Related Party Transaction filter. Therefore, we find no infirmity in the order of the Ld. CIT (A) directing the exclusion of this company from the final set of comparables.

(ii) Choksi Laboratories Ltd.

With respect to this company, it has been submitted that this company is not functionally comparable as this is a commercial testing and analysis laboratory engaged in testing of various products which included food and agricultural products, cement and building materials, chemicals, drugs and paints. It has also been submitted that the other services rendered by the company are calibration services, consultancy and pollution control. A

perusal of the Directors' Report and the Annual Financial Statements shows that the contentions of the Ld. AR are correct on both the counts. We also note that the TPO himself has observed in page 9 of his order that the core activity of this company was providing analytical and testing services. We also note that this company had a significantly high proportion of testing instruments which was approximately 58% of its total net assets which implies that the functions performed by the company are capital intensive in nature and there is no similarity with the functions of a service provider. Therefore, we find no infirmity in the order of the Ld. CIT (A) directing the exclusion of this company from the final set of comparables.

(iii) Vimta Labs Ltd.

With respect to this company, it has been submitted that this company is a leading provider of multi-disciplinary contract-research and testing services in India. It has also been submitted that this company is mainly engaged in providing testing services in India in areas of clinical research, environmental assessments, pre-clinical animal studies, clinical reference lab services and analytical testing of a wide variety of products. A perusal of the Directors' Report and the Annual

Financial Statements shows that the contentions of the Ld. AR are correct on both the counts. We also note that this company had incurred huge expenditure on testing and analysis whereas the assessee company did not incur any expenditure on testing services. We also note that the assets employed by the assessee in terms of plant and machinery were approximately 70% of its total net assets which implies that the functions performed by this company were more capital intensive than the assessee company which was a mere service provider. Thus, it can be safely concluded that this company is not a good comparable to the assessee company. Therefore, we find no infirmity in the order of the Ld. CIT (A) directing the exclusion of this company from the final set of comparables.

6.0.1 With respect to the other two comparables viz. Scal Services Ltd. and Isgec Coverma Ltd., whose exclusion by the Ld. CIT (A) was being challenged, the Ld. AR has submitted that the assessee had no objection if these two comparables were included in the final set of comparables. Accordingly, we direct the TPO/AO to include these two companies in the final set of comparables.

6.1 As far as the disallowance of club expenses is concerned, the Ld. Commissioner of Income Tax (Appeals) has deleted the disallowance by observing that the Assessing Officer has made the disallowance on *ad hoc* basis without bringing any fact on record to prove that some kind of personal element was involved. We further note that the Hon'ble Bombay High Court in the case of C.I.T. (Large Tax Payer Unit) vs. Lubrizol India Ltd. (*supra*) has held that entrance fee for membership of a club is to be considered as revenue expenditure. Although entrance fee does have an enduring benefit, it was not considered to be capital in nature by the Hon'ble Bombay High Court as no asset was created. Applying the same analogy, membership fee would also necessarily have to be regarded as revenue in nature. The nature of expenditure is not in doubt here. The Assessing Officer also has not brought out any fact which would justify the disallowance. Therefore, we are unable to differ with the findings of the Ld. Commissioner of Income Tax (Appeals) on this issue and we dismiss ground no. 2 of the department's appeal.

6.3 As far as ground no. 3 challenging the action of the Ld. Commissioner of Income Tax (Appeals) in allegedly admitting additional evidence with respect to approval of gratuity fund is

concerned, a perusal of the impugned order shows that the Ld. Commissioner of Income Tax (Appeals) has not admitted any evidence which could be taken as being in the nature of additional evidence. The approval letter pertaining to the gratuity fund is a matter of record and we find no infirmity in the action of the Ld. Commissioner of Income Tax (Appeals) in taking cognizance of this approval letter while deleting the related disallowance. Thus, ground no. 3 also stands dismissed.

6.4 As far as ground no. 4 is concerned wherein the department has contested the action of the Ld. Commissioner of Income Tax(A) in treating the provision of gratuity and the provision for leave encashment as ascertained liability for the purpose of calculation of book profit u/s 115JB of the Act, it is undisputed from the disclosure made by the assessee in its notes on account that as against accumulated provision of Rs. 8,55,136/-, a payment of Rs. 8,50,000/- has been made against the gratuity and, thus it is not an estimate as inferred by the Assessing Officer but is based on actual payment. As far as the provision for leave encashment is concerned, it is undisputed that it is based on actuarial valuation of the assessee's liability in this regard. The same has been duly disclosed by way of a note in the

'notes on accounts' annexed to the annual financial statement of the assessee company. We also find support from the judgment of the Hon'ble Bombay High Court in the case of C.I.T. vs. Echjay Forgings (P) Ltd. wherein the Hon'ble Bombay High Court had held that provision for doubtful debts, gratuity etc. on the basis of actuarial valuation would have to be excluded from the net profit for computing the book profit u/s 115JB of the Act. Therefore drawing analogy from this judgement and respectfully following the ratio of the judgment of the Hon'ble Bombay High Court as aforesaid, we dismiss ground no. 4 of the department's appeal.

6.5 Ground no. 5 is general in nature and needs no separate adjudication.

7.0 In the result, the appeal of the revenue stands partly allowed.

8.0 Since the assessee has not pressed its Cross Objection, the same stands dismissed.

9.0 In the final result the appeal of the department stands partly allowed and the assessee's C.O. stands dismissed.

Order pronounced in the open court on 19.06.2019.

Sd/-

**(N.S. SAINI)
ACCOUNTANT MEMBER**

Sd/-

**(SUDHANSHU SRIVASTAVA)
JUDICIAL MEMBER**

Dated: 19th JUNE, 2019
'GS'

Copy forwarded to: -

- 1) Appellant
- 2) Respondent
- 3) CIT(A)
- 4) CIT
- 5) DR

By Order

ASSTT. REGISTRAR

Date of dictation	
Date on which the typed draft is placed before the dictating Member	
Date on which the typed draft is placed before the Other Member	
Date on which the approved draft comes to the Sr.PS/PS	
Date on which the fair order is placed before the Dictating Member for pronouncement	
Date on which the fair order comes back to the Sr.PS/PS	
Date on which the final order is uploaded on the website of ITAT	
Date on which the file goes to the Bench Clerk	
Date on which the file goes to the Head Clerk	
The date on which the file goes to the Assistant Registrar for signature on the order	
Date of dispatch of the Order	