

IN THE INCOME TAX APPELLATE TRIBUNAL
“B” BENCH : BANGALORE

BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT
AND SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER

ITA Nos.1071 & 1072/Bang/2018
Assessment years : 2004-05 & 2005-06

The Assistant Commissioner of Income Tax, Circle 7(1)(1), Bangalore.	Vs.	M/s. e4e Business Solutions India Pvt. Ltd., No.389/1, 7 th Main, 42 nd Cross, 5 th Block, Jayanagar, Bangalore – 560 043. PAN: AAACI 6324A
APPELLANT		RESPONDENT

CO No.97/Bang/2018 [in ITA Nos.1071/Bang/2018]
Assessment year : 2004-05

M/s. e4e Business Solutions India Pvt. Ltd., Bangalore – 560 043. PAN: AAACI 6324A	Vs.	The Assistant Commissioner of Income Tax, Circle 7(1)(1), Bangalore.
CROSS OBJECTOR		RESPONDENT / APPELLANT IN APPEAL

Revenue by	:	Shri Priyadarshi Mishra, Addl.CIT(DR)(ITAT), Bangalore.
Assessee by	:	Shri T. Ravindra, CA

Date of hearing	:	27.10.2021
Date of Pronouncement	:	29.11.2021

ORDER

Per N V Vasudevan, Vice President

ITA Nos.1071 & 1072/Bang/2018 are appeals by the revenue against the common order dated 30.12.2017 of the CIT(Appeals)-III, Bangalore relating to assessment year 2004-05 & 2005-06. The assessee has filed Cross Objections in CO No.97/Bang/2018 against the revenue's appeal for AY 2004-05 i.e., ITA No.1071/Bang/2018.

2. The main issue that needs to be adjudicated in the appeals of the revenue is as to, whether the CIT(Appeals) was justified in directing the AO to apply the internal Transactional Net Margin Method (TNMM) as the most appropriate method (MAM) for benchmarking the international transactions entered into by the assessee with its Associated Enterprise (AE). The factual background under which the aforesaid issue arises for consideration is that the assessee rendered Information Technology enabled Services [ITeS] to its AEs and therefore the price that the assessee received in rendering such services has to satisfy the arm's length price (ALP) test as laid down u/s. 92 of the Income-tax Act, 1961 [the Act]. The TPO to whom reference was made by the AO under the provisions of section 92 of the Act for determination of the ALP passed an order dated 15.12.2006 in which he determined the ALP of the international transactions by selecting the following comparable companies:-

Sl. No.	Name	Operative Cost	Operative Revenue	Operative Profit	Operative Profit/Cost
1.	Vishal Information Technologies Ltd.	9.37	13.88	4.51	48.13%
2.	Wipro BPO Ltd.	322.3	430.31	108.01	33.51%
3.	Tricom India Ltd.	6.34	9.24	2.9	45.74%
4.	Fortune Infotech Ltd.	8.08	11.38	3.3	40.84%

5.	Spanco Telesystems & Solutions Ltd.	10.32	15.44	4.57	40.1%
6.	Ultramarine Pigments Ltd.	6.18	10.09	3.91	63.27%
7.	Allsec Technologies Ltd.	24.10 (Adj)	24.94	0.83	3.44%
	Arithmetic Mean				19.29%

3. The TPO determined the ALP of the international transactions as follows:-

Arms Length Price of the services	A	Rs.29,14,83,345
Price charged by you	B	Rs.23,69,08,600
Adjustment u/s. 92CA	C = A-B	Rs.5,45,74,745

4. The sum of Rs.5,45,74,745 suggested by the TPO in his order was incorporated in the draft assessment order dated 29.12.2003 passed by the AO u/s. 143(3) of the Act. The assessee did not file any objections before the DRP against the draft assessment order, but filed appeal before the CIT(Appeals). One of the contentions taken by the assessee in the form of additional ground was that the assessee entered into transactions of rendering ITeS similar to the one entered into the AE with third parties and that the internal margin in respect of the transactions with non-AE was at 23%. If that margin is compared with the margin charged by the assessee in respect of the international transactions with the AE, then the price charged by the assessee would be at arm's length. This argument was accepted by the CIT(Appeals) who observed as follows:-

“5.0 Additional Ground No. 1 is regarding granting an internal margin of 23% worked out by the appellant under the Transactional Net Margin Method.

In this regard, the appellant submitted in para 5 on page 48 of the original written submissions dated 26th August 2013 filed before the CIT Appeals that e4e India rendered services to Non-AEs similar to the services that were rendered to its AEs. Wherein the margin earned with Non AE's was 23% (Being the overall margin less the AE margin as per the TP study). The appellant requested to adopt the internal TNMM for the TP purposes alternatively. It has also submitted the orders passed by the ITAT in its own case for the AY 2010-11 wherein the Hon'ble ITAT in IT(TP)A No.324(B)/2015 in page 12 of the order has directed the TPO to choose internal comparable in un-controlled transaction as against an external comparable, relying on the decision of the Co-ordinate Bench in the case of M/s.Mylan Labs Ltd in IT(TP)A 179/Bang/2015 and 214/Bang/2015.

As the facts and the business profile remaining unchanged going back and forward from the AY 2004-05 till the AY 2010-11, the appellant requested to adopt the internal comparable in un-controlled transaction as against an external comparable for the current year.

In view of the above, it is observed from the agreed facts, that the services rendered to Non-AEs are similar to the services that were rendered to its AEs. Hence, respectfully following the decision of the jurisdictional Hon'ble ITAT in assessee's own case for AY 2010-11, I am of the view that internal TNMM is appropriate in the present circumstances.

Sl No.		Mean Margin
1	Mean Margin as per the comparables retained in this Appellate order supra	21.93%
2	Internal Margin worked out by appellant	23.00%
3	AE Margin	11.59%

Considering the differences of opinion in respect of selection/rejection of the external comparables between the Appellant and the TPO, I am of the view that adopting the internal margin for TP comparability sake seems more appropriate. Considering the alternative ground taken up by the appellant, to accept internal TNMM, for TP comparability, the

TPO/AO is directed to compute the Arm's length price on the AE transactions by adopting the internal TNMM of 23%.”

5. Insofar as AY 2005-06 is concerned, the facts are identical. The TPO determined the ALP by adopting the following companies of comparables and determined the ALP of international transactions as follows:-

“6 Computation of Arms Length Price:

The arithmetic mean of the Profit Level indicators is taken as the arms length margin. (Please see Annexure 1 for details of computation of PLI of the comparables). Based on this, the arms length price of the IT enabled services rendered by the taxpayer is computed as under:

Arithmetic mean PLI	24.07%
Less working capital adj.	0.37%
Adj. Arithmetic mean	23.70%

Arms Length Price:

Operating Cost	Rs.261019180
Less working capital adj. as	23.70% of the Operating Cost
Adj. Arithmetic mean PLI	Rs.32,28,79,488

16.7 Price Received vis-a-vis the Arms Length Price:

The price charged by the tax payer to its Associated Enterprises is compared to the Arms Length price as under:

Arms Length Price @ 23.70% of Operating Cost	Rs.32,28,79,488
Price received	Rs.29,30,42,751
Shortfall being adjustment u/s. 92CA	Rs.2,98,36,737

6. A sum of Rs.2,98,36,737 was added to the total income by the AO in the draft order of assessment as addition on account of determination of ALP by order dated 29.12.2008. The order of the TPO u/s. 92CA was dated 24.10.2008.

7. Against the aforesaid additions, the assessee preferred appeal before the CIT(Appeals), who agreed with the contention of the assessee that internal TNMM should be applied. The relevant observations of the CIT(Appeals) are as follows:-

“4.4 Ground of appeal 4.6 & Additional Ground:

4.6 The TPO erred in making a transfer pricing adjustment even in respect of the transactions with non-associated enterprises.

&

Additional Ground

1. The Transfer Pricing Officer erred in not granting internal margin of 12.98% worked out by the appellant under the Transactional Net Margin Method.

This additional ground raised by the appellant being legal in nature, the same is admitted. In this regard, the appellant submitted on page 60 of the original written submissions dated 26' August 2013 filed before the CIT Appeals that M/s e4e Business Solutions-India, rendered services to Non-AEs similar to the services that were rendered to its AEs. Wherein the margin earned for the Non AE's segment was 12.98%. In the additional ground, the appellant requested to adopt the internal TNMM for the TP purposes alternatively. It has also submitted the orders passed by the ITAT in its own case for the AY 2010-11, wherein the Hon'ble ITAT in IT(TP)A No.324(B)/2015 on page 12 of the order, has directed the TPO to choose the internal comparable in controlled transaction as against an external comparable, relying on the decision of the Co-ordinate Bench in the case of M/s. Mylan Labs Ltd in IT(TP)A 179/Bang/2015 and 214/Bang/2015.

As the facts and the business profile remaining unchanged going back and forth from the AY 2004-05 till the AY 2010-11, the appellant requested to adopt the internal comparable in uncontrolled transaction as against an external comparable for the current year. The following table gives the details of the various margins:

S1 No.		Mean Margin
1	Mean Margin as per the comparables retained in this Appellate order supra	14.73% which is within +/- 5% of appellant margin being 16.49 and 6.49
2	Internal Margin (as per TP study report)	12.98%
3	AE Margin	11.49%

Considering the differences of opinion in respect of selection/rejection of the external comparables between the Appellant and the TPO and also considering the Hon'ble ITAT decision in the assessee's own case for AY 2010-11, I am of the view that adopting the internal margin for TP comparability sake, seems more appropriate. Considering the additional ground taken up by the appellant, to accept internal TNMM, for TP comparability, the TPO/AO is directed to compute the Arm's length price on the AE transactions by adopting the internal TNMM of 12.98%.”

8. The revenue is aggrieved by the aforesaid observations of the CIT(Appeals) for both the AYs 2004-05 & 2005-06 and has raised the following grounds in its appeals:-

AY 2004-05

“4. Granting an internal margin of 23% worked out by the appellant under the TNMM

i) Whether the Id CIT(A) erred in fact and law by directing the TPO to adopt the internal TNMM as the most appropriate method for benchmarking without appreciating the fact that the revenue earned from the associated enterprise is from the international market where as the revenue earned from the non-associate enterprise is from domestic market.

ii) Whether the Ld CIT(A) erred in not appreciating the fact that services rendered in two different markets cannot be same or similar and hence internal TNMM was not the most appropriate method for benchmarking the international transaction.

iii) Whether the Ld CIT(A) erred in not appreciating the fact that profit margins earned from transactions with international markets cannot be same or similar to the profit margins earned from transactions with the domestic market since there are difference in the factors that influence the profit margins and hence Internal TNMM was not the most appropriate method for benchmarking the international transaction.

iv) Whether the Ld CIT(A) ought to have appreciated the fact that factors like geography, functions performed, assets employed, risk taken, cost of labor, legal provisions between two different markets have a bearing on the profit margins. Hence the margin earned from international transactions cannot be compared with profit margins earned from transactions with the domestic market, therefore Internal TNMM was not the most appropriate method for benchmarking the international transaction.

v) Whether the Ld CIT(A) ought to have appreciated the fact that the taxpayer has not reported segmental break-up in respect of AE and Non AE's transactions in the audited financials. It is only before the transfer pricing office that a break-up between AE and Non AE segment has been furnished and it is without any key of allocation and supporting evidences in respect of expenses across the segments. Hence the Internal TNMM is not the most appropriate method for benchmarking.

vi) Whether on the facts and circumstances of the case, the Ld CIT(A) was correct in directing the TPO to adopt internal TNMM method, when the assessee has not raised this issue before the TPO during TP proceedings for arriving at the ALP.”

AY 2005-06

“Granting an internal margin of 12.98% worked out by the appellant under the TNMM

i) Whether the Id. CIT(A) erred in fact and law by directing the TPO to adopt the Internal TNMM as the most appropriate method for benchmarking without appreciating the fact that the revenue earned from the AE is from the international market whereas the revenue earned from the non-AE is from the domestic market.

ii) Whether the Id. CIT(A) erred in not appreciating the fact that services rendered in two different markets cannot be same or similar and hence Internal TNMM was not the most appropriate method for benchmarking the international transaction.

iii) Whether the Id. CIT(A) erred in not appreciating the fact that the profit margins earned from transactions with international markets cannot be same or similar to the profit margins earned from transactions with the domestic market since there are differences in the factors that influence the profit margins and hence Internal TNMM was not the most appropriate method for benchmarking the international transaction.

iv) Whether the Id. CIT(A) ought to have appreciated the fact that factors like geography, functions performed, assets employed, risk taken, cost of labor, legal provisions between two different markets have a bearing on the profit margins. Hence, the profit margin earned from international transactions cannot be compared with profit margins earned from transactions with the domestic market, therefore internal TNMM was not the most appropriate method for benchmarking the international transaction.

v) Whether the Id. CIT(A) ought to have appreciated the fact that the taxpayer has not reported segmental break-up in respect of AE and Non AE's transactions in the audited financials. It is only before the transfer pricing officer that a break-up between AE and Non AE segment has been

furnished and it is without any key of allocation and supporting evidences in respect of expenses across the segments. Hence the internal TNMM is not the most appropriate method for benchmarking.

vi) whether on the facts and circumstances of the case, the Id CIT(A) was correct in directing the TPO to adopt internal TNMM method, when the assessee has not raised this issue before the TPO during TP proceedings for arriving at the ALP.”

9. At the time of hearing, it was brought to our notice by the Id. counsel for the assessee that identical issue of applying internal TNMM had come up for consideration before the ITAT Bangalore Bench in assessee's own case for the AY 2010-11 in IT(TP)A No.324/Bang/2015 & 220/Bang/2015. The Tribunal vide its order dated 4.11.2015 upheld the application of internal TNMM, observing as under:-

“7. First we shall adjudicate the Additional grounds. The learned counsel for the assessee submitted that several rulings of the Hon'ble Tribunal, subsequent to the petitioner finalizing its TP study have accepted internal ALP in case the assessee renders similar services to both Associated Enterprises (AE) and non-AE's. The counsel relied on the decision in the case of Mylan Labs Ltd. I(TP)A No.179/Bang/2015 and 214/Bang/2015.

7.1 We find that in IT(TP)A No.214/Bang/2015 and IT(TP)A No.179/Bang/15 in the case of M/s Mylan Labs Ltd. at para-10 it has been held as follows;

10. The TPO had applied external TNMM on entity level and on this issue, the Third Member decision of the Mumbai Bench of the Tribunal in the case of M/s. Technimont ICB Pvt. Ltd. v. Addl. CIT in ITA No.4608/Mum/2010 for AY 2005-06, order dated 17.7.2012 is relevant. In para 10 of the said order, the Tribunal held as under:-

“10. Clause (i) of Rule 10B(e) stipulates that net profit margin from an international transaction with an AE is computed in relation to cost incurred or sales effected or assets employed etc. IT(TP)A Nos.324 (B)/15 & 220(B)15 10 Clause (ii) is material for the present purpose. It provides that the net profit margin realized by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base. The ‘base’ of this provision takes one back to clause (i) which refers to cost incurred or sales effected or assets employed or to be employed. On splitting clause (ii) into two parts, it divulges that the reference is made to internal and external comparables. One part of clause (ii) refers to the net profit margin realised by the enterprise from a comparable uncontrolled transaction’ and the other part talks of the net profit margin realised by an uncontrolled enterprise from a comparable uncontrolled transaction’. It transpires that whereas the first part refers to the profit margin from internal comparable uncontrolled transactions, the second part refers to profit margin from an external comparable uncontrolled transaction. Thus it is discernible that what is to be compared under this method is profit from a comparable uncontrolled transaction. The word ‘comparable’ may encompass internal comparable or external comparable. There is cue in the rule itself as to preference to be given to internal comparable uncontrolled transactions vis-à-vis externally comparable uncontrolled transactions. It is because the delegated legislature has firstly referred to the net profit margin realized by the enterprise (internal) from a comparable uncontrolled transaction and, thereafter, it points towards net profit margin realized by an unrelated enterprise (external) from a comparable uncontrolled transaction. Thus where potential comparable is available in the IT(TP)A Nos.324 (B)/15 & 220(B)15 11 shape of an uncontrolled transaction of the same assessee, it is likely to have higher degree of

comparability vis-à-vis comparables identified amongst the uncontrolled transactions of third parties. The underlying object behind computing ALP of an international transaction is to find out the profits which such enterprise would have earned if the transaction had been with some third party instead of related party. When the data is available showing profit margin of that enterprise itself from a third party, it is always safe and advisable to have recourse to such internal comparable case. The reason is patent that the various factors having bearing on the quality of output, assets employed, input cost etc. continue to remain by and large same in case of an internal comparable. The effect of difference due to such inherent factors on comparison made with the third parties, gets neutralized when comparison is made with internal comparable. Ex consequenti, it follows that an internal comparable uncontrolled transaction is more noteworthy vis-à-vis its counterpart i.e. external comparable.”

11. It has also been brought to our notice that in the subsequent year i.e. AY 2011-12, the TPO has accepted the internal comparability.

12. The ld. DR relied on the order of DRP.

13. We are in conformity and are inclined to follow the decision of the Third Member, ITAT Mumbai Bench in the case of M/s. Tecnimont ICB Private Ltd. (supra) wherein it is held that

“..... The underlying object behind computing ALP of an international transaction is to find out the profits which such IT(TP)A Nos.324 (B)/15 & 220(B)15 12 enterprise would have earned if the transaction had been with some third party instead of related party. When the data is available showing profit margin of that enterprise itself from a third party, it is always safe and advisable to have recourse to such internal comparable case.”

14. Hence we are of the opinion that the TPO had erred in choosing an external comparable, when there was an internal comparable uncontrolled transaction which the assessee had taken in its TP study. The assessee's appeal is allowed".

Respectfully following the decision of the Co-ordinate Bench authored by JM in this appeal, we direct the TPO to choose internal comparable in controlled transaction as against an external comparable."

10. Following the aforesaid decision, we uphold the orders of the CIT(Appeals) applying internal TNMM method for determination of the ALP. We may also observe that the manner of determination of internal margin under the internal TNMM has not been questioned. In these circumstances, we dismiss the relevant grounds of appeal of the revenue.

11. Insofar as the other grounds of appeal as raised by the revenue in its appeal and by the assessee in its CO are concerned, the same are in relation to choice of the comparable and other issues insofar as it relates to determination of ALP by applying the external TNMM. Since we have accepted the internal TNMM as the MAM for determining the ALP, these grounds of appeal are rendered purely academic and do not require any adjudication.

12. In the result, the appeals by the revenue as well as the CO by the assessee are dismissed.

Pronounced in the open court on this 29th day of November, 2021.

Sd/-

(CHANDRA POOJARI)
ACCOUNTANT MEMBER

Bangalore,

Dated, the 29th November, 2021.

/Desai S Murthy /

Sd/-

(N V VASUDEVAN)
VICE PRESIDENT

Copy to:

1. Assessee
2. Revenue
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.

By order

Assistant Registrar
ITAT, Bangalore.