

**IN THE INCOME TAX APPELLATE TRIBUNAL  
'A' BENCH, BANGALORE**

**BEFORE SHRI SUNIL KUMAR YADAV, JUDICIAL MEMBER  
AND  
SHRI INTURI RAMA RAO, ACCOUNTANT MEMBER**

IT(TP)A No.442/Bang/2011
(Assessment year: 2004-05)

**Assessee's Appeal**

M/s. Acusis Software India Pvt. Ltd., No. 17/2, Dollars Chambers, Lalbagh Road, Bangalore - 560 027. <b>PAN : AADCA2415P</b>	Vs.	The Income Tax Officer, Ward-11(1), Bangalore.
Appellant		Respondent

**Revenue's Appeal**

IT(TP)A No.444/Bang/2011
(Assessment year: 2004-05)

The Income Tax Officer, Ward-11(1), Bangalore.	Vs.	M/s. Acusis Software India Pvt. Ltd. Bangalore - 560 027. <b>PAN : AADCA2415P</b>
Appellant		Respondent

IT(TP)A No. 445/Bang/2011
(Assessment year: 2005-06)

The Income Tax Officer, Ward-11(1), Bangalore.	Vs.	M/s. Acusis Software India Pvt. Ltd. Bangalore - 560 027. <b>PAN : AADCA2415P</b>
Appellant		Respondent

Assessee by	:	Shri. Chavali Narayana, CA
Revenue by	:	Shri. D. Sudhakar Rao, CIT-DR

Date of hearing	:	10.08.2016
Date of Pronouncement	:	09.11.2016

**ORDER**

***Per INTURI RAMA RAO, AM :***

These cross appeals filed by the assessee company as well as the revenue directed against the consolidated order of learned Commissioner of Income Tax (Appeals), Bangalore dated 21.01.2011 for the assessment years 2004-05 and 2005-06.

2. We shall now deal with the appeals for the assessment years 2004-05. Briefly the facts of the case are that the assessee is a company incorporated under the Companies Act, 1956. It is a wholly owned subsidiary of M/s. Acusis Holding Company Ltd., British Virgin Islands, which in turn is a wholly owned subsidiary of Acusis LLC, USA. It is engaged in the business of providing medical transcription services falling within the category of information technology enabled services ["ITES"] to its AEs i.e., Acusis LLC, USA.

3. The return of income for the assessment year 2004-05 was filed on 27.10.2004 declaring income of Nil under the normal provisions of Act. Against the said return of income, the case was selected for scrutiny by issuing notice under section 143(2) of the Act. The assessee company also reported the international transactions with its AE of "Provision of medical transcription services" at Rs.10,93,59,573/-.

4. The assessee company sought to justify the consideration received for the above international transactions entered with its AE to be at arm's length price. The assessee company also submitted a transfer pricing study report adopting the operating profit to total cost as a profit level indicator for the transfer pricing study. The assessee company applied the Transactional Net Margin Method (TNMM) which was considered to be the most appropriate method for the purpose of bench marking the international transactions. The assessee company used the multiple year's financial data i.e., data pertaining to financial year 2001-02 to 2002-03. The assessee company's profit margin was computed at 11.04%. The assessee company claimed that the same was comparable with the other companies rendering IT enabled services. For the purpose of TP study, the assessee company had chosen 14 comparable entities and arithmetic margin and operating profit margin of said comparables was computed at 7.18%. Therefore, it was claimed that its margin was more than the average of comparable entities. Thus it was claimed that the transactions with AE are at arm's length. The assessee company for the purpose of its TP study had adopted certain filters for the purpose of its TP study:

5. Applying the filters adopted, 14 entities were chosen as comparables whose average profit margin was computed at 11.04%. However, during the course of proceedings

before the TPO, an updated set of 12 comparables were submitted *using the single year's data and the following 12 comparables were chosen: whose average arithmetic margin was computed at 3.12%.*

SI No.	Particulars	Margin
1	Ace Software Ltd.	0.72%
2	Allsec Technologies Ltd.	-37.68%
3	CMC Ltd.	13.05%
4	CS Software Enterprise Ltd.	13.36%
5	Compudyne Winfosystems Ltd.	-94.26%
6	Fortune Infotech Ltd.	34.07%
7	Mapro Industries Ltd.	-5.66%
8	Mercury Outsourcing Management Ltd.	5.70%
9	Nucleus Netsoft & Gis Ltd.	16.88%
10	Pentasoftware Technologies Ltd.	13.18%
11	Spanco Telesystems and Solutions	29.71%
12	Vishal Information Technologies Ltd.	48.32%
	<b>Arithmetic Mean</b>	<b>3.12%</b>

6. The assessing officer after noticing above international transactions, referred the matter to the Transfer Pricing Officer (TPO). The TPO, by order dated 20.12.2006, passed under section 92CA(3) of Income Tax Act computed the transfer pricing adjustment at Rs.2,35,24,271/-. The learned TPO accepted the TNMM adopted by the assessee company but rejected the transfer pricing report. Then the TPO proceeded to identify the different set of comparables for the purpose of determining ALP. While doing so, the TPO had applied the following filters:

- i. Use of contemporaneous data
- ii. Companies which are showing diminishing revenue are excluded.
- iii. Companies that have substantial underutilisation of assets were excluded.
- iv. Companies having persistent losses are excluded.
- v. Companies whose financial information not on the public domain are excluded.
- vi. Companies having export earnings less than 25% of total revenue are excluded.

7. The TPO has rejected all comparables selected by the assessee company in the TP study and introduced 9 new companies which are in page No. 25 of the TPO order. The final set of comparables selected by TPO are as under:

Sl. No.	Name	Operative Cost	Operative Revenue	Operative Profit	Operative Profit/Cost
1	Nucleus Net Soft & Gis India Ltd	1.66	1.94	0.28	16.87%
2	Vishal information Technologies Ltd	6.37	13.56	4.51	48.19%
3	Wipro BPO Ltd	322.3	430.31	108.01	33.51%
4	Tricom India Ltd	6.34	9.24	2.9	45.74%
5	Fortune Infotech Ltd	8.08	11.38	3.3	40.84%
6	Mercury Outsourcing Ltd	1.02	1.08	0.058	5.7%
7	Spanco Telesystems & solutions Ltd	10.32	15.44	4.57	40.1%
8	Allsec Technologies Ltd	24.10(adj.)	24.94	0.83	3.44%
9	Ultramarine Pigments Ltd	6.18	10.09	3.91*	63.27%
	Arithmetic mean				33.07%

8. The TPO computed the average profit margin of the comparables finally selected at 33% and after giving working capital adjustment of 2%, adjusted Arithmetic Mean was determined at 31% and on the above said basis, TPO computed transfer pricing adjustment in respect of ITeS services as follows:

**11.5 Determination of ALP**

Average PLI as determined in para 8.8	33%
Less: working capital adjustments as discussed in para 9	2%
Adjusted average PLI	31%

Adjusted Arithmetic mean of the PLIs of the comparables comes to 31% of cost. The ALP of the services rendered by the taxpayer is computed @31% of the cost as under:

Operating Cost	A	Rs.101438125 /-
Arms Length Margin	B	31%
Arms Length Price of the services @31% of Arms Length Margin	$C=A \times (100+B)$	Rs.13,28,83,944/-

**11.6 Adjustment to Income u/s 92CA**

The margin earned by the taxpayer falls substantially short of the margin earned by comparable enterprises or the arms length margin. This necessitates the following adjustment:

Arms Length Price of the services	A	Rs.13,28,83,944/-
Price charged by you	B	Rs.10,93,59,673/-
Adjustment u/s 92CA	$C-A-B$	Rs.2,35,24,271/-

9. The assessing officer passed the assessment order dated 26.12.2006 u/s. 143(3) incorporating the above adjustments and also disallowing the claim u/s 10A to the extent of Rs.15,25,550/- in respect of travel and communication expenditure incurred by reducing the same from the export turnover alone.

10. Being aggrieved by the above assessment order, an appeal was preferred before the learned Commissioner of Income-Tax (Appeals), contending inter alia that the learned TPO ought to have accepted the use of multiple year data for computing the final margin of the comparables, accepted the transfer price study undertaken by the assessee company, the foreign exchange fluctuation gain/loss should be considered as operating cost for the purpose of computing margins, working capital adjustment should be given to the assessee company on account of difference in working capital. The assessee company also contended that the criteria adopted by the assessee company for choosing the comparables should not have been rejected by the TPO. The assessee company also contended that the TPO should not have rejected persistent loss making companies as comparables. Finally it was contended that the benefit of proviso to sub section (2) to 92C of the Act should be granted to the assessee as a standard deduction.

11. As regards the entities M/s. Ultra Marine Pigments Limited and M/s. Vishal Info Tech Ltd., it was contended that these companies cannot be considered as comparables with that of assessee company as these companies were making super abnormal profits. The assessee company also contended that in respect of travelling expenditure and telephone expenditure incurred in foreign exchange, reducing the same from export turnover alone is not correct.

12. After considering the above submissions of the assessee company, the learned CIT(A) vide order dated 21.01.2011, upheld the filter applied by the learned TPO and application of use of only current year data as against multiple data as adopted by the assessee. And in respect of selection of comparables is concerned, the learned CIT(A) held that the entities making super abnormal profits are to be excluded. However, in respect of travelling and telecommunication expenditure incurred in foreign currency, the CIT(A) directed the TPO/AO to reduce from both the export turnover as well as the total turnover for the purpose of computing of deduction under section 10A. The CIT(A) also held that the foreign exchange gain/loss should be considered as a part of operating profit for the purpose of computing margins. Being aggrieved by that part of the assessment order, the assessee company is in appeal before us raising the following grounds of appeal in ITA No. 442/B/2011:

13. The assessee company raised the following grounds of appeal :

1. The order of the learned Assessing Officer is based on incorrect interpretation of law and therefore is bad in law.
2. The learned Assessing Officer has erred, in law by making a reference to the learned Transfer Pricing Officer without meeting the preconditions for such reference under Section 92CA of the Act. Based on the facts and circumstances of the case, there was neither necessity nor expediency for such reference as there was no attempt on the part of the Appellant to wilfully understate the value of its international transaction. Further, no opportunity was provided by the learned Assessing Officer to the Appellant before referring the transfer pricing issues to the learned Transfer Pricing Officer.
3. The learned Transfer Pricing Officer and the learned Assessing Officer have erred, in law and in facts, 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"), for the determination of the arm's length price in connection with the impugned international transaction and holding that the Appellant's international transaction is not at arm's length.
4. The learned Transfer Pricing Officer and the learned Assessing Officer have erred, in law and in facts, by determining the arm's length margin/price using the margins earned by the comparable companies during the financial year 2003-2004 and considering additional comparables at the time of assessment proceedings, the data pertaining to which was not available to the Appellant at the time of complying with the transfer pricing documentation requirements.
5. The learned Transfer Pricing Officer and the learned Assessing officer have erred, in law and in facts, by rejecting certain comparable companies identified by the Appellant as having substantial related party transaction without going in depth of the definition of the related parties under section 92A(2) and relying on certain assumptions that are not tenable keeping in mind the provision of the law and intention of the legislation.
6. The learned Transfer Pricing Officer and the learned Assessing officer have erred, in law and in facts, by rejecting certain comparable companies identified by the Appellant as being functionally different using unreasonable comparability criterion and rejecting companies which are primarily engaged in providing IT Enabled services.
7. The learned Transfer Pricing Officer and the learned Assessing officer have erred, in law and in facts, by rejecting certain comparable companies identified by the Appellant as being persistent operating loss makers. The Appellant had used this criterion and rejected companies that had operating losses for a continuous period of three or more financial years. However, the learned transfer pricing officer has rejected the comparables identified by the Appellant although these companies have operating profit in one of the financial years and are not persistent operating loss makers.

8. The learned Transfer Pricing Officer and the learned Assessing officer have erred, in law and in facts, by rejecting certain comparable companies identified by the Appellant with no foreign exchange revenue and providing services only in the domestic market. The learned Transfer Pricing Officer has failed to accept that the Rules, for analysing comparability requires one to look into the functions performed, risks assumed and assets employed by a particular company in order to judge its comparability and these factors do not change depending upon whether the services are provided locally or to overseas customers.
9. The learned Transfer Pricing Officer and the learned Assessing officer have erred, in law and in facts, by rejecting certain comparable companies identified by the Appellant using comparability criterion such as underutilisation of assets incorrectly determined and applied. While the learned Transfer Pricing Officer has mentioned that a loss due to underutilisation of the assets is not an "industrial" factor, the learned Transfer Pricing Officer has failed to accept that these are business/market risks faced by independent service providers.
10. The learned Transfer Pricing Officer and the learned Assessing officer have erred, in law and in facts, by rejecting the comparable companies identified by the Appellant on the grounds that the losses are on account of "internal" issues of the Company. The TPO has failed to accept that factors like clients leaving due to non delivery of projects on time, key personnel leaving the company etc are normal for any company operating in an open market. It cannot be said that these are "internal factors" on account of which the company has incurred losses and therefore is not a valid rejection criterion.
11. The learned Transfer Pricing Officer and the learned Assessing officer have erred, in law and in facts, by rejecting additional comparable companies identified by the Appellant for lack of sufficient information in the printed annual reports.
12. The learned Transfer Pricing Officer and the learned Assessing Officer have erred, in law and in facts, by not applying the selection criterion consistently while selecting companies that can be considered as comparable to the Appellant, for the purpose of determining the arm's length price for the international transaction.
13. The learned Transfer Pricing Officer and the learned Assessing officer have erred, in law and in facts, by not taking into consideration foreign exchange fluctuation gain/loss and other income in computing the operating margins of the Appellant and the comparable companies.
14. The learned Transfer Pricing Officer and the learned Assessing Officer have erred in law and in facts, in computing operating margins of one of the comparables by adopting incorrect financial data (ie normalising certain operating expenses by taking an average of such expenses incurred by the company over prior and subsequent two years) thereby resulting in an upward adjustment to the arm's length price.
15. The learned Transfer Pricing Officer and the learned Assessing Officer have erred, in law and in facts, by considering an arbitrary downward adjustment of (-2 percent) for differences in the working capital and differences in the risk profile. While doing so the learned transfer pricing officer and the learned assessing officer have disregarded the working capital adjustment provided by the Appellant.
16. The learned Transfer Pricing Officer and the learned Assessing Officer have erred, in law and facts, by not considering that the adjustment to the arm's length price, if any, should be limited to the lower end of the 5 percent range as the Appellant has the right to exercise this option under the proviso to section 92C of the Act.

17. The learned Assessing Officer has erred, in law, and in facts, in assessing/computing the total income as Rs 23,597,598 and the total net tax payable as Rs 11,248,545.
18. The learned Assessing Officer erred, in law, and in facts, in levying interest of Rs 2,789,071 under section 234B of the Act.
19. The learned Assessing Officer erred, in law, and in facts, by initiating penalty proceedings under section 271(1)(c) of the Act without recording adequate justification and without concluding that the Appellant has concealed particulars of income or has furnished inaccurate particulars or has not acted in good faith and has not exercised due diligence.

14. Ground No. 1 is general in nature and do not require any adjudication. Ground Nos. 2 to 12 challenges the selection of comparables. The learned AR vehemently contended the following comparables cannot be included in the list of comparables:

- i. M/s. Tricom India Limited
- ii. M/s. Wipro BPO Limited

The learned AR had pleaded for inclusion of the following companies in the list of comparables:

- i. M/s. Allsec Technologies Limited
- ii. M/s. Mercury Outsourcing Limited
- iii. M/s. Mapro Industries Limited
- iv. M/s. Cosmic Global Limited
- v. M/s. C. S. Software Enterprise Limited

Now we shall deal with each of them:

**(i) M/s. Tricom India Limited:** The learned AR vehemently contended that entity M/s. Tricom India Limited., cannot be compared with the assessee company as it is functionally dissimilar. It is submitted that this company is engaged in in-

house development of software products that are used for service delivery and this has led to high profit margins. Even before TPO it was contended that the financial information pertaining to the financial year 2003-04 was not available in the public domain. Therefore this company cannot be compared with that of assessee company and reliance in this regard was placed on the following decision of the coordinate bench in the case of *M/s. 24/7 Customer.com Pvt. Ltd., vs. Dy. Commissioner of Income Tax (Bangalore) ITA No. 227/Bang/2010.*

On the other hand, the learned CIT(DR) relied on the orders of the lower authorities.

We heard the rival submissions and perused the material on record. From page No. 23 of the Annual Report of M/s. Tricom India Limited., it is clear that the revenue is derived only from the Information and Technology services of Rs.9,24,39,411/-. Even in the schedule to the current assets of the balance sheet no closing stock is shown. Further, the company had expressly stated in schedule "S" that it is engaged wholly in ITeS and BPO business as under:

*"After the scheme of Arrangement and Reconstruction, the company is engaged in the providing the services in the information & Technology Enabled Services (ITES)/BPO : Transaction Processing to customers in overseas market."*

The decision of the coordinate bench in the case of 24/7 customers cited supra is based on the functional dissimilarity i.e., the company is engaged in the development of software products. But the evidence on the record as stated above is contrary. Therefore the decision of the coordinate bench in the case of 24/7 Customer is *per incuriam*, as said decision was rendered by the coordinate bench without referring to any material on record in support of the conclusion that company is engaged in software development.

In the circumstances, we are unable to agree with the submission that the company was engaged in software development. Hence we uphold the action of TPO/AO in including this company in the list of comparables.

**(ii) M/s. Wipro BPO Ltd:** The learned AR contends that this company cannot be compared with that of assessee company as it is functionally dissimilar having high brand value, goodwill and high turnover. The learned AR has placed reliance on the following decisions:

- a. 24/7 Customer.Com Pvt. Ltd.,
- b. Market Tools Research Private Limited
- c. Deloitte Consulting India Pvt. Ltd.,
- d. Maersk Global Service Center  
(India) P. Ltd., Vs. ACIT

On the other hand, the learned DR placed reliance on the orders of the lower authorities.

It is undisputed fact that the company Wipro BPO Ltd., is having high brand value, goodwill with high turnover. Now it is trite law that the company having high brand value and intangibles cannot be compared with a company rendering purely ITES services. And in this regard, reliance can be placed on the following decisions:

- (a) *Genisys Integratingn Systems (India) (P.) Ltd., Vs. Dy. CIT [2012] 20 taxmann.com 715/53 SOT 159 (Bang.-Trib.)*
- (b) *Kodiak Networks (India) (P.) Ltd, V. Asstt. CIT [2012] 18 taxmann.com 32/51 SOT 191 (Bang.-Trib.)*
- (c) *Telcordia Technologies India (P.) Ltd., V. Asstt. CIT [2012] 22 taxmann.com 96/137 ITD 1 (Mum.-Trib.)*

We do not find any reason to differ with the ratio laid down in the above cases. Therefore, we direct the TPO/AO to exclude this company from the list of the comparables.

**(iii) M/s. Allsec Technologies Limited:** The assessee company had argued for inclusion of this

company in the list of comparables. There is no dispute about the functional comparability of this company. The CIT(A) had deleted this company from the list of comparables on the ground of low margins. Now it is trite law that the companies cannot be excluded for the reason of abnormal profits or abnormal losses as held by the special bench in the case of DCIT Vs. M/s. Quark Systems Pvt Ltd., [2010] 38 SOT 307 (Chd.) (SB). However, the TPO/AO is expected to go into the reasons for the abnormal losses or abnormal profits. If it is demonstrated with some evidence that the abnormal losses/profits are incurred on account of some special reasons, the same may be excluded. The coordinate bench in the case of 24/7 Customer.com (P.) Ltd. Vs. Dy. CIT [2012] 28 taxmann.com 258/[2013] 140 ITD 344 (Bang. – Trib.) following the decision of Exxon Mobil Company India (P.) Ltd. Vs. Dy. CIT [2011] 12 taxmann.com 84/46 SOT 294 (URO) (Mum.-Trib), held to the same effect. We find from the record that the TPO/AO had not undertaken the exercise of going into the reasons for abnormal losses. Therefore we remit back to the file of TPO/AO to undertake this exercise, and if it is found that the losses are incurred not on account of any special reasons and is a normal business loss to include it in the list of comparables otherwise to exclude the same from list of the comparables.

**iv) M/s. Mercury Outsourcing Limited:** The assessee company had argued for inclusion of this company in the list of comparables. There is no dispute about the functional comparability of this company. The CIT(A) had deleted this company from the list of comparables on the ground of low margins. Now it is trite law that the companies cannot be excluded for the reason of high/low profits as held by the special bench in the case of DCIT Vs. M/s. Quark Systems Pvt Ltd., [2010] 38 SOT 307 (Chd.) (SB). Therefore, the reasoning of the CIT(A) to exclude this company from the list of comparables is not in consonance with the settled position of law on the above issue. Therefore we direct the TPO/AO to include in the list of comparables.

**v) M/s. Mapro Industries Limited:** The assessee company had pleaded for inclusion of this company as functionally comparable with the assessee company. He further submitted that the company made profit in the financial year 2001-02. It is only in the financial year 2002-03, 2003-04 the company incurred losses on account of under utilization of resources. Thus according to the assessee company, this company is not a persistent loss company. Normal loss making

company cannot be excluded following the law laid down by special bench in Quark Systems Pvt. Ltd.

We heard the rival submissions. As held by us in the para supra that a comparable cannot be excluded only because it is making losses. It cannot be said that this company was persistently incurring losses and therefore this company cannot be excluded from the list of comparables. We place reliance on the following 2 decisions:

- i) Technimount ICB (P.) Ltd. V. Asstt. CIT [2011] 11 taxmann.com 49 (mum.)
- ii) ITO V. CRM Services India (P.) Ltd., [2011] 14 taxmann.com 96/48 SOT 41 (RO) (Delhi-Trib.)

Following the ratio laid down in the above cases, we direct the TPO/AO to include this company in the list of comparables.

**vi) M/s. Cosmic Global Limited:** The assessee company is seeking inclusion of this company in the list of comparables. There is no dispute about the functional comparability with that of the assessee company. The CIT(A) deleted this company on account of loss making company.

We heard the rival submissions and perused the material on record. The reasoning given by us in respect of Mapro Industries holds good even in respect of this

comparable. It is not the case of the TPO/AO that the company is incurring persistent losses. Therefore, we direct the TPO/AO to include this company in the list of comparables.

**vii) M/s. CS Software Enterprise Limited:** This company was included in the list of comparables by the assessee company. The TPO rejected this company as according to him it does not pass the filter the export turnover of 25%. The assessee contends that this company should be included in the list of comparables as the export earnings have no bearing on the comparability. On other hand, the learned DR placed reliance on the lower orders.

We heard the rival submissions and perused the material on record. The conditions prevailing in the export and domestic market in which the respective parties to the transactions operate are different and therefore the filter of 25% export earnings to total sales is held to be valid by the decisions of *Customer.Com Pvt Ltd v DCIT* [2012] 28 taxmann.com 258 (Bang.) : [2013] 140 ITD 344 (Bang.) : [2013] 21 ITR (Trib) 514 (Bang.), *ITO V CRM Services India (P) Ltd.*, [2011] 48 SOT 41 (Del (URO)), *M/s. Stream International Services Pvt. Ltd v ADIT* [2013] 31 taxmann.com 227 (Mum.).

It is not the case of assessee company that it passes through the export filter of 25% to total revenue. Therefore

the ratio laid down in the cases cited supra is squarely applicable to the facts of the present case. We therefore uphold the action of TPO/AO in including this company in the list of comparables.

15. Thus the grounds of appeal 2 to 12 are disposed off. The other grounds of appeal are neither pressed nor argued during the course of hearing of appeal and therefore dismissed as such.

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

**Departmental appeal No. 444/Bang/2011**

17. The revenue being aggrieved by that part of the order of CIT(A) which is against the revenue had filed the present appeal raising the following grounds of appeal:

1. The order of the Learned CIT (Appeals), in so far as it is prejudicial to the interest of revenue, is opposed to law and the facts and circumstances of the case.
2. The Learned CIT (Appeals) was not justified in allowing relief out of the adjustment of Rs.2,35,24,271/- made by the Assessing Officer u/s 92CA of the I.T. Act, 1961 by directing the Assessing Officer to adopt the mean PLI of 33.418% as reduced by 5% i.e. 28.418% and adjustment towards foreign exchange gain, without appreciating the facts and circumstances under which the adjustment was made by the Assessing Officer based on the TPO's order.
3. The Learned CIT (Appeals) was not justified in holding that the foreign exchange fluctuation gain need not be excluded while computing the operating margin of the assessee company for comparability analysis.
4. The Learned CIT (Appeals) has failed to appreciate that the TP study is in respect of profits realized from international transactions of which the foreign exchange gain/loss does not form a part and therefore, the foreign exchange gain is not a part of the operating profits of the assessee company.
5. The Learned CIT (Appeals) was not justified in holding that the assessee was entitled to a standard deduction of 5% from the arithmetical mean of the profit margin of the comparables under the proviso to section 92C(2) of the I.T. Act, 1961 while computing the arm's length price (ALP).
6. The Learned CIT (Appeals) has erred in interpreting the second limb of the proviso to section 92C(2) of the I.T. Act, 1961 as it stood prior to the amendment brought about by the Finance (No.2) Act 2009 with effect from 01.10.2009 without taking into consideration the ITAT decision in the case of DCIT vs Global Vantage Pvt Ltd. (2010-TIOL-24-ITAT-DEL).

7. The Learned CIT (Appeals) has erred in relying on the CBDT Circular No.5/2010 dated 03.06.2010 where it has been clarified that the second proviso to section 92C(2) was applicable for the assessment year 2009-10 onwards, which was subsequently modified by CBDT by way of a corrigendum dt. 30.9.2010.
8. The Learned CIT (Appeals) has erred in directing the Assessing Officer to exclude 4 (four) comparable companies as being super profit making cases and companies making profits at wide variance with the arithmetic mean of the PLI of the comparables, without appreciating the detailed reasons recorded in the TPO's order for the selection of such companies as functionally comparable companies following an elaborate search process and application of appropriate filters.
9. The Learned CIT (Appeals) has erred in following the order of the ITAT, Bangalore Bench in the case of Sap Labs Ltd. for the assessment year 2003-04 in ITA No.398 and 418/Bang/2008 dated 30.08.2010 without examining the facts and circumstances of the assessee's case in detail and without appreciating that the assessee company is not a risk mitigated company and that in the above mentioned ITAT decision, no bench marks have been laid down for categorizing a company as a super profit or low profit case.
10. The Learned CIT (Appeals) has erred in relying on the above mentioned ITAT, Bangalore Bench decision in the case of Sap Labs Ltd. without pointing out any peculiar economic conditions to which the so called super profit or low profits of the concerned companies are attributable.
11. The Learned CIT (Appeals) has erred in arriving at the adjusted mean PLI of 35.418% on page 15 of the appellate order after deducting working capital adjustment of 2% as worked out by the TPO which was based on the 9 (nine) comparables selected by the TPO, whereas, the working capital adjustment was required to be recomputed in consequence of the CIT (Appeals) direction to exclude 7 (seven) of the comparables selected by the TPO.
12. 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 in so far as the above mentioned issues are concerned and that of the assessing officer be restored.
13. The appellant craves leave to add, to alter, to amend or to delete any of the grounds that may be urged at the time of hearing of the appeal.

18. The revenue has raised 13 grounds of appeal. Ground No. 1, 12 & 13 are general in nature and do not require any adjudication. The ground No. 2, 3 & 4 challenge direction of the CIT(A) to include the foreign exchange fluctuation profit as a part of operating profit for the purpose of computing the margins.

19. The learned CIT(A) following the decision of the coordinate bench, Bangalore in the case of Sap Labs P. Ltd., held that the foreign exchange fluctuation gain should be treated as a part of the operating profit for the purpose of computing the margins of the comparables and the assessee company.

20. There is no dispute that the gain on account of foreign exchange fluctuation is made on account of the sale proceeds of the exports. Therefore such gain is inextricably connected with the business activities of the assessee company and therefore should be treated as operating income. As held by the following decisions of coordinate bench:

- *S. Narendra v Addl CIT* [2013] 32 taxmann.com 196 (Mum.) - Held that forex gain relating to business is operating in nature.
  - *Trilogy E Business Software India (P.) Ltd. v DCIT* [2011] 12 taxmann.com 464 (Bang.) : [2011] 47 SOT 45 (Bang.)(URO)
  - *Sumit Diamond (India) Pvt Ltd v Ad CIT* TS-17-ITAT-2013-Mum-TP - Held that foreign exchange gain is operating in nature
  - *Trilogy E-Business Software India Pvt Ltd v DCIT* [2013] 29 taxmann.com 310 (Bang.) : [2013] 140 ITD 540 (Bang.)
  - *Bearing Point Business Consulting (P.) Ltd. v DCIT* [2013] 33 taxmann.com 92 (Bang-Trib.).
  - *CSR India (P.) Ltd. v ITO* [2013] 31 taxmann.com 265 (Bang.).
  - *Mercedes-Benz Research & Development India (P.) Ltd. v DCIT* IT (TP)A No. 1222/Bang/2011 : TS-108-ITAT-2013-Bang-TP
  - In the case of *Rusabh Diamonds v ACIT* ITA No. 7217/Mum/2012 : TS-91-ITAT-2013-Mum-TP, the ITAT held that gain on hedging of foreign currency exposure on the underlining trade receivable or payable the profit of loss will be operating in nature.
- *Four Soft Limited v DCIT* ITA No. 1495/HYD/2010 : TS-518-ITAT-2011(HYD)-TP
  - *M/s. Capital IQ Information Systems (India ) Pvt. Ltd v DCIT* [2013] 32 taxmann.com 21 (Hyd.).
  - *Brigade Global Services (P.) Ltd v ITO* [2013] 33 taxmann.com 618 (Hyd-Trib.)
  - *First Advantage Offshore Services (P.) Ltd. v DCIT* ITA No. 1086/B/11

21. Therefore we do not find any reason to interfere with the order of the CIT(A).

22. In the result, the grounds of appeal raised by the revenue in this regard are dismissed.

23. Ground Nos. 5 to 7 challenges the direction of CIT(A) to grant the benefit of the proviso to sub section (2) of section 92C of IT Act as a standard deduction. This issue is

covered against the assessee by the decision of Bombay Bench in the case of Bayer crop Science Ltd. V. Addl. CIT [2012] 25 taxmann.com 575 (Mum. – Trib) wherein it has been held as follows:

*“Last ground of the assessee's appeal is against the rejection of benefit of 5% margin as prescribed in proviso to section 92C(2) in determining the Arm's Length Price (ALP) of its export transactions. Filtering out unnecessary details it is observed that the assessee's international transactions were referred to the TPO for determination of ALP. The TPO proposed adjustment of Rs. 19,23,948, for which addition was made by the A.O. It was argued before the ld. first appellate authority that the TPO ought to have allowed standard adjustment of 5% before making addition as per proviso to section 92C(2). The learned CIT(A) rejected this contention by holding that since the ALP exceeded the price declared by the assessee by more than 5%, the entire excess was liable to be added. It is this direction of the learned CIT(A) against which the assessee has come up in appeal before us.*

*After considering the rival submissions and perusing the relevant material on record, we find that the dispute about the question as to whether plus minus 5% standard adjustment should be allowed while determining the ALP or the entire amount representing difference between ALP and the declared price should be added where the difference exceeds 5%, has been set to rest by the Finance Act, 2012 with the insertion of sub-section (2A) to section 92C with retrospective effect. With this amendment it has been made clear that where the variation between arithmetical mean and price at which the transaction has actually been undertaken exceeds 5% of arithmetical mean, the assessee shall not be entitled to exercise the option. The learned AR was fair enough to concede that the retrospective amendment by the Finance Act, 2012 has the effect of upholding the opinion taken by the learned CIT(A). In view of this amendment to section 92C, we hold that the learned CIT(A) was justified in not granting standard adjustment of 5%. This ground is not allowed.”*

24. Even the special bench in the case of IHG IT Services (India) (P.) Ltd. V. ITO [2013] 33 taxmann.com 1 (Delhi – Trib.) (SB) held that after the amendment by the Finance (No.2) Act, 2009 with effect from 1.10.2009, such benefit of 5% tolerance margin was restricted to the cases where variation between the arm's length price and the price at

which the international transaction has actually taken place does not exceed 5%. In other words the benefit under the proviso cannot be given as a standard deduction. In the results, the grounds of appeal raised by the revenue on this issue are allowed.

25. Ground Nos. 8 to 10 challenges the direction of CIT(A) to exclude the companies making super profits and the low margin loss making companies as comparables. As held by us in the assessee's appeal supra, no company can be excluded from the list of comparables mainly on the ground that the companies making abnormal profits without going into the reasons for such abnormal profits. Therefore the reasoning of CIT(A) is not acceptable and does not hold water. However, the AR had pleaded for exclusion of Ultramarine Pigments Ltd., and Vishal Information Technologies Limited for different reasons. We shall deal with each of them:

**(i) M/s. Ultramarine Pigments Limited:** It is contended before us that this company cannot be compared with that of the assessee company as it is functionally different and it is engaged in the business of publishing, healthcare and litigation support. Thus it was submitted that it is functionally dissimilar with that of assessee company. This company was considered by the coordinate bench for the same assessment year in the case of 24/7 Customer.Com Pvt. Ltd., Vs. DCIT

TS 708 ITAT 2012 (Bang. Trib) wherein it was held that the segmental results were available in the audited financial statements of said company. Hence, the coordinate bench found no reason to reject this company as a comparable. Therefore following the same reasoning, we uphold the inclusion of this company in the list of comparables.

**(ii) M/s. Vishal Information Technologies Limited:** This company was rejected by CIT(A) on the ground of abnormal profits. The assessee company contended before us that this company is not comparable with that of assessee company as it significantly outsourced its services and very low employee cost, whereas the assessee company had carried out the entire operation by itself. The learned AR had placed reliance on the decision of coordinate bench in the case of 24/7 Customer.Com Pvt. Ltd., V. DCIT [2012] 28 taxmann.com 258 (Bang).

26. We heard the rival submission and perused the material on record. This company was considered by the coordinate bench in the case of 24/7 Customer.Com Pvt. Ltd., V. DCIT [2012] 28 taxmann.com 258 (Bang) wherein following the decision of coordinate bench, Mumbai bench held in the case of Mearsk Global Services (I) Pvt. Ltd. This company was held to be incomparable on the reasons that this company had outsourced a considerable portion of its business and whereas the tax payer had carried out the

entire operations by itself which made it incomparable. Hence following the above decision, we hold that this company cannot be compared with that of assessee company.

27. Ground No. 11 challenges the direction of CIT(A) to grant working capital adjustment of 2% based on the 9 comparables selected by the TPO and whereas these working capital adjustment was required to be recomputed in consequence of CIT(A) order to exclude certain companies selected by the TPO. This ground of appeal is only consequential in nature and does not require any adjudication.

28. In the result, appeal filed by the revenue is partly allowed.

**ITA No. 445/B/2011, Assessment Year 2005-06:**

29. In the TP study, the assessee has chosen 12 comparables. The return of income for the assessment year 2005-06 was filed on 27.10.2005 declaring a total income of Rs. Nil. against the said return of income the assessment was completed under section 143(3) after issuing notice under section 143(2) after referring the matter to TPO for determining of arm's length price in respect of the international transaction of provision of providing medical transcription services of Rs.15,32,19,356/- to its AE i.e., Acusis LLC, USA on the basis of cost plus 10% margin.

30. The assessee company sought to justify the consideration received for the above international transactions entered with its AE to be at arm's length price. The assessee company also submitted a TP study report adopting the operating cost to the total cost as a profit level indicator for the TP study. The assessee company applied the Transactional Net Margin Method (TNMM) which was considered to be the most appropriate method for the purpose of bench marking the international transactions. The assessee company's profit margin was computed at 11.6%. The assessee company claimed that the same was comparable with the other companies rendering IT enabled services. For the purpose of TP study, the assessee company had chosen 12 comparables and weighted Arithmetic Margin of these comparables was computed at 8.48%. Thus it was claimed that the transactions with AE are at arm's length. The assessee company selected the following 12 comparables:

Sl. No.	Particulars
1	Ace Software Ltd.
2	Allsec Technologies Ltd.
3	Nucleus Netsoft & GIS Ltd.
4	Transworks Information Services Ltd.
5	Vishal Information Technologies Ltd.
6	Fortune Infotech Ltd.
7	Mercury Outsourcing Management Ltd.
8	Spanco Telesystems and Solutions Ltd.
9	CMC Ltd.
10	CS Software Enterprise Ltd.
11	Compudyne Winfosystems Ltd.
12	Genesys International Corporation Ltd.

31. The AO, after noticing the above international transactions referred the matter to the TPO. The TPO, by order dated 23.09.2008, passed under section 92CA of the act and computed Transfer Pricing adjustment at Rs.1,33,59,948/-. The learned TPO accepted the TNMM adopted by the assessee company but rejected the Transfer Pricing report. Then the TPO proceeded to identify the different set of comparables for the purpose of determining

arm's length price. While doing so, the learned TPO had applied the following filters:

- Use of current year's data, etc.

32. The TPO had also not considered the foreign exchange fluctuations gain/loss as a part of operating profit. The TPO while applying the above filters accepted the 5 comparables chosen by the assessee company and introduced 4 new comparables. Thus finally the TPO selected following set of comparables:

SI No.	Particulars
1	Ace Software Ltd. (TP Study comparable)
2	Allsec Technologies Ltd. (TP Study comparable)
3	Nucleus Netsoft & GIS Ltd. (TP Study comparable)
4	Transworks Information Services Ltd. (TP Study comparable)
5	Vishal Information Technologies Ltd. (TP Study comparable)
6	Cosmic Global Ltd. (additional company by TPO)
7	Maple eSolutions Ltd. (additional company by TPO)
8	Saffron Global Ltd. (additional company by TPO)
9	Wipro BPO Solutions Ltd. (additional company by TPO)

33. The TPO computed the average profit margin of the comparables finally selected at 21.03%. The TPO computed the transfer pricing adjustment at Rs.1,33,59,948/- as follows:

Cost incurred for software development activity	13,76,34,722/-
Arms length markup on cost (arithmetic mean PLI)	21.03%
Arms Length Income @ 121.03% of cost	16,65,79,304/-
Income actually received	15,32,19,356
Shortfall being adjustment u/s 92CA	1,33,59,948/-

34. The AO passed the assessment order under section 143 vide order dated 26.12.2008 incorporating the above TP adjustment and reducing the telecommunication charges and internet charges of Rs.19,93,519/- reducing from export turnover for the purpose of computing the deduction under section 10A of the income tax act.

35. Being aggrieved by the assessment order, appeal was filed before CIT(A)-IV, Bangalore, who vide consolidated order dated 21.1.2011 for the assessment year 2004-05 and 2005-06 had held that the high profit companies and the low margin companies cannot be considered as comparables following the law laid by the jurisdictional high court in Sap Labs Pvt. Ltd. Thus the following 3 companies were held to be uncomparable with that of assessee company:

1. Vishal Info Tech Ltd
2. Nucleus Net Soft and GIS Ltd
3. Transworks Information Service Ltd

36. The CIT(A) also held that in respect of telecommunication and internet charges incurred to the extent of Rs.19,93,519/-, the same should be reduced from the total turnover as well as from export turnover and in respect of tolerance, the benefit of proviso to sub section (2) of 92CA, the CIT(A) held that the same should be allowed as a standard deduction.

37. The CIT(A) also held that the foreign exchange fluctuations gain/loss should be considered as operating profit. Being aggrieved by the order, the revenue is in appeal before us raising the following grounds of appeal:

1. The order of the Learned CIT (Appeals), in so far as it is prejudicial to the interest of revenue, is opposed to law and the facts and circumstances of the case.
2. The learned CIT (Appeals) was not justified in directing the AO to recompute the deduction allowable u/s. 10A of I.T.Act, 1961 after reducing the telecommunication expenses amounting to Rs. 19,93,519-00 both from the export turnover and the total turnover, without appreciating the facts and circumstances of the case.
3. The learned CIT (Appeals) has erred in not appreciating that there is no provision in section 10A, which requires the telecommunication expenses reduced from the export turnover as per clause(iv) of Explanation 2 to section 10A, to be reduced from the total turnover also.
4. The Learned CIT (Appeals) was not justified in allowing relief out of the adjustment of Rs.1,33,59,948/- made by the Assessing Officer u/s 92CA of the I.T. Act, 1961 by directing the Assessing Officer to adopt the mean PLI of 18.97% as reduced by 5% and adjustment towards foreign exchange gain, without appreciating the facts and circumstances under which the adjustment was made by the Assessing Officer based on the TPO's order.
5. The Learned CIT (Appeals) was not justified in holding that the foreign exchange fluctuation gain need not be excluded while computing the operating margin of the assessee company for comparability analysis..
6. The Learned CIT (Appeals) has failed to appreciate that the TP study is in respect of profits realized from international transactions of which the foreign exchange gain/loss does not form a part and therefore, the foreign exchange gain is not a part of the operating profits of the assessee company.

7. The Learned CIT (Appeals) was not justified in holding that the assessee was entitled to a standard deduction of 5% from the arithmetical mean of the profit margin of the comparables under the proviso to section 92C(2) of the I.T. Act, 1961 while computing the arm's length price (ALP).
8. The Learned CIT (Appeals) has erred in interpreting the second limb of the proviso to section 92C(2) of the I.T. Act, 1961 as it stood prior to the amendment brought about by the Finance (No.2) Act 2009 with effect from 01.10.2009 without taking into consideration the ITAT decision in the case of DCIT vs Global Vantage Pvt Ltd. (2010-TIOL-24-ITAT-DEL).
9. The Learned CIT (Appeals) has erred in relying on the CBDT Circular No.5/2010 dated 03.06.2010 where it has been clarified that the second proviso to section 92C(2) was applicable for the assessment year 2009-10 onwards, which was subsequently modified by CBDT by way of a corrigendum dt. 30.9.2010.
10. The Learned CIT (Appeals) has erred in directing the Assessing Officer to exclude 3 (three) comparable companies as being super profit making cases and companies making profits at wide variance with the arithmetic mean of the PLI of the comparables, without appreciating the detailed reasons recorded in the TPO's order for the selection of such companies as functionally comparable companies following an elaborate search process and application of appropriate filters.
11. The Learned CIT (Appeals) has erred in following the order of the ITAT, Bangalore Bench in the case of Sap Labs Ltd. for the assessment year 2003-04 in ITA No.398 and 418/Bang/2008 dated 30.08.2010 without examining the facts and circumstances of the assessee's case in detail and without appreciating that the assessee company is not a risk mitigated company and that in the above mentioned ITAT decision, no bench marks have been laid down for categorizing a company as a super profit or low profit case.
12. The Learned CIT (Appeals) has erred in relying on the above mentioned ITAT, Bangalore Bench decision in the case of Sap Labs Ltd. without pointing out any peculiar economic conditions to which the so called super profit or low profits of the concerned companies are attributable.

13. The Learned CIT (Appeals) has erred in arriving at the adjusted mean PLI of 18.97% on page 16 of the appellate order after deducting working capital adjustment of 3.65% as worked out by the TPO which was based on the 10 (ten) comparables selected by the TPO, whereas, the working capital adjustment was required to be recomputed in consequence of the CIT (Appeals) direction to exclude 7 (seven) of the comparables selected by the TPO.

14. 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 in so far as the above mentioned issues are concerned and that of the assessing officer be restored.

15. The appellant craves leave to add, to alter, to amend or to delete any of the grounds that may be urged at the time of hearing of the appeal.

38. The revenue had raised 15 grounds of appeal. Ground Nos. 1, 14 and 15 are general in nature and do not require any adjudication. Ground No. 2 and 3 challenges the directions of CIT(A) to exclude the telecommunication expenditure of Rs.19,93,519/- to reduce from export turnover as well as from total turnover for the purpose of computing deduction under section 10A of the Income Tax Act.

39. This issue is no more *resintegra* as it is covered in favour of the assessee company. According to the revenue, the order of the Hon'ble High Court in the case of CIT vs. Tata Elxsi Ltd. (349 ITR 98) has not been accepted by the department and a SLP has been filed before the Hon'ble Supreme Court. Therefore, the order of the CIT(A) should be reversed. Thus the ground Nos. 2 and 3 raised by revenue are dismissed.

40. Ground Nos. 4, 5 and 6: The issue raised in the ground Nos. 4, 5 and 6 is with regard to the direction of the learned CIT(A) to treat the gain on account of foreign exchange fluctuations arising out of exports made as a part of operating profit. This issue is already decided by us in favour of the assessee company in the assessment year 2004-05 in ITA No. 442/Bang/2011. Following the same, we dismiss this ground of appeal.

41. Ground Nos. 7, 8 and 9 challenges the direction of the learned CIT(A) to allow the benefit under proviso to sub section (2) of 92CA as standard deduction. This issue is already decided by us in the assessee's own case for the assessment year 2004-05 in favour of the revenue following the same reasoning we dismiss the ground of appeal filed by the revenue. Hence dismissed.

42. Ground Nos. 10, 11 and 12 challenges the orders of the CIT(A). The directions of the CIT(A) to delete the entities M/s. Vishal Info Tech Ltd, M/s. Nucleus Net Soft and GIS Ltd and M/s. Transworks Information Service Ltd for the reasons that the high profit making companies and low margin companies cannot be considered as comparables. This reasoning of CIT(A) was reversed by us in the assessee's own case in the assessment year 2004-05. However, the learned AR submitted that these companies needs to be excluded for the reasons of functionality differences, which we shall deal with each of them as follows:

**i. M/s. Vishal Info Tech Ltd:** The assessee company pleaded that this company cannot be compared with that of assessee company as it is functionally different. It was submitted that this company had outsourced its activities and has got very low employee cost compared to a typical ITES company. Thus it was submitted that this company cannot be compared with that of assessee company. On the other hand, the learned CIT (DR) placed reliance on the orders of the lower authorities.

We heard the rival submissions and perused the material on record. This company was considered by the coordinate bench, Mumbai in the case of ACIT V. Maersk Global Service Centre (India) P Ltd [2011] 16 taxmann.com 47 (Mum), wherein it was held that the company cannot be considered as comparable, as it outsources major of its activities.

This decision was subsequently followed by the coordinate benches in the case of ITO v Nextlkinx India Pvt Ltd v TS-722-ITAT-2012(Bang)-TP, Nomura Fin Services (India) (P.) Ltd. v ACIT [2013] 33 taxmann.com 4 (Mum-Trib.) and ACIT v M/s. Hapag Lloyd Global Services Pvt Ltd TS-47-ITAT-2013 (Mum)-TP and respectively following the decisions, we direct that this company cannot be included in the list of comparables with that of the assessee company

and accordingly, we uphold the decision of the CIT(A) to delete this company from the list of comparables, though on a different reasoning.

**ii. Nucleus Net Soft and GIS Ltd:** It was contended that it is a functionally different company as it is engaged in the development of software products. Thus it was submitted that this company cannot be compared with that of ITES company like that of assessee company. However we find that no material was filed before us establishing this fact. In the circumstances, we remand this issue back to the file of TPO/AO to examine whether the company is engaged in the software development. If it is found so, then to exclude it from the list of comparables.

**iii. Transworks Information Service Ltd:** The appellant pleaded for the inclusion of this company in the list of comparables. There is no dispute about the functional comparability with that of assessee company. The only ground on which the CIT(A) had directed exclusion of this company from the list of comparables is that the company is making very low margins. As held by us in the assessee's own case for the assessment year 2004-05, no company can be excluded for the reasons of making high profit and low profit making companies. Therefore the reasoning of the

CIT(A) does not stand the test of the law laid down by the special bench in the Quark Systems. In the circumstances, we direct the TPO/AO to include this company in the list of comparables for the purpose of computing ALP.

43. In the result, the appeal filed by the assessee in IT(TP)A No. 442/Bang/2011 is partly allowed for statistical purpose. The appeals filed by revenue in IT(TP)A No. 444/Bang/2011 for assessment year 2004-05 and in IT(TP)A No. 445/Bang/2011 for assessment year 2005-06 are partly allowed for statistical purposes.

*Order pronounced in the open court on this      day of  
November , 2016*

Sd/-

**(SUNIL KUMAR YADAV)**  
**JUDICIAL MEMBER**

Sd/-

**(INTURI RAMA RAO)**  
**ACCOUNTANT MEMBER**

Place : Bangalore  
Dated : 09/11/2016  
/NS/

Copy to :

1. Appellant
2. Respondent
3. CIT(A)-II Bangalore
4. CIT
5. DR, ITAT, Bangalore
6. Guard File

By order

Assistant Registrar  
Income-tax Appellate Tribunal  
Bangalore