

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

BEFORE SHRI VIJAY PAL RAO, JUDICIAL MEMBER AND
SHRI S. JAYARAMAN, ACCOUNTANT MEMBER

IT(TP) No.1105/Bang/2014 and
No. 1043/Bang/2014
Assessment year : 2009-10

M/s. Acusis Software India Pvt. Ltd., No. 17/2, Dollars Chamber, Lalbagh Road, Bangalore – 560 029. PAN : AADCA 2415 P	Vs.	Income Tax Officer, Ware – 11(1), Bangalore.
APPELLANT		RESPONDENT

Assessee by	:	Shri. Chavali Narayan, CA
Revenue by	:	Shri. Sanjai Kumar Verma, CIT (DR)

Date of hearing	:	29.09.2016
Date of Pronouncement	:	19.10.2016

ORDER

Per Vijay Pal Rao, Judicial Member

These cross appeals are directed against the order dated 26.6.2014 of CIT (A) for the assessment year 2009-10. First we take up the appeal filed by the assessee wherein the assessee has raised various grounds. However, at the time of hearing, the learned AR of the assessee has stated at bar that the assessee presses only one issue regarding the treatment of foreign exchange fluctuations gain as operating in nature while computing the operating margin of the assessee for the purpose of determining the arm's length price. Thus the learned AR stated that except the foreign exchange fluctuations being part of operating margin and benefit

of tolerance range under proviso to section 92C of the Act, the assessee does not press other grounds raised in this appeal. Accordingly the effective grounds which are pressed by the assessee are ground Nos. 8 to 10, as under:

“8. The learned CIT(A) has erred in not deciding on the treatment of foreign exchange fluctuation gain as operating in nature while computing the operating margin of Appellant and that of comparable companies.

9. The learned CIT(A) has erred in computing the arm's length price while providing the benefit of ± 5 percent under the proviso to section 92C of the Act;

10. The learned CIT(A) erred in confirming the imposition of interest under section 234B and 234C of the Act;”

2. Ground No. 8 regarding foreign exchange fluctuations being a part of operating profit: The assessee is the Indian Medical Transcription centre of M/s. Acusis Software India Pvt. Ltd., resident of British Virgin Islands, which is a wholly owned subsidiary Acusis LLC, USA. The assessee is registered as Software Technology Park (STP) unit under STP scheme of Govt. of India. The assessee has carried out international transactions for providing medical transcription services to Acusis LLC for Rs.25,92,00,211/-, the only international transaction which falls under ITES segment. The assessee furnished T.P. study and claimed its international transaction at arm's length by considering a set of 8 comparables having average profit margin @ 18.56% on cost in comparison to the assessee's operating margin at 22.69% on cost. The TPO did not accept the TP analysis as well as the comparables selected by the assessee and carried out fresh search. The TPO has

finally selected 8 comparables having average Profit Level Indicator (PLI) at 25.04%. There is no dispute regarding the most appropriate method adopted by the parties as Transaction Net Margin Method (TNMM). The TPO has worked out a negative working capital adjustment of 3.18% and accordingly arrived at the adjusted mean margin of 28.22%. Accordingly the TPO proposed an upward adjustment under section 92CA of Rs.2,66,09,306/- . The assessee challenged the action of the TPO before the CIT(A) and got part relief. Since the assessee has not pressed the other grounds in this appeal, therefore the only issue before us is regarding the treatment of foreign exchange gain for the purpose of determining the arm's length price. The learned AR of the assessee has submitted that the foreign exchange gain is accrued due to fluctuation on the receivables from exports and therefore it will be a part of the operating profit of the assessee. In support of his contention, he has relied upon the following decisions:

1. M/s. SAP LABS India Pvt. Ltd., Vs. ACIT, Bangalore [2011] 44 SOT 156 (Bang.)
2. M/s. Trilogy E-Business Software India Pvt. Ltd., Vs. DCIT dated 23.11.2012 in ITA No. 1054/Bang/2011.
3. On the other hand, the learned DR has relied upon the order of the TPO and submitted that in the absence of necessary details, the foreign exchange fluctuations cannot be considered as operating profit.
4. Having considered the rival submissions as well as relevant material on record we note that the issue of treatment of foreign exchange fluctuations (gain/loss), accrued on account of export sales has been consistently considered as

part of the operating margin for the purpose of determining transfer pricing analysis in a series of decisions by this tribunal. In the case of SAP LABS India Pvt. Ltd., Vs. ACIT (Supra), the tribunal held that if the foreign exchange (gain/loss) is accrued to the assessee on export sale, then the same will be considered as operating in nature. Similarly, the foreign exchange fluctuations on sales turnover of the comparables should also be considered as part of operating margins. The tribunal in the case of M/s. Trilogy E-Business Software Vs. DCIT supra has again considered and decided this issue in para (B) as under:

“B. As far as foreign exchange gain/loss being considered a not forming part of the operating cost, the reasoning of the revenue is that such loss or gain cannot be said to be one realized from gain/loss of the enterprise and therefore they should be excluded while determining operating cost. On the above issue we find that the Bangalore Bench of ITAT in the case of Sap Labs India (P) Ltd., Vs. ACIT (2011) 44 SOT 156 (Bang.) has taken the view that Foreign Exchange fluctuation gains are required to be directed to accept the claim of the Assessee in this regard. As far as provision for bad debts are concerned, the TPO has accepted that the same would be part of operating expenses provided the same is incurred every year for at least three years and the manner in which provision is made is consistent. The Assessee in reply to the query of the TPO on the above aspect has not furnished any details. We are of the view that the Assessee should be afforded opportunity to explain its position on the above and the AO is directed to consider the same in accordance with law. As far as fringe Benefit Tax (FBT) is concerned, the same was not considered by the TPO as part of operating cost in the case of comparables and therefore the same should also

not be considered as part of operating cost of the Assessee. We hold accordingly and direct the AO to compute the operating cost of the Assessee”.

5. In view of the above discussion as well as by following the orders of this tribunal, we direct the AO/TPO to recompute the operating margin of the assessee by considering the foreign exchange fluctuations (gain/loss) arising from export as operating in nature. Similarly, the foreign exchange fluctuations (gain/loss) on sales shall be considered as part of operating margins of comparables for the purpose of determining arm's length price.

6. Ground No. 9 is regarding the benefit of tolerance range as per the proviso to section 92C of the Act. The TPO is directed to consider the benefit of tolerance range as per the proviso to section 92C if the price of the assessee is within the range of $\pm 5\%$ of the comparable price. Accordingly this ground is disposed off.

7. Ground No. 10 is regarding levy of interest under section 234 B & C which is mandatory and consequential and therefore no specific adjudication is required.

8. The revenue has raised the following grounds:

1. The order of the CIT (Appeals) is opposed to law and the facts and circumstances of the case.
2. The CIT (A) erred in law as well as on facts in holding that, as the working capital adjustment provided by the TPO has negative impact on adjusted margin, the assessee is entitled to risk adjustment as per prevailing norms, which shall be worked out by the TPO and granted to the assessee without appreciating that risk adjustment could not be allowed in the absence of specific difference in risk and its impact on profit margin when TP regulations in India are against making any assumptions in respect of any adjustments and such risk adjustment cannot be provided without making necessary assumptions.
3. The CIT (A) erred in holding that foreign exchange loss / gain is operating in nature without appreciating that such loss / gain though attributable to

the operating activity is not derived from the operating activity and without ascertaining the nexus of the forex gain / loss with the business activity of the taxpayer.

4. The CIT(A) erred in concluding that forex gain / loss are to be treated as operating in nature without appreciating that though they may be incidental to the operating activity, they cannot be deemed as operating in nature since, they are not critical to operational activities of the business conducted by the taxpayer.
 5. The CIT CA) erred in law as well as on facts by directing the TPO to decide the case of the assessee, by applying the principles emerging from the orders of the Delhi Bench of the Hon'ble Tribunal in Haworth (India) Pvt. Ltd. v Deputy Commissioner of Income-tax 11 ITR (Trib) 757 and the Bangalore Bench of the Hon'ble Tribunal in Trilogy E-Business Software v Deputy Commissioner of Income-tax 23 ITR(Trib) 464 without appreciating that in transfer pricing every case is unique and requires to be decided independently and that the directions issued are beyond the mandate of the provisions of Section 251(1)(a) of the I.T. Act which does not empower the CIT(A) to set aside the issue.
 6. The CIT(A) erred in directing the AO to follow the ratio laid down by the Hon'ble High Court in the case of Tata Elxsi Limited 349 ITR 98 while computing the deduction u/s 10A by excluding the value of the telecommunication expenditure and expenses incurred in foreign currency from the total turnover also, without appreciating the fact that there is no provision in Section 10A that such expenses should be reduced from the total turnover also, as clause (iv) of the explanation to Section 10A provides that such expenses are to be reduced only from the export turnover.
 7. The CIT(A) erred in not appreciating the fact that the jurisdictional High Court's decision in the case of Tata Elxsi Limited 349 ITR 98 has not been accepted by the department and an appeal has been filed before the Hon'ble Supreme Court.
 8. For these and such other grounds that may be urged at the time of hearing, it is humbly prayed that the order of the CIT(A) be reversed and that of the Assessing Officer be restored.
 9. The appellate craves leave to add, to alter, to amend or delete any of the grounds that may be urged at the time of hearing of the appeal.
9. Ground No. 1 is general in nature and does not require any specific adjudication.
10. Ground No. 2 regarding the directions of the CIT (A) to consider the risk adjustment. We have heard the learned DR and as well as learned AR

and consider relevant material on record. The CIT(A) has observed that the TPO has worked out the negative working capital adjustment and therefore the assessee is entitled to risk adjustment as per the prevailing norms which shall be worked out by the TPO. The revenue is aggrieved by the directions of the CIT(A) for granting risk adjustment to be worked out by TPO. It is pertinent to note that since the assessee is a captive service provider and therefore there is a difference in the financial risk involved in the transactions between two independent parties and between the related parties as in the case of the assessee. Accordingly, in the facts and circumstances of the case, we do not find any error or irregularity in the order of the CIT(A) on this issue. However we direct the TPO to reconsider this issue after verification and examination of the relevant details and materials.

11. Ground No. 3 to 5 are regarding the directions given by the CIT(A) for considering the foreign exchange (gain/loss) as part of the operating margin. This issue is common as it was also involved in the appeal of the assessee. In view of our finding on this issue while dealing with the appeal of the assessee, accordingly these grounds of the revenue appeal stand adjudicated on the same terms.

12. Ground No. 6 and 7 regarding exclusion of telecommunication expenditure and other expenses incurred in foreign currency from export turnover as well as total turnover while computing deduction under section 10A.

13. We have heard the learned DR as well as learned AR and consider the relevant material on record. The AO has excluded telecommunication expenditure and other expenses incurred in foreign currency from export turnover while computing deduction under section 10A. On appeal, the CIT(A) has decided this issue by following judgment of Hon'ble High Court in case of CIT Vs. Tata Elxsi Ltd., 349 ITR 98 and directed AO to exclude the said expenditure from total turnover as well. At the outset we note that this issue is covered by the Hon'ble jurisdictional High Court in the case of Tata Elxsi (Supra). Accordingly we do not find any error or irregularity in the impugned order of the CIT(A) qua this issue. The ground Nos. 6 and 7 of the revenue's appeals are dismissed.

14. In the result, both the appeals filed by the assessee as well as revenue are partly allowed.

Pronounced in the open court on this 19th day of October, 2016.

Sd/-
(S. JAYARAMAN)
Accountant Member

Sd/-
(VIJAY PAL RAO)
Judicial Member

Bangalore,
Dated, the 19th October, 2016.
/NS/

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| 1. Appellants | 2. Respondent | 3. CIT |
| 4. CIT(A) | 5. DR, ITAT, Bangalore. | 6. Guard file |

By order

Assistant Registrar,
ITAT, Bangalore.