

**IN THE INCOME TAX APPELLATE TRIBUNAL
BANGALORE BENCHES "B", BANGALORE**

Before Shri Chandra Poojari, AM & Shri George George K, JM

IT(TP)A No.2171/Bang/2019 : Asst.Year 2012-2013

M/s.Outsourcepartners International Private Limited Tower 2D, Embassy Tech Village Devarabeesanahalli Outer Ring Road Bangalore – 560 037. PAN : AAACO5734C.	v.	The Deputy Commissioner of Income-tax Circle 5(1)(2) Bengaluru.
(Appellant)		(Respondent)

Appellant by : Sri.K.R.Vasudevan, Advocate
Respondent by : Sri.Srinivas T.Bidari, CIT-DR

Date of Hearing : 22.11.2021	Date of Pronouncement : 24.11.2021
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ORDER

Per George George K, JM:

This appeal was disposed of by the ITAT vide common order dated 31.10.2017 for assessment years 2011-2012 and 2012-2013 (assessment year 2012-2013 was wrongly mentioned as assessment year 2009-2010 in the original Tribunal order and later was correct by the order of ITAT dated 14.09.2018 in MP No.123/Bang/2018).

2. The Tribunal vide its earlier order dated 31.10.2017, had set aside certain issues to the Transfer Pricing Officer (TPO) for the assessment year 2012-2013. The present appeal arises out of the order of TPO, pursuant to the ITAT's order concerning assessment year 2012-2013. The assessee had raised thirteen grounds and one additional ground. However,

during the course of hearing the learned AR restricted his argument to only the following four issues, namely,

- (i) assessee is seeking to exclude (a) Infosys BPO Limited and (b) TCS E-Serve Limited from the list of comparables (ground 3),
- (ii) depreciation adjustment (ground 4),
- (iii) negative working capital adjustment (ground 7), and
- (iv) deduction of educational cess (additional ground).

2.1 We shall adjudicate the above issues as under:

Exclusion of Infosys BPO Limited & TCS E-Serve Limited (Ground 3)

3. The Tribunal in its earlier order dated 31.10.2017 had remanded the issue to the TPO for exclusion of two comparables, namely, Infosys BPO Limited and TCS E-Serve Limited. In fresh TP proceedings, the TPO held that these two companies are comparable to the assessee. The Dispute Resolution Penal (DRP) confirmed the action of the TPO.

3.1 Aggrieved, the assessee has raised this issue before the Tribunal. The learned AR submitted that these two companies are not comparable to the assessee since they are functionally dissimilar. In this context, the learned AR relied on the order of the Tribunal in the case of Indecomm Global Services (India) Private Limited in IT(TP)A No.185/Bang/2018 (order dated 28.09.2019).

3.2 The learned Departmental Representative supported the orders of the Income Tax Authorities.

3.3 We have heard rival submissions and perused the material on record. The assessee is an ITES company engaged in the business of providing business processing outsourcing to its AEs. The assessee is a captive service provider to its AEs. The Bangalore Bench of the Tribunal in the case of Indecomm Global Services (India) Pvt. Ltd. (supra) had excluded Infosys BPO Limited and TCS E-Serve Limited from the list of comparables. The Tribunal excluded Infosys BPO Limited, since the said company was functionally incompatible, on account of presence of intangibles and ownership of `brands'. As regards TCS E-Serve Limited, the said company was excluded, since it engaged in high end KPO services and cannot be compared to the assessee, who is rendering a low end BPO service. The relevant finding of the Bangalore Bench of the Tribunal in the case of Indecomm Global Services (India) Private Limited (supra) for exclusion of Infosys BPO Limited and TCS E-Serve Limited, reads as follow:-

“2. Infosys BPO Ltd.

Assessee objected for inclusion of this comparable primarily on the basis of functional incompatibility and presence of intangibles. It has been submitted that this company owns huge brand and not a fit comparables for company like assessee, who provide captive service to its AE's.

Ld.CIT DR opposed the exclusion and placed reliance upon orders passed by authorities below.

6. We have perused submissions advanced by both sides in the light of the records placed before us. Assessee placed reliance upon decision of this Tribunal in case of *Zyme Solutions Pvt Ltd., vs ACIT* vide order dated 28/06/19 in ITA (TP) a No. 1661/Bang/2016, wherein this comparable has been excluded by observing as under:

'5. We have heard the rival submissions on the comparability of Infosys BPO as a comparable company. The Delhi ITAT in the case of *Baxter India Pvt. Ltd. Vs. ACIT* ITA No.6158/Del/2016 for AY 2012-13 in the case of a company rendering ITES such as the Assessee, vide order dated 24.8.2017 Paragraph 23 held that Infosys BPO is not comparable with a company rendering ITES for the following reasons:-

"23. In so far as exclusion of Infosys BPO Ltd. is concerned, we find from the submissions made by the assessee before the Assessing Officer/TPO/DRP is that Infosys BPO Ltd. is predominantly into areas like Insurance, Banking, Financial Services, Manufacturing and Telecom which are in the niche areas, unlike the assessee. Further it was also submitted that the Infosys BPQ Ltd. comprises brand value which will tend to influence its business operation and the pricing policy thereby directly impacting the margins earned by the Infosys BPO Ltd.. We find the submissions of the ld. counsel for the assessee before TPO/DRP that in order to maintain the brand image of Infosys BPQ Ltd. in the market, the company incurs substantial selling and marketing expenditure whereas the assessee being a contract service provider does not incur such expenses to maintain its brand has not been controverted by them. Further, Infosys BPO Ltd. being a subsidiary of Infosys has an element of brand value associated with it. This can be further confirmed by the presence of brand related expenses incurred by Infosys BPO Ltd. Further, Infosys BPO Ltd. has acquired Australian based company M/s Portland Group Pty Ltd. during financial year 2011-12. They provide sourcing and category management services in Sydney, Australia. Therefore, this company also failed the TPO's own filter of rejecting companies with peculiar circumstances. In view of the above i.e. functionally not comparable, presence of brand and extraordinary event that has taken place during the year on account of acquisition of Australian based company, we are of the considered opinion that Infosys BPO Ltd. should not be included in the list of comparables. We accordingly direct the Assessing Officer/TPO to exclude Infosys BPO Ltd. from the list of comparables for the purpose of computing the average margin."

It was also brought to our notice that the Hon'ble Delhi High Court in ITA No.260/2018 in the appeal filed by the Revenue against the aforesaid order dismissed the appeal at the admission stage observing that rationale given by the ITAT for exclusion was correct. In view of the aforesaid decision, we direct exclusion of Infosys BPO from the list of comparable companies chosen by the TPO. From above, it is clear

that this company is functionally not comparable with captive service provider.

Respectfully following the same we direct this company to be excluded from the list of comparables.

3. TCS e-Serve Ltd.

Ld.AR submitted that this company has been objected by assessee for its functional dissimilarity as it renders both BPO and KPO services without segmental reporting. It is submitted that this company owns huge brand of TATA group and has also incurred brand related expenses and therefore cannot be accepted to be compared with a captive service provider like assessee. Ld.CIT DR on the contrary opposed its exclusion and placed reliance upon orders passed by authorities below.

7. We have perused submissions advanced by both sides in light of records placed before us. Assessee placed reliance upon following decisions in support of its argument for exclusion of this comparable:

• Zyme Solutions Pvt Ltd. vs ACIT (supra) • Baxter India Pvt. Ltd vs ACIT reported in (2017) 85 Taxmann.com • 285 (Delhi-Trib) • PCIT vs BC Management Services Pvt. Ltd. reported in TS-948- HC-

• 2017 (Del)-TP It is observed that this comparable has been excluded by this Tribunal. Assessee placed reliance upon decision of this Tribunal in case of [Zyme Solutions Pvt Ltd., vs ACIT](#) reported in (2019) 101 taxman.com 292, by observing as under:

"11.3 We have heard rival submissions and perused material on record. The issue of comparability of this company was considered by the co-ordinate bench of Tribunal in the case of [XLHealth Corpn. India \(P.\) Ltd. \(supra\)](#). The relevant findings of the Tribunal are as under:

". . . We have heard the rival submissions and perused the material on record. From the perusal of the Annual Report of this entity placed at page Nos. 583 to 678 of paper book, at page No. 604 it is stated as under.

"2. COMPANY OVERVIEW IT(TP)A No.185(B)/2018 Your Company, along with its subsidiary companies - TCS e-Serve International Limited and TCS e-Serve America Inc., is primarily engaged in the business of providing Business Process Services (BPO) for its customers in Banking, Financial Services and Insurance domain. The Company's operations include delivering core business processing services, analytics & insights (KPO) and support services for both data and voice processes.

Your Company is an integral part of the Tata Consultancy Services' (TCS) strategy to build on its 'Full Services Offerings' that offer global customers an integrated portfolio of services ranging from IT services to BPO services.

The Company provides its services from various processing facilities, backed t) a robust and scalable infrastructure network tailored to meet clients' needs. A detailed Business Continuity Plan has also been put in place to ensure the services are provided to the customers without any disruptions."

Thus, this company is also stated to be a K n o w l e d g e Process Outsourcing and therefore for reasons stated by us wh ile dealing with this issue of comparability of the company Infosys BPO Ltd. shall equally hold good and therefore we direct the AO/TPO to exclude this company from the list of comparables.' Since the appellant company is into lo w end BPO, it cannot be compared with KPO service provider.

11.4 Respectfully following the decision of the co-ordinate bench of Tribunal, we direct for exclusion this company from the list of comparable". It has been observed that this company is into high-end KPO services and an assessee rendering low end BPO services cannot be compared with it. Further, this company has been excluded due to absence of segmental information.

Respectfully following aforesaid decision, we direct Ld.TPO to exclude this company from the list of comparables."

3.4 In the instant case, the profile of the assessee and that of the profile of assessee in the case of M/s.Indecomm Global Services (India) Private Limited are similar. The assessment year concerned this case and in in the case of M/s.Indecomm Global Services (India) Private Limited is 2012-2013. Therefore, respectfully following the Co-ordinate Bench order of the Bangalore Tribunal in the case of M/s.Indecomm Global Services (India) Private Limited (supra), we direct the AO / TPO to exclude Infosys BPO Limited and TCS e-Serve Limited from the list of comparables. Therefore, ground 3 is allowed.

Depreciation Adjustment (ground 3)

4. The Tribunal in its earlier order had remanded the matter to the files of the TPO. The Tribunal directed the AO / TPO to re-examine if they notice that the rates of depreciation are different in the case of the assessee and comparable companies, and if found, reasonable adjustment ought to be made. During the remand proceedings, the TPO did not grant any depreciation adjustment. The DRP confirmed the action of the TPO.

4.1 Aggrieved, the assessee has raised this issue before the Tribunal. The learned AR contended that the TPO in the remand proceedings had accepted that the rate of depreciation of the assessee and that of the comparable companies are different. However, the TPO refused to grant depreciation adjustment on some other extraneous issues. The DRP confirmed the action of the TPO and tried to apply depreciation ratio to turnover as a parameter of comparison. According to the learned AR, directions of the Tribunal are unambiguous and both the TPO and the DRP has not followed the directions of the Tribunal.

4.2 The learned Departmental Representative, on the other hand, supported the orders of the Income Tax Authorities.

4.3 We have heard rival submissions and perused the material on record. The Tribunal in its earlier order had restored the issue to the AO / TPO with specific directions. The relevant finding of the Tribunal reads as follows:-

“17. The Tribunal has taken a consistent view that wherever different rates of depreciation are charged in the case of assessee as well as the comparables, the depreciation adjustment should be allowed. In the instant case, the learned counsel for the assessee had tried to demonstrate that the rate of depreciation charged in the case of assessee and the comparables are different. Therefore we are of the view that let this matter be re-examined by the TPO / AO and if they notice that the rates of depreciation are different in the case of assessee and the comparables companies, the reasonable depreciation adjustment be made in order to determine the ALP for the international transactions.”

4.4 From the above order of the Tribunal, it is clear if there is difference in depreciation in the case of assessee and the comparable cases, reasonable depreciation adjustment is to be made to determine the arm's length of the international transaction. On perusal of the TPO's order and the DRP's order, confirming the same, it is clear that the directions of the Tribunal in its earlier order has not been given effect to. The TPO has admitted that depreciation cost of the comparable companies is lesser than the assessee (since deprecation policy followed by comparable companies is as per Companies Act, whereas the assessee was showing higher rate of depreciation based on some agreement (see page 5 of the TPO's order). Hence, suitable depreciation adjustment ought to have been made by AO / TPO. Therefore, this issue is restored to the files of the AO / TPO. The AO / TPO is directed to allow depreciation adjustment if they notice the rate of depreciation are different in the case of the assessee and the comparable cases. Therefore, ground 4 is allowed for statistical purposes.

Negative Working Capital Adjustment (Ground 7)

5. It was contended that this issue was raised before the Tribunal in the original proceedings in ground 4.9A and the same is reproduced at page 27 of the Tribunal order. However, there is no specific adjudication on this issue. It was submitted that in the remand proceedings, the TPO again computed the working capital adjustment at (-) 1.48%. The DRP confirmed the view taken by the TPO.

5.1 Aggrieved, the assessee has raised this issue before the Tribunal. The learned AR submitted that it is settled principle that negative working capital adjustment cannot be made for captive service providers. The learned AR relied on the orders of the Bangalore Bench of the Tribunal in the case of ACIT v. e4e Business Solutions India Private Limited in IT(TP)A No.2900/Bang/2018 (order dated 08.21.2020) and GXS India Technology Centre Private Limited v. ACIT in IT(TP)A No.128 & 331/Bang/ 2018 (order dated 16.11.2021).

5.2 The learned Departmental Representative supported the orders of the Income Tax Authorities.

5.3 We have heard rival submissions and perused the material on record. It is settled position of law that negative working capital adjustment cannot be made for captive service providers. The Bangalore Bench of the Tribunal in the case of ACIT v. e4e Business Solutions India Private Limited (supra), after elaborately considering the judicial pronouncements on the subject, had held as follows:-

“14. The CIT(A) has given a finding that the assessee is captive service provider and is operating on cost plus basis. Since the entire revenue of assessee was from its AE’s, the CIT(A) held that negative working capital adjustment is not appropriate by relying on the order of the Bangalore Bench of the Tribunal in the case of Lam Research India Pvt. Ltd. v. DCIT in IT(TP)A No.1437 & 1385/Bang/2014 (order dated 30.04.2015). The relevant observation of the CIT(A) reads as follows:-

“11.1 In relation to working capital adjustment, it is observed that the appellant is a captive service provider in the Software Development Segment. It is operating on cost plus basis and the entire revenue in this segment is from AE. So the decision of Bangalore Bench of ITAT in the case of Lam Research India Private Limited (supra) is squarely applicable to its case. This ground of appeal of the appellant is allowed.”

15. Revenue being aggrieved, has raised this issue before the Tribunal. The learned DR had submitted that the financials of the assessee had mentioned borrowing during the year and therefore no working capital adjustment should be allowed. In this context, the learned DR referred to the order of the Tribunal in the case of ACIT vs. e4e Business Solutions India Pvt. Ltd. in IT(TPA) No.2900/Bang/2018 (order dated 08.12. 2020).The learned AR, on the other hand, submitted that the assessee does not have any borrowing / loan for working capital and is a captive service provider providing software development services only to its AEs. It was submitted that the long term borrowings of Rs.99,74,434 that is mentioned in the notes of the financial statement is to secure hypothecation of vehicles acquired on financial lease.

16. We have heard rival submissions and perused the material on record. The CIT(A) has given a categorical finding that the assessee is a captive service provider and is operating on cost plus basis. It was held by the CIT(A) that since the entire revenue of the assessee was from its AEs, negative working capital is not appropriate by relying on the Co-ordinate Bench order of the Tribunal in the case of Lam Research India Pvt. Ltd. (supra). In the notes to financial statement under the head long term borrowing an amount of Rs.99,74,436 is mentioned. This amount is secured against hypothecation of vehicles on financial lease. In the financials an amount of Rs.16,43,002 has been mentioned under the heading interest expenses. This interest is against the amount taken for financial lease as mentioned earlier. Therefore, the assessee does not have borrowings / loans for working capital and is purely a captive service provider providing software development services only to its AEs. Therefore, in

such circumstances, there is no working capital risk since the assessee is working on a cost plus model. The co-ordinate Bench of the Tribunal in the case of e4e Business Solutions India Private Limited (supra) had in detailed discussed the entire concept of negative working capital adjustment and why it should not be made. The said order of the Tribunal has also discussed in detail, the case of Technotree Convergence relied on by the learned DR (para 9 of e4e Business Solutions India Private Limited). Since the assessee in this case does not have working capital loans / borrowings and entails no working capital risks, the ratio decidendi in the case of e4e Business Solutions India Private Limited (supra) directly applies to the assessee and no working capital adjustment should be made. Therefore, the CIT(A)'s conclusion that no negative working capital adjustment is to be made by placing reliance on the order of the Bangalore Bench of the Tribunal in the case of Lam Research India Private Limited (supra) is correct and no interference is called for. It is ordered accordingly."

5.4 Admittedly in this case, the assessee is a captive service provider and it is operating on cost plus basis. Therefore, following the order of the Tribunal in the case of ACIT v. e4e Business Solutions India Private Limited (supra), we hold that there should not be any negative working capital adjustment. It is ordered accordingly. Therefore, ground 7 is allowed.

Deduction of Educational Cess (additional ground)

6. The additional ground raised does not require investigation of new facts and it is purely legal ground. Therefore, placing reliance on the judgment of the Hon'ble Apex Court in the case of *National Thermal Power Co. Ltd. v. CIT (1998) 229 ITR 383 (SC)*, we admit the additional ground and proceed to dispose of the same on merits.

6.1 We have heard rival submissions and perused the material on record. On identical facts, the Bangalore Bench of the Tribunal in the case of DCIT v. GE BE Private Limited in

IT(TP)A No.251/Bang/2016 (order dated 27.11.2020) had held that educational cess is to be allowed as a deduction. The relevant finding of the Bangalore Bench of the Tribunal reads as follow:

“17. On merits, Ld.AR submitted that, education cess is not tax and hence is not disallowable. We also rely on the judgment of Hon'ble Rajasthan High Court in the case of [Chambal Fertilizers and Chemicals Ltd. v. Jt. CIT \(supra\)](#), which after taking into account aforementioned CBDT circular held that [section 40\(a\)\(ii\)](#) applies only to taxes and not to education cess. Relevant extract of the decision is reproduced for ease of reference:-

"13. On the third issue in appeal no. 52/2018, in view of the circular of CBDT where word "Cess" is deleted, in our considered opinion, the tribunal has committed an error in not accepting the contention of the assessee. Apart from the Supreme Court decision referred that assessment year is independent and word Cess has been rightly interpreted by the Supreme Court that the Cess is not tax in that view of the matter, we are of the considered opinion that the view taken by the tribunal on issue no. 3 is required to be reversed and the said issue is answered in favour of the assessee."

Respectfully following the aforesaid view, we allow the additional ground raised by assessee."

6.2 In view of the Co-ordinate Bench order of the Bangalore Tribunal in the case of DCIT v. GE BE Private Limited (supra) we direct the AO / TPO to allow the educational cess as a deduction. It is ordered accordingly.

7. In the result, the appeal filed by the assessee is partly allowed.

Order pronounced on this 24th day of November, 2021.

Sd/-
(Chandra Poojari)
ACCOUNTANT MEMBER

Sd/-
(George George K)
JUDICIAL MEMBER

Bangalore; Dated : 24th November, 2021.
Devadas G*

Copy to :

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2. The Respondent.
3. The DRP-2, Bengaluru.
4. The Pr.CIT-5, Bengaluru.
5. The DR, ITAT, Bengaluru.
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Asst.Registrar/ITAT, Bangalore