

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH: 'I' NEW DELHI
BEFORE SHRI R. S. SYAL, ACCOUNTANT MEMBER
AND
SMT SUCHITRA KAMBLE, JUDICIAL MEMBER
I.T.A .No.-1427/Del/2014
(ASSESSMENT YEAR-2009-10)**

XL India Business Services Private Limited, FF-101, Building NO. G-11, Sarines Sonia Sadan, Community Centre, Vikas Puri, New Delhi 110 018 (APPELLANT)	vs	I.T.O., Ward 18(4), New Delhi (RESPONDENT)
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I.T.A .No.936/DEL/14
(ASSESSMENT YEAR-2009-10)

I.T.O., Ward 18(4), New Delhi (APPELLANT)	vs	XL India Business Services Private Limited, FF-101, Building NO. G-11, Sarines Sonia Sadan, Community Centre, Vikas Puri, New Delhi 110 018 (RESPONDENT)
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Appellant by	Sh.Harpreet Singh Ajmani, Adv. Ms. Ananya Kapoor, Adv.
Respondent by	Sh.S.L. Anuragi, Sr. DR

Date of Hearing	27.11.2015
Date of Pronouncement	02.12.2015

ORDER

PER SUCHITRA KAMBLE, JM

I.T.A .No.-1427/Del/2014
(ASSESSMENT YEAR-2009-10)

This appeal is filed by the assessee against the Assessment Order dated 27.01.2015 for A.Y. 2009-2010 passed under Section 143(2) read with Section 144C of the Income Tax Act, 1961.

2. The grounds of appeal are as follows:-

1. *The order passed by the Ld. Additional Director of Income Tax, Transfer Pricing Officer-II (4) (Ld. TPO'), draft assessment order passed by Ld. Income-tax Officer, Ward 18(4), New Delhi (Ld. Assessing Officer ') and the final assessment order passed, pursuant to the directions of the Hon'ble Dispute Resolution Panel-II ("DRP"), by the Ld. Assessing Officer are bad in law and void ab-initio.*
2. *The Ld. Assessing Officer has erred in law and on the facts of the case in determining the total income of the Appellant at Rs.8,77,18,381/- as against a returned income of Rs.8,47,480/-.*

Part 1- Transfer Pricing Grounds

3. *That on facts and in law, the Ld. Assessing Officer /TPO/DRP erred in making/upholding an upward adjustment of Rs.73,880,694/- in respect of the international transaction of the appellant pertaining to provision of IT enabled services to its Associated Enterprises ("AEs")*
4. *That on facts and in law, the Ld. TPO has erred in not discharging his statutory onus to establish that any of the conditions specified in clause (a) to (d) of Section 92C (3) of the Act have been satisfied before disregarding the arm's length price determined by the Appellant and proceeding to determine the arm's length price himself.*
5. *The Learned AO/TPO/DRP have erred by not accepting the economic analysis undertaken by the Appellant in accordance with the provisions of the Act read with the Income Tax Rules, 1962 ("the Rules") and conducting a fresh economic analysis for the determination of Arm's Length Price ("ALP") of the Appellant's international transaction and holding that the international transaction is not at an arm's length.*
6. *That on facts and in law, the Learned Assessing Officer /TPO/DRP have erred in using single year date of companies.*
7. *The Learned Assessing Officer /TPO/DRP have erred by rejecting certain comparable companies identified by the Appellant by incorrectly using the following comparability criterion*
 - (a) *Turnover less than INR 1 crore*
 - (b) *Diminishing revenue trend*

- (c) *Export earnings less than 75 percent of sales from IT enabled services.*
- (d) *Different financial year*
8. *The Learned AO/TPO/DRP have erred in rejecting certain companies which are functionally comparable to the Appellant and adding certain functionally dissimilar companies to the final set of comparable companies. In doing so, the Learned AO/TPO/DRP have resorted to cherry picking of comparables to determine arm's length price for the impugned transaction.*
 9. *The Learned AO/TPO/DRP have erred in selecting certain companies which are earning super normal profits.*
 10. *That on facts and in law, the Learned AO/TPO/DRP have failed to make appropriate adjustments to account for the differences in the risk profile of the Appellant vis-à-vis the comparables and in the process also neglected the Indian transfer pricing regulations, OECD guidelines on transfer pricing and judicial precedence.*
 11. *That on facts and in law, the Learned DRP has erred in not providing any basis for rejecting certain companies considered comparable by the Appellant and in doing so violated the principles of natural justice.*
 12. *That on facts and in law, the Learned AO/TPO/DRP erred in considering incorrect profit margin of the appellant.*
 13. *That on facts and in law, the Learned AO/TPO/DRP have grossly erred in passing an order without providing the basis of determination of operating cost of the Appellant which has used as a base for determining the quantum of transfer pricing adjustment.*
 14. *That on facts and in law, the Learned TPO/Assessing Officer have erred in passing an order which has computational errors in the margin of the comparable companies used in determination of arm's length margin.*
 15. *That on facts and in law, the Learned AO/TPO/DRP have erred by not considering that the adjustment of the ALP, if any, should be limited to the lower end of the 5 percent as the appellant has the right to exercise this option under the proviso to Section 92C of the Act.*

Part II- Corporate Tax Grounds

15. *That on facts and in law, the Learned DRP/Assessing Officer erred in holding that the interest income of Rs.1,30,23,015/- earned in short term deposits made out of surplus funds from export activities of the Appellant, be treated as "Income from Other Sources" and not business income.*
16. *That on facts and in law, the Learned Assessing Officer /DRP has erred in holding that such interest income earned on short term deposits is not eligible for deduction under Section 10A of the Act.*

17. *That on facts and in law, the Learned Assessing Officer has erred in initiating penalty under section 271 (1) (c) of the Act, as consequences of the additions made in the assessment order passed under section 143(3) read with Section 144C of the Act.*
18. *That on facts and in law, the Learned Assessing Officer has erred in charging interest under section 234B and 234C of the Act, as consequences of the additions made in the assessment order passed u/s 143(3) read with Section 144C of the Act.*

3. Ground No. 1 and 2 of the assessee's appeal are general in nature and not pressed by the assessee hence accordingly, dismissed.

4. The main grounds contested by the assessee are that of Transfer Pricing and Corporate Tax.

5. XL India was incorporated as a 100 percent Export Oriented Unit under the Software Technology Park Scheme in Gurgaon, Harayan. The income of the Assessee was exempt from tax under Section 10A. The Assessee has entered into an agreement with XL Services Switzerland ("XLSS") and Cybersettle Inc., USA (collectively referred as Associated Enterprises ("AEs")) for rendering information technology ("IT") enabled services. As per the terms of the agreement, XL India provides IT enabled services such as interim financial reporting; external financial reporting; credit control; etc. to XLSS. Furthermore, the Company provides services such as provision of accounting and other back-office support, IT support for the web-portal etc. to Cybersettle Inc.

6. The international transactions entered into, by the assessee are tabulated below:

Nature of international transaction	Method Selected	Amount (in INR)
Provision of IT enabled services	TNMM	742,318,028
Purchase of stationary material	TNMM	31,607
Payment of interest on External Commercial Borrowings	CUP	13,315,144
Reimbursement of expenses paid to associated enterprises	-	47,587,726
Reimbursement of expenses received from associated enterprises		3,648,929

7. The assessee submitted following comparables

1. Allsec Technologies Ltd.
2. C G VAK Software & Exports Ltd.
3. Cosmic Global Ltd.
4. Informed Technologies Ltd.
5. R Systems International Ltd.
6. Vishal Information Technologies Ltd.
7. Aditya Birla Minacs Worldwide Ltd.
8. Cepha Imaging Pvt. Ltd.

8. The TPO finalized the comparables and used in the assessee's case as below:

Sl. No.	Name of comparable	OP/TC(%)
1.	Cosmic Global Ltd.	48.2

2.	Informed Technologies Ltd.	23.13
3.	Vishal Information Technologies Ltd.	38.69
4.	Aditya Birla Minacs Worldwide Ltd.	25.7
	Average	33.93

The TPO rejected the other comparables given by the assessee for the reasons stated in the order.

9. About the working capital adjustment, the TPO denied the same as the assessee did not possess reasonable and accurate rate that would allow for the calculation of a working capital adjustment.

10. The Assessing Officer vide order dated 27.01.2014 has made an addition of Rs.7,38,90,694/- under Section 92CA of the Income Tax Act, 1961. The Assessing Officer further made an addition of Rs.1,30,23,015/- as interest on FDRs as Income from other sources as after verification the Assessing Officer found that the interest of Rs.1,30,23,015/- is included in the business income. As relates to excess payment under Section 40A(2)(b) read with Section 92CA of the Income Tax Act, 1961, the Assessing Officer held that since the DRP directed the Assessing Officer to drop the proposed disallowance for the reasons stated in the order of the DRP and did not add the same.

11. The AR submitted that the comparable Cosmic Global Ltd. should have been excluded by the TPO as the same is engaged in outsourcing activity. Vishal Information Technologies (Coral Hub) was rejected as comparable on similar line (outsourcing activity) by DRP. Segmental revenue of BPO segment is very low. The AR further submitted that there should be inclusion of R

systems as the same cannot be rejected only for having a different financial year ending, it can be seen from the audited accounts of the company that audited data for each quarter is available and hence data for financial year ending 31.03.2009 can be compiled. Allsec Technologies Limited should have been included as it passes the exports earning filter rule-there can be no hard and fast rule in applying 75% earning. As relates to CG-VAK Software & Exports Ltd. the same passes all the filters and turnover cannot be the sole basis of rejecting a company, which is otherwise comparable. Thus, the same should have been accepted. On the issue of working capital adjustment the AR submitted that the finding of DRP are not proper. The findings of the DRP are as follows:

“..in view of the Rule 10B(3), to improve the comparability, in the facts of the present case, while comparing the margins of tested party with that of the comparables, adjustment be made for working capital for which the reliable data is to be provided by the taxpayer. Working capital is measured by trade receivables/debtors, trade payables/creditors and inventories. Interest cost will be high if the trade receivable time cycle is large. Interest cost will be low if the company can pay its liabilities after a larger period of gap then pay it in a shorter period. Holding of inventory has also interest costs. If inventory turnover is for a shorter period, interest cost will be lower. These parameters affected the overall results of the company. But in reality, the impact is financial in nature due to the requirement of Working Capital. Financial results or interest burden primarily depends on following:-

- (i) How the Working Capital is financed, either through own source or through borrowed funds.*
- (ii) Terms and conditions of receipts and payments i.e. terms of payments of debtors and creditors*

(iii) Inventory management through backward & forward linkages, the efficiency of holding inventory.

Further, interest cost is a financial cost. In order to cover the interest cost, the margin may seem to be high in absolute term, but when interest cost is accounted for, the margin changes its luster. Therefore, working capital requirements do affect the margins or prices, costs or profits because this an implicit cost which is recovered/recoverable from the customers.”

12. The AR further submitted that the comparable in respect of Cosmic Global Ltd. should have not been included by the TPO and there should have been inclusion of R Systems International Ltd., Allsec Technologies Ltd. and C G VAK Software & Exports Ltd. The AR submitted that in many cases these three inclusions stated herein above were held as proper comparables and held the same by the various High Courts as well as this very Tribunal. As relates to corporate tax ground, the AR submitted that during the year under consideration, the assessee placed its unutilized funds in short term fixed deposits with banks in order to effectively manage the working capital requirements of its business. Such funds were placed with banks in form of short term fixed deposit instruments yielding interest income so as to better manage the unutilized funds which can be deployed in the business on liquid basis. The interest income earned by XL India during the year under consideration has been classified as business income since the source of such term deposits is inextricably linked to the business of the assessee. Hence such interest income was considered as profit of the business of the undertaking eligible for deduction under section 10A of the Income Tax Act, 1961. In respect of this the assessee cited case of ABB Global Industries and Services Ltd passed by ITAT, Bangalore Bench as well as Delhi High Courts judgment in case of Rivieri Home Furnishing Vs. Addl. Commissioner of Income Tax. He further stated that the assessee company has done FDR only for short term

period for capital to be used in day to day business activities of the assessee. The AR also relied upon the judgment of Hon'ble Delhi High Court in case CIT vs. Hritinik Exports Pvt. Ltd. (ITA Nos. 219/2014 and 239/2014 decided on 13.11.2014).

13. The DR relied upon the order of the Assessing Officer and TPO. The DR submitted that the TPO has rightly taken into consideration and allowed the proper comparables. As relates to the issue of 10A, the DR relied upon the DRPs findings.

14. We have perused all the records and proceedings. We have also heard both the parties. In respect of Grounds relating to Transfer Pricing as set out in Part I -Ground No. 3 to 15 on comparables and working capital adjustment, the ITAT, New Delhi in assessee's own case for the Assessment Year 2008-2009 (being ITA No. 6448/Del/12 decided on 18.02.2015) has remitted the matter to the assessment stage for fresh adjudication for the reasons set out in para 10 and 11 of the said judgment. In view of this, the issues relating to the comparables and working capital adjustment before us are identical for A.Y. 2009-2011. Hence, it will be proper to remit both these issues to the assessment stage for fresh adjudication. Needless to say that the assessee be given opportunity to be heard.

15. As relates to the issue of Corporate Tax as set out in Part II- Ground 15 to 16, the Assessing Officer has rightly held that interest on FDRs as Income from other source. There was no business exigency or condition to make short Term FDRs therefore, the investment in FDRs cannot be regarded as inextricably connected with business of the assessee. Accordingly, the interest

receipts from such FDRs constitute income from other sources and are not eligible for deduction u/s 10A of Income Tax Act, 1961.

16. In result, Part I - Ground No. 3 to 15 of the Appeal of the Assessee are partly allowed for statistical purpose and Part II - Ground No. 15 and 16 are dismissed. As relates to Ground No. 17 and 18 the same are consequential to ground No. 15 and 16 (Part II).

I.T.A .No.-3634/DEL/13
(ASSESSMENT YEAR-2006-07)

17. This cross appeal is filed by the Revenue against the Assessment Order dated 27.01.2015 for A.Y. 2009-2010 passed under Section 143(2) read with Section 144C of the Income Tax Act, 1961.

18. The ground of appeal raised herein, is as follows:-

- (i) *“On the facts and circumstances of the case and in law, Ld. DRP, Panel-II, New Delhi erred in deleting the addition of Rs.10,98,436/- (Rs.7,49,79,130-7,38,80,694) disallowed by A.O u/s 92CA of the Act.”*
- (ii) *“On the facts and circumstances of the case and in law, Ld. DRP, Panel-II, New Delhi erred in deleting the addition of Rs.1,90,00,000/- excess payment u/s 40A(2)(b) r.w.s 92CA of the Act.”*

19. In respect of Department's appeal, the first ground was not pressed by the DR hence dismissed.

20. The DR submitted that about the second ground that one Mr. Popp's salary was too high and the Assessing Officer rightly disallowed the same. The AR relied on the DRP's findings.

21. We have perused all the records and proceedings. We have also heard both the parties. The DRP observed that the AO has raised very valid issue but missed the fact as claimed by the assessee that it has recovered the salary cost with mark up as its service income and offered the same for taxation. If the payment to Mr. Popp is unreasonably high then in the same proportion income earned is also high as the same is cost plus mark up. Therefore any disallowance will require corresponding correction in receipt also. Therefore, AO was directed to drop the proposed disallowance by the DRP. This finding of the DRP is proper as there is no correlation established by the Assessing Officer to the corresponding income as to the payment to Mr. Popp in the Assessment Order. Therefore, the ground of the Revenue that the addition of Rs.1,90,00,000/- excess payment u/s 40A(2)(b) r.w.s 92CA of the Act should have been sustain by the DRP does not survive.

22. In result, the Appeal of the assessee is partly allowed and the appeal of the Revenue is dismissed.

The order is pronounced in the open court on 2nd of December, 2015.

Sd/-

**(R.S. SYAL)
ACCOUNTANT MEMBER**

Sd/-

**(SUCHITRA KAMBLE)
JUDICIAL MEMBER**

Dated: 02/12/2015

*R. Naheed **

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

ASSISTANT REGISTRAR

ITAT NEW DELHI

		Date	
1.	Draft dictated on	.30.11.2015	PS
2.	Draft placed before author	30.11.2015	PS
3.	Draft proposed & placed before the second member	11.2015	JM/AM
4.	Draft discussed/approved by Second Member.		JM/AM
5.	Approved Draft comes to the Sr.PS/PS	02.11.2015	PS/PS
6.	Kept for pronouncement on		PS
7.	File sent to the Bench Clerk	03.11.2015	PS
8.	Date on which file goes to the AR		
9.	Date on which file goes to the Head Clerk.		
10.	Date of dispatch of Order.		

