

आयकर अपीलीय अधिकरण 'डी' न्यायपीठ चेन्नई में।
IN THE INCOME TAX APPELLATE TRIBUNAL
"D" BENCH, CHENNAI

माननीय श्री वी. दुर्गा राव, न्यायिक सदस्य एवं
माननीय श्री मनोज कुमार अग्रवाल, लेखा सदस्य के समक्ष।
BEFORE HON'BLE SHRI V. DURGA RAO, JUDICIAL MEMBER AND
HON'BLE SHRI MANOJ KUMAR AGGARWAL, AM

आयकर अपील सं./ **ITA No.1385/Chny/2014**
(निर्धारण वर्ष / **Assessment Year: 2009-10**)

M/s. MPS Technologies Ltd. (Now merged with MPS Ltd.) RR Tower-4, 4 th Floor Super A, 16&17, TVK Industrial Estate, Guindy, Chennai – 600 032.	बनाम/ Vs.	ACIT Company Circle-IV(3), Chennai.
स्थायी लेखा सं./जीआइ आर सं./ PAN/GIR No. AAECM-0205-A		
(□ पीलार्थी/ Appellant)	:	(प्रत्यर्थी / Respondent)

&

आयकर अपील सं./ **ITA No.1120/Chny/2014**
(निर्धारण वर्ष / **Assessment Year: 2009-10**)

ACIT Company Circle-IV(3), Chennai.	बनाम/ Vs.	M/s. MPS Technologies Ltd. (Now merged with MPS Ltd.) RR Tower -4, 4 th Floor Super A, 16&17, TVK Industrial Estate, Guindy, Chennai – 600 032.
स्थायी लेखा सं./जीआइ आर सं./ PAN/GIR No. AAECM-0205-A		
(□ पीलार्थी/ Appellant)	:	(प्रत्यर्थी / Respondent)

अपीलार्थी की ओरसे/ Assessee by	:	Shri S.P. Chidambaram (Advocate)-Ld. AR
प्रत्यर्थी की ओरसे/ Revenue by	:	Shri S. Palani Kumar- Ld. CIT-DR

सुनवाई की तारीख/ Date of Hearing	:	07-12-2021
घोषणा की तारीख / Date of Pronouncement	:	31-01-2022

आदेश / ORDER

Manoj Kumar Aggarwal (Accountant Member)

1.1 Aforesaid cross-appeals for Assessment Year (AY) 2009-10 arises out of final assessment order dated 27.02.2014 passed by learned Assessing Officer u/s. 143(3) r.w.s. 144C(13) & 92CA(3) of the Act pursuant to the directions of Ld. Dispute Resolution Panel, Chennai (DRP) dated 20.12.2013 u/s.144C(5) of the Act.

1.2 The grounds raised by the Revenue read as under:

1. The order of the learned-CIT(A) is contrary to law and facts of the case.
- 2.1. The learned Dispute Resolution Panel (DRP) erred in directing the Assessing Officer (A.O.) to include 'provision for bad debts' in the case of the comparable, M/s. Microgenetics Systems Ltd. for the reason that the Transfer Pricing Officer (TPO) has included 'bad debts' as part of operating expenditure in the case of the assessee company.
- 2.2. The learned DRP failed to appreciate that 'bad debts' has only been included by the Transfer Pricing Officer (TPO) in the calculation of operating margin of the Assessee Company and not 'provision for doubtful debts'.
- 2.3. The learned DRP ought to have seen that in the case of the comparable, M/s. Microgenetics Systems Ltd., what was excluded by the Transfer Pricing Officer (TPO) was only 'provision for bad debts' and not 'bad debts'.
- 2.4. The learned DRP has grossly erred in drawing a comparison between M/s. Microgenetics Systems Ltd. and the assessee company, without observing that only 'provision for bad debts' was excluded in the case of Microgenetics Systems Ltd., whereas, the case on hand deals with 'bad debts'.
- 3.1. The learned DRP erred in directing that the comparables M/s. Accentia Technologies Ltd. & M/s. Coral Hub Ltd. (Vishal Information Technologies Ltd.) should be excluded from the set of comparables, on the ground that both the comparables had events by way of mergers and acquisitions.
- 3.2. The learned DRP failed to appreciate that the Hon'ble Mumbai Tribunal in the case of Vodafone India Services (P) Ltd. v. DCIT (146 ITD 78), relying upon a co-ordinate Bench decision of the same Tribunal in the case of Willis Processing Services (I)(P) Ltd. v. DCIT (57 SOT 339), has held that 'a comparable cannot be excluded merely on ground of merger / amalgamation, unless the resultant company is functionally different'.
- 3.3. In the absence of any material to demonstrate that the resultant company in the case' of the two comparables are functionally different, the learned DRP ought to have upheld the action of the Assessing Officer (A.O.) in including the two comparables to arrive at the Arms Length Price.
- 4.1. The learned DRP erred in directing the A.O. to exclude expenditure towards freight and telecommunication charges from 'total turnover' for purpose of deduction

u/s.10A, relying upon the Hon'ble Chennai Tribunal's decision in the case of ITO v. Sak Soft Ltd. (30 SOT 55).

4.2. It is submitted that the relied upon decision has not become final and appeal has been preferred before the Hon'ble Jurisdictional High Court.

1.3 The grounds raised by the assessee read as under:

2. Transfer Pricing Grounds

2.1 The Dispute Resolution Panel ('DRP') / learned Assessing Officer ('AO') erred in partly confirming the order of the learned Transfer Pricing Officer ('TPO') in relation to determination of arms' length price and the resultant upward adjustment of Rs.3,12,73,328/- to value of the international transaction.

2.2 Adjustment towards unutilized floor space

- a. The TPO has erred in not granting the benefit for adjustment towards unutilized floor space.
- b. The TPO failed to appreciate the fact that the floor space, for which Assessee had claimed adjustment for, remained vacant throughout the year and therefore the same ought not to be considered as operating expense.

3. Foreign currency fluctuation

- a. The DRP has erred in holding that gain / loss arising due to the fluctuation in the value of foreign currency as an operating item for computing operating profit.

2.4 Functional incomparability

- a. The DRP erred in not adjudicating Appellant's objection with respect to functional incomparability of Cosmic Global Limited and Informed Technologies Limited.
- b. The TPO has erred in accepting Cosmic Global Limited as a comparable as the said company is primarily engaged in outsourcing its activities to third parties and not of rendering Information Technology Enabled Services and as such the said comparable company is not functionally comparable.
- c. The TPO has erred in accepting Informed Technologies Limited as a comparable without appreciating that the income from letting out premises accounts to 46% of total income and as such the said comparable company is not functionally comparable.

2.5 Extreme Profit Margin

- a. The TPO should have rejected Cosmic Global Limited with extremely high profit margin as the company was not demonstrating the normal industry trend.

2.6. Employee cost filter

- a. The DRP erred in not adjudicating the Appellant's objection with respect to application of employee cost filter as a percentage of turnover.
- b. The TPO erred in calculating employee cost as a percentage of total cost whereas the TPO should have applied employee cost as a percentage of turnover.

1.4 The Ld. AR sought exclusion of few comparable entities in final set of comparable entities. It was submitted that no other grounds are being urged in assessee's appeal. The Ld. CIT-DR supported the adjustment

made by Ld. TPO. The Ld.CIT-DR also assailed directions rendered by Ld. DRP in assessee's favor. Having heard rival submissions and after due consideration of material on record as well as judicial decisions cited by both the parties, our adjudication would be as under.

Proceedings before lower authorities

2.1 The assessee being resident corporate assessee is stated to be engaged in Software Development, maintenance, support & testing services and business process outsourcing (BPO) services predominantly in the publishing domain. These activities in common parlance are termed as Information Technology enabled services (ITeS). It was noted by Ld. TPO that the assessee is a 100% subsidiary of M/s. MPS Ltd.

2.2 The international transactions as carried out by the assessee with its Associated Enterprises (AE) during the year were referred to Ld. Transfer Pricing Officer (TPO) for determination of Arm's Length Price (ALP). The assessee rendered software development, transaction processing and other business process services to its various AEs situated at UK, USA and Australia. These transactions were benchmarked using Transactional Net Margin Method (TNMM). The Profit Level Indicator (PLI) was taken as Operating profit / cost. The mark-up on cost for the comparable companies was shown as 13.84% as against assessee's own margin of 14.83% and therefore, no adjustment was offered.

2.3 It was noted by Ld. TPO that the assessee operated in two segments viz. BPO segment and software segment. The sales turnover fell substantially which was attributed to global recession. It was submitted that due to sudden drop in business, the company had

incurred idle costs and unabsorbed fixed cost which were quantified as Rs.335.14 Lacs. The adjustment of the same was made by the assessee in computing its margins.

2.4 It was further noted by Ld. TPO that the assessee had excluded software development expenses capitalized for Rs.363.44 Lacs, unabsorbed fixed costs for Rs.204.90 Lacs and loss on forex fluctuations for Rs.60.68 Lacs. The assessee offered explanation with respect to under-utilization of the capacity. It was submitted that BPO division was transferred during the year but the assessee had to pay lease rentals for idle space devoted to this division. In other segment, it was submitted that due to global recession, the assessee had to offer substantial discounts which led to drastic reduction in revenue. The assessee identified unabsorbed fixed cost of Rs.204.90 Lacs against this segment. However, Ld. TPO rejected assessee' submission regarding lease payment by observing that the assessee had new division for software development which was evident from the fact that it had capitalized sum of Rs.363.44 Lacs and therefore, lease payments were to be treated as operating items. On similar observations, the plea of under-utilization for another segment was to be denied. Accordingly, Profit Level Indicator (PLI) of the assessee was revised to 0.47% as given in para-7 of the order. While revising PLI, the forex fluctuation for Rs.60.68 Lacs and unabsorbed fixed cost for Rs.204.90 Lacs was considered as operating items.

2.5 At the same time, Ld. TPO, disturbing the final set of comparable entities as adopted by the assessee, revised the final set of comparable entities for benchmarking. In the final analysis, Ld. TPO adopted 8

comparable entities having PLI of 20.82% as computed in the following manner: -

No.	Name of Company	OP/TC
1.	Accentia Technologies Ltd.	42.20%
2.	Vishal Information Technologies Ltd. (Coral Hub Ltd.)	22.34%
3.	Cosmic Global Ltd.	43.96%
4.	Microgenetics Systems Ltd.	6.23%
5.	Aditya Birla Minacs Worldwide Ltd.	-1.04%
6.	Caliber point Business Solutions Ltd.	25.53%
7.	Informed Technologies Ltd.	19.51%
8.	R. Systems International Ltd.	7.86%
		20.82%

While doing so, the comparable viz. M/s Allsec Technologies Ltd., M/s Maple esolutions Ltd. And M/s Msource India Ltd. as taken by the assessee were rejected. On the other hand, comparable viz. M/s Aditya Birla Minacs Worldwide Ltd., M/s Informed Technologies Ltd., M/s R. Systems International Ltd. & M/s Caliber Point Business Solutions Ltd. as selected by the assessee were accepted. The first four comparable entities as listed above were introduced by Ld. TPO despite the objection of the assessee. The margins of comparable entities were computed after working capital adjustment. Applying the same to the value of international transaction, Ld. TPO proposed an adjustment of Rs.2.65 Crores in its order dated 28.01.2013. The adjustments thus proposed were incorporated in the draft assessment order dated 11.03.2013 which was subjected to objections before Ld. DRP.

3. The Ld. DRP, after considering assessee's submissions, directed Ld. TPO to re-consider adjustment of unutilized floor space for BPO division. The adjustment of under-utilization of capacity was denied in view of the fact that any unilateral adjustment to financial of tested party

without knowledge of similar circumstances in case of comparable entities would give distorted picture. The forex fluctuation loss was held to be operative in nature. The provision of bad-debts for Rs.76 Lacs as claimed by the assessee to be non-operative in nature was not to be accepted since the financial results as per the books were to be accepted for computing profit-margin of the assessee. Certain directions were issued to Ld. TPO for inclusion / exclusion of comparable entities.

4. Pursuant to these directions, Ld. TPO has revised the Transfer Pricing adjustment to Rs.163.24 Lacs in its order dated 04.02.2014 wherein final set of comparable entities as well as their respective margins have been revised as under: -

No.	Name of Company	OP/TC
1.	Cosmic Global Ltd.	44.04%
2.	Microgenetics Systems Ltd.	-2.81%
3.	Aditya Birla Minacs Worldwide Ltd.	-1.01%
4.	Informed Technologies Ltd.	19.25%
5.	R. Systems International Ltd. (seg.)	5.48%
		12.99%

Further, the assessee's plea to allow unutilized rental capacity adjustment was again not allowed. The assessee's PLI were adopted as 0.47%. Aggrieved, the assessee as well as revenue is in further appeal before us.

5. Before us, the revenue contest exclusion of M/s Accentia Technologies Ltd. & M/s. Coral Hub Ltd. whereas the assessee seek exclusion of M/s Cosmic Global Limited and M/s Informed Technologies Limited from final set of comparable entities. For the same, Ld. AR relies on various decisions of Tribunal for the same assessment year in case of assessee engaged in similar line of business. The copies of the same have been placed on record. After considering the facts as well as the

finding in all these decisions, our adjudication with respect to comparable entities would be as under: -

(i) M/s Accentia Technologies Ltd.

We find that this entity was held to be functionally comparable by Ld. TPO. However, Ld. DRP excluded the same on the ground that this entity had events by way of merger and amalgamation. After considering various decisions, we find that this entity has been excluded for AY 2009-10 in similarly profiled assessee by Delhi Tribunal in the case of **Xchanging Technology Services India (P.) Ltd. V/s DCIT (57 Taxmann.com 437)**. In the order, the bench noted that this entity completed the acquisition of M/s Oak Technologies Inc. which was into healthcare back-office processing and this company was engaged in medical billing, coding and transcription activities. It was finally held that this entity would not be comparable because of exceptional financial results due to mergers / demergers. The revenue's further appeal against this order has already been dismissed by Hon'ble Delhi Court in ITA No.813/2015 dated 20.10.2015. We find that similar is the reasoning of Ld. DRP. Therefore, we do not any infirmity in the same. This ground urged by the revenue stand dismissed.

(ii) M/s. Coral Hub Ltd. (M/s Vishal Information Technologies Ltd.)

This entity has been excluded by Ld. DRP on similar reasoning that this entity had events by way of merger and amalgamation. We find that this entity has been excluded by Mumbai Tribunal in the case of **M/s Dimension Data India Ltd. V/s Addl. CIT (ITA No.1155/Mum/2014 dated 17.12.2020; authored by one of us)** for AY 2009-10 in similarly profiled assessee. This entity has been excluded on the ground that this entity had outsourced its services to outside vendors and the business

model was different. Accordingly, this entity was held to be not comparable. Taking the same View, we do not find any infirmity in the order of Ld. DRP in directing for exclusion of the same. This ground urged by the revenue stand dismissed.

(iii) M/s Cosmic Global Limited

Before Ld. DRP, the assessee had sought exclusion of the same on the ground that this entity reported super-normal profits. However, this plea was rejected. Aggrieved, the assessee is in further appeal before us. We find that this entity has been excluded by Delhi Tribunal in the case of **Xchanging Technology Services India (P.) Ltd. V/s DCIT (supra)** wherein it was noted that this entity had outsourced its activities in comparison to the assessee which had done business in-house. Further, this entity was found to be having different business model. The revenue's further appeal against this order has already been dismissed by Hon'ble Delhi Court in ITA No.813/2015 dated 20.10.2015. Respectfully following the same, we direct for exclusion of this entity. The ground raised by the assessee stand allowed.

(iv) M/s Informed Technologies Limited

This entity was selected by the assessee and the same was accepted by Ld. TPO. The Ld. DRP has not rendered any finding with respect to this entity. However, upon perusal of financials of this entity, as placed on record, it could be seen that this entity has earned income from letting out of premises which are approx. 46% of its revenue. Since this entity has rental income as major source of revenue, this entity could not be held to be comparable entity. The business models are different. The margins in rental business could not be compared with the margins in

ITeS services. Therefore, we direct for exclusion of this entity. This ground urged by the assessee stand allowed.

6. In ground nos. 2.1, the revenue is aggrieved by the directions of Ld. DRP with respect to M/s Microgenetics Systems Ltd. This entity's PLI was taken as 6.23% by Ld. TPO. However, pursuant to the directions of Ld. DRP, the margins have been recomputed as -2.81%. The same stem from the fact that provision of bad-debts for Rs.76 Lacs as claimed by the assessee to be non-operative in nature was held to be not acceptable for the reason that financial results as per the books were to be accepted for computing profit-margin of the assessee. Consequently, a direction was issued to Ld. TPO that if different treatment was given to these provisions while computing PLI of M/s Micro Genetics Ltd. then the same would be corrected. Accordingly, Ld. TPO has verified the same and revised the PLI of this entity. We find that Ld. DRP has only directed Ld. TPO to give similar treatment to provision for doubtful debts while computing PLI of the assessee and comparable entity. Therefore, no infirmity could be found in the same. The grounds thus raised stands dismissed.

7. Ground No.1 of revenue's appeal is general in nature. Ground Nos. 2.1 to 3.3 stands dismissed. The only grounds urged in assessee's appeal are exclusion of comparable entities which have already been dealt with by us in the order. The argument raised by Ld. AR with respect to grant of lease rental adjustment for unutilized floor space as well as treatment of foreign exchange gains / losses do not convince us to interfere in the orders of lower authorities. By concurring with the findings of Ld. DRP, in this regard, we reject the grounds thus raised by the assessee. The other grounds have not been pressed by Ld. AR during

hearing before us. The assessee's appeal stands partly allowed to the extent indicated in the order.

8.1 The remaining issue in revenue's appeal is issue of Telecommunication charges and foreign currency expenses for the purpose of computation of deduction u/s 10A. During assessment proceedings, it transpired that the assessee incurred expenses in the nature of Telecommunication charges and other expenditure in foreign currency which were taken into account while computing deduction u/s 10A. The foreign currency expenses were in the nature of Vendor Management Charges, Managed Services Expenses, technical service charges, usage statistical expenses, product support charges and foreign travel expenses. The Ld. AO, invoking explanation 2(iv) of Section 10A(8), opined that these expenses should not be included in 'export turnover'.

8.2 The assessee submitted that 'export turnover' as adopted by the assessee did not include telecommunication expenses in relation to rendering of services outside India but consist only of quantum of turnover / sales. It was further submitted that since the turnover / sales do not include any such charges, the same should not be excluded from 'export turnover' while computing deduction u/s 10A.

8.3 Regarding expenditure in foreign currency, the assessee relied on CBDT Circular No. 694 dated 23.11.1994 which provided that a distinction was to be drawn between consideration received against expenditure incurred for the purpose of goods sold / manufactured/produced and consideration received against independent services rendered. Up-to the point of sale of goods, expenditure incurred relating to goods cannot be said to be expenditure for technical services.

If the technical services are rendered independently which is being agreed to separately charge in addition to the price of goods, only then the expenditure could be in the nature of expenditure for the purposes of technical services. In the said background, the assessee submitted that the expenditure was for the purpose of development of product software and BPO services and not in the nature of expenditure for technical services. Therefore, this expenditure was not to be excluded while computing 'export turnover for computing deduction u/s 10A.

8.4 The assessee alternatively submitted that if both the expenditure was excluded from 'export turnover' then the same was to be excluded from 'total turnover'.

8.5 However, Ld. AO held that the foreign currency expenditure was technical services and further, telecommunication expenses were attributable to rendering of such technical services abroad. Therefore, both the items were to be excluded from 'export turnover'. In other words, benefits of Sec.10A would not be available on these items. The alternative plea was to be rejected since 'total turnover' would simply imply the absolute sum of all receipts constituting the assessee's turnover in its business and there is no reason as to why any receipt should be excluded from its ambit. The decision of Special Bench Chennai Tribunal in **ITO v. Sak Soft Ltd. (30 SOT 55)** would not be acceptable since the appeal was pending before Hon'ble High Court of Madras. Finally, the deduction u/s 10A was recomputed as Rs.28.44 Lacs as against Rs.52.97 Lacs as claimed by the assessee.

8.6 Upon further appeal, Ld. DRP directed Ld. AO to follow the cited decision of Chennai Tribunal and accordingly, full deduction of Rs.52.97

Lacs was granted to the assessee in the final assessment order. Aggrieved, the revenue is in further appeal before us.

9. As is evident from the order of Ld. DRP, this issue is covered in assessee's favor by the decision of Special Bench of Chennai Tribunal in **ITO v. Sak Soft Ltd. (30 SOT 55)** wherein it was held that for the purpose of applying the formula under sub-section (4) of section 10B, the freight, telecom charges or insurance attributable to the delivery of articles or things or computer software outside India or the expenses, if any, incurred in foreign exchange in providing the technical services outside India are to be excluded both from the export turnover and from the total turnover, which are the numerator and the denominator respectively in the formula. The Hon'ble Supreme Court in the case of **CIT V/s HCL Technologies Ltd. (404 ITR 719)** held that expenses excluded from export turnover have to be excluded from total turnover also otherwise any other interpretation would make the formula unworkable and absurd. Therefore, such deduction shall be allowed from total turnover in same proportion as well. This decision has been followed by Hon'ble High Court of Madras in various subsequent decisions, the latest being the decision in **Pr. CIT V/s Mizpah Publishing Services (P.) Ltd. (434 ITR 663)** wherein it has been reiterated that expenditure in foreign exchange incurred by assessee was to be excluded both from export turnover and total turnover while computing eligible deduction under section 10A. On the basis of all these decisions, we do not find any infirmity in the order of Ld. DRP. Therefore, the grounds raised by the revenue, in this regard, stand dismissed.

Conclusion

10. The revenue's appeal stand dismissed whereas the assessee's appeal stands partly allowed in terms of our above order.

Order pronounced on 31st January, 2022

Sd/-
(V. DURGA RAO)
न्यायिक सदस्य / JUDICIAL MEMBER

Sd/-
(MANOJ KUMAR AGGARWAL)
लेखक सदस्य / ACCOUNTANT MEMBER

चेन्नई / Chennai; दिनांक / Dated : 31-01-2022

EDN/-

आदेश की प्रतिलिपि ँ ग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी/Appellant 2. प्रत्यर्थी/Respondent 3. आयकर आयुक्त (अपील)/CIT(A) 4. आयकर आयुक्त/CIT 5. विभागीय प्रतिनिधि/DR 6. गार्ड फाईल/GF