

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

श्री एन.आर.एस. गणेशन, न्यायिक सदस्य एवं
श्री अब्राहम पी. जॉर्ज, लेखा सदस्य के समक्ष।
[BEFORE SHRI N.R.S. GANESAN, JUDICIAL MEMBER AND
SHRI ABRAHAM P. GEORGE, ACCOUNTANT MEMBER]

आयकर अपील सं./I.T.A.No.985/Mds/2014
निर्धारण वर्ष /Assessment year : 2009-2010

Saipem India Projects Limited,
Yarlagadda Towers, 4, Fourth Lane,
Off. Nungambakkam High Road,
Chennai 600 034.

Vs. The Deputy Commissioner of
Income Tax,
Company Circle VI(1)
Chennai.

आयकर अपील सं./I.T.A. No. 1400/Mds/2014
& C.O. No.79/Mds/2014
(in ITA No.1400/Mds/2014)
निर्धारण वर्ष /Assessment year : 2009-2010

The Deputy Commissioner of
Income Tax,
Company Circle VI(1)
Chennai

Vs. Saipem India Projects Limited,
Yarlagadda Towers, 4, Fourth Lane,
Off. Nungambakkam High Road,
Chennai 600 034.

[PAN AAACI 7915F]

(अपीलार्थी/Appellant)

Assessee by

Department by

सुनवाई की तारीख/Date of Hearing

घोषणा की तारीख /Date of

Pronouncement

(Respondent/Cross Objector)

: Shri. Sharath Rao, Pranith Golecha &
Anathakrishnan N. C.A's.

: Shri. Pathlavath Peerya, CIT.

: 28.03.2017

: 05.04.2017

आदेश / ORDER

PER ABRAHAM P. GEORGE, ACCOUNTANT MEMBER

These are cross appeal of the assessee and Revenue respectively and cross objection of the assessee, all directed against an assessment order dated 20.02.2014 passed by Id. Assessing Officer pursuant to directions by Id. Dispute Resolution Panel (in short "the DRP") u/s. 144C of the Income Tax Act, 1961 (in short "the Act").

2. Ld. Counsel for the assessee at the outset submitted that he was not pressing the cross objection. Accordingly, cross objection is dismissed as not pressed.

3. Assessee in its appeal has taken altogether six grounds of which grounds 1 & 6 are general in nature needing no specific adjudication.

4. In addition to the original grounds, assessee has also filed a petition pleading for admission of additional ground, through which it seeks exclusion of one M/s. Mahindra Consulting Engineers Limited from the list of comparables considered by the Id. TPO for fixing the Arms Length Price of the international transactions of the assessee with its Associated Enterprise. Original grounds 1 to 4 also concern

transfer pricing issues. First of this is on disallowance of a claim for idle capacity while computing its operating margin and the second seeks exclusion of one M/s. TCE Consulting Engineers Ltd from the list of comparables.

5. Facts apropos are that assessee a wholly owned subsidiary of an M/s.Saipem SA, France was primary engaged in the business of providing engineering design and ancillary services to its Associated Enterprises abroad. During the relevant previous year assessee also provided design services to some domestic third party customers. Assessee was billing its customers on hourly rate on the services provided by it. Assessee had during the relevant previous year established a new engineering process centre at New Delhi as a step towards expanding its service delivery mechanism. Assessee also started engineering procurement and construction activity on turnkey basis during the relevant previous year but it seems revenue was still to be generated from this line of activity.

6. For justifying the pricing of its international transactions on engineering design services, technical services charges and reimbursement of expenses, assessee had adopted TNM method as the most appropriate one. Assessee had selected a set of four comparables, and their average operating profit to operating cost

margin or Profit Level Indicator (PLI) came to 13.5%. Assessee worked out its own operating profit to operating margin at 37.5%. This PLI of 37.5% was arrived, after excluding certain expenditure claimed by the assessee as extraordinary and after making adjustment for idle capacity. Claim of the assessee was that it had an idle time cost ₹21,42,52,588/- for its Chennai center. Assessee also claimed deduction of extra ordinary costs in the nature of exchange loss of ₹2,66,47,200/- from forward cover contracts while calculating its PLI. Former claim of the assessee was on a premise that it could only utilize 7,76,120 man hours out of total billable man hours of 11,67,011 which translated to a capacity utilization of 66.50 percent.

7. The Id. TPO however did not accept the claim for idle time adjustment or exclusion of foreign exchange loss while working out the operating profit. Observation of the Id. TPO with regard to the claim for idle time adjustment were as under:-

“Service industries require skilled manpower. The recruitment and training process always involve a time lag in getting the right people recruited at the right time(may be even through campus absorption) and training them to suit the job requirements. The nature of the industry itself is such that this process is not something unique to the assessee alone and not the same in the case of the comparables. All the players in the similar industry cannot recruit/hire people on need based and fire them when they are not required. Unskilled labour can be hired and fired on a day to day need basis. The costs associated with the process of recruiting and retaining them in anticipation of business is similar to a situation in a manufacturing industry where

normal loss as part of the manufacturing process is inevitable and such a loss is always reckoned as part of the operating cost.

It is also admitted that the details of capacity utilization in the case of comparables are not available and therefore the adjustment has been made to the financials of the tested party by appropriately adjusting its fixed cost. It is appreciated that normally adjustments are made to the profit margin of the comparables to bring it on level with that of the tested party. The prerequisite for making this sort of adjustment is the availability of data in the case of comparables. Therefore, the presumption of the assessee that the comparables are working at 100% of their capacity and its capacity utilization is only 65% and therefore an adjustment is called for is misplaced for the reasons stated in the preceding para.

As per the Id. TPO assessee was in business since 2001 and annual reports of the assessee for various financial years demonstrated improved working with better volume of work load, thereby vitiating its claim for idle capacity adjustment.

8. Ld. TPO also analyzed the foreign exchange loss on forward contract claimed by the assessee as extra ordinary which comprised of following items:-

'Loss on foreign exchange *5,53,32,920/-*
(includes loss on account of forward contract
amounting to Indian Rupees 2,66,47,200/-)

Gain on foreign exchange
(forex gain on account of invoicing and
realization and restatement of debtors") *2,80,54,016/-*

Assessee had banked its claim based on a reasoning that forward contracts were cancelled, when expected orders did not materialize. According to it, loss arising therefrom was operational in nature. Ld. TPO after verifying the submissions of the assessee took a view that assessee had eleven contracts of which eight were entered on 28.12.2007 and balance three on 09.01.2009. As per Ld. TPO contract commitments were honoured by the assessee to the extent of 2/3rd even in those contracts where there were forward exchange loss. Further, as per Ld. TPO assessee's earning from Associated Enterprises came to 88% of its total earning and its receivables from Associated Enterprise had gone up from ₹9,44,78,840/- to ₹33,92,88,509/-. Again as per Ld. TPO, when forward contracts were cancelled due to non realization of the receivables from the Associated Enterprise, loss arising therefrom was operational in nature. Though the assessee stated that increase in receivables was due to sales of ₹22.76 crores recorded in the month of March, 2009, Ld. TPO was of the opinion that such claim was not capable of verification. Thus, claim of the assessee that forex loss was non operating in nature and arose on account of low workload was not accepted. He reworked the PLI of the assessee as under:-

<i>"Operating income (as computed by the assessee)</i>	<i>102,43,36,314</i>
<i>Operating expenses (including EPC segment & excluding interest paid)</i>	<i>107,48,33,846</i>
<i>Operating Profit</i>	<i>-5,04,97,532</i>
<i>OP/ OE (-5097532/107,48,33,846)*100</i>	<i>-4.70%"</i>

9. Ld. TPO thereafter made an analysis of the four comparables selected by the assessee for its TP study. He rejected one of the four called M/s. IBI Chematur, but accepted the other three comparables. However in addition to these three comparables, Id. TPO also selected two fresh comparables, namely M/s. Stewarts & Lloyds of India Ltd and M/s. TCE Consulting Engineers Ltd. Ld. TPO worked out the PLI of the five companies as under:-

<i>Sl.No</i>	<i>Comparable Companies</i>	<i>Operating Margin</i>
<i>1</i>	<i>Telecommunications Consultants India Ltd</i>	<i>-0.11</i>
<i>2</i>	<i>M N Dastur & Co Pvt. Ltd</i>	<i>7.23</i>
<i>3</i>	<i>Mahindra Consulting Engineers.</i>	<i>43.49</i>
<i>4</i>	<i>Stewards & Lloyds of India Ltd</i>	<i>6.08</i>
<i>5</i>	<i>TCE Consulting Engineers Ltd</i>	<i>24.05</i>
	<i>Average</i>	<i>16.15</i>

Since operating margin of the assessee was -4.70% against 16.15% of the comparables, Id. TPO recommended an Arms Length Price adjustment of ₹22,40,83,198/-. Such Id. Arms Length Price adjustment was worked out by the Id. TPO as under:-

$$\begin{aligned}
 \text{ALP Profit considering the above} &= (\text{Op. Exp X ALP Profit})/100 \\
 &= (107,48,33,846 \times 16.15)/100 \\
 &= ₹17,35,85,666/-
 \end{aligned}$$

$$\begin{aligned}
 \text{ALP Sales considering the ALP profit} &= \text{Op. Exp X ALP Profit} \\
 &= 107,48,33,846 + 17,35,85,666 \\
 &= ₹124,84,19,512/-
 \end{aligned}$$

$$\begin{aligned}
 \text{ALP Sales} &= 124,84,19,512 \\
 \text{Less : Sales reported} &= 102,43,36,314 \\
 &----- \\
 \text{Difference} &= 22,40,83,168/- \\
 &-----
 \end{aligned}$$

10. When the Id. Assessing Officer made a proposal on the lines recommended by the Id. TPO, assessee chose to move Id. DRP. Before Id. DRP assessee pressed for idle capacity adjustment for working out its operating cost and exclusion of forex loss as non operating in nature while computing its operating margin. Assessee also sought

exclusion of TCE Consulting Engineers Ltd from the five comparables selected by the Id. TPO. The Id. DRP in its direction dated 20.12.2013 held that idle time capacity adjustment sought by the assessee could not be allowed and was rightly denied by the Id. TPO. As per Id. DRP service industry players recruited/ hired employees only based on needs and fired them when they were not required. According to Id. DRP a presumption could not be taken that comparables selected by the assessee worked at 100% of the capacity and assessee alone worked at 65% of the capacity. Further, as per Id. DRP setting up of the new processing centre at New Delhi could not be a good reason for claiming idle time adjustment since assessee was in the service sector since long. Related observations of the Id. DRP is reproduced hereunder:-

"This Panel upholds the action of the TPO to deny the capacity utilization adjustment claimed by the Assessee. Likewise this Panel upholds the action of the TPO to deny the exclusion of Delhi Office expenditure claimed by the Assessee. While upholding the action of the TPO we agree with the reasoning given by the TPO in this regard. The Assessee is in the line of Engineering Services and maximum business in this segment the Assessee has done with the AEs. In this situation Assessee cannot claim the unilateral sharing of capacity utilization and capacity expansion risks. Capacity created or facilities expanded to other regions is cannot be considered as an extraordinary expenditure and hence, cannot be excluded. Assessee

claims that in hourly rate model followed by the Assessee for billing the AEs fixed costs would be under absorbed and such unabsorbed costs would be in the in the nature of abnormal costs. Whereas other Companies compensated by the customers on a cost plus method basis would be insulated from idle capacity risk. Thus whether costs are unabsorbed or compensated with mark up depends on the model one adopts while entering into an agreement with the recipients of services. This is quite obvious in the case of assessee itself. The assessee has entered into agreements with the AEs on hourly charges basis whereas in respect to Non-AEs the Assessee has followed fixed price contract model. This difference in the basis of services rendered by the Assessee makes it clear apparent that the Assessee has favored the AEs. It is expected from the Assessee that business is done with AEs on same terms and conditions on which they do the business with the Non-AEs. Further, in respect to Capacity Utilization, this Panel finds that the Assessee knows about its own capacity underutilization but what about capacity utilization in the case of comparables? Further, it is quite possible that in this business it is normal to have this much underutilized capacity. Adjustment for difference in the capacity utilized by the Assessee and the uncontrolled comparables should be made after excluding the normal unutilized capacity in this business. But such details are not, available. This Panel also finds that capacity utilization concept is vague and entity specific. As discussed above in the Cost Plus Method all the costs are taken in to consideration while deciding the contract amount and hence there is nothing as underutilization of capacity, whereas as per Assessee's admission capacity utilization concept comes into vogue in hourly basis' of charge.

Therefore, in absence of reasonably accurate details of capacity utilization this Panel upholds the decision of the TPO”.

11. However, Id. DRP was one with the assessee viz-a-viz its claim for exclusion of foreign exchange loss as non-operating, while working out the PLI of the assessee as well the comparables.

12. Viz-a-viz assessee’s pleading for exclusion of M/s. TCE Consulting Engineers Ltd from the list of comparables, opinion of the Id. DRP was that the said company was rightly taken as a comparable. As per Id. DRP assessee could not establish that M/s. TCE Consulting Engineers Ltd was undertaking any turn key projects.

13. Now before us, Id. Authorised Representative submitted that idle capacity adjustment had to be given since assessee had provided all required details before lower authorities. As per Id. Authorised Representative cost of idle capacity was worked out as under:-

Particulars		No. of Hrs
Total Billable & non billable hours		1,468,371
Less: leave hours	(138,764)	
Less; Support hours	(129,084)	(301,361)
Less: EPC related hours	(33,513)	
Net Capacity hours (A)		1,167,011

Total billable hours(B)		776,120
% of capacity utilized (c)=(B)/(A)		66.50%
% of unutilized capacity (D) =1- (C)		33.50%
Idle capacity adjustment	Amount (INR)	Amount (INR)
Total personal cost incurred during the year in Chennai region	580,732,926	
Rental cost towards Chennai region	58,921,421	
Total fixed overhead cost pertaining to Chennai region		639,654,347
Idle capacity as computed in (D)		33.50%
Idle capacity adjustment (as mentioned in Annexure 6 of TP Documentation)	(639654347*33.5%)	214,252,588
Computation of idle capacity of NDPC office		
Particulars	Ref	No. of persons
Total capacity pertaining to NDPC office	(a)	80
Average no. of persons employed	(b)	33
Unutilised capacity	(c) =(a) -(b)	47
idle capacity	(d) = (c)/(a)	58.65%
Idle capacity adjustment		
Total rental cost pertaining to NDPC		45,225,561
Idle capacity component of the rental cost (as mentioned in annexure 6 of TP Documentation)	(45225561*58.65%)	26,522,907

Contention of the Id. Authorised Representative was that capacity was worked out, considering the numbers of employees at the start of the year, number of employees recruited during the year and number of employees who left during the year. Id. Authorised Representative

submitted that monthly man hours which were billed and which could not be billed were given in detail by the assessee as under:-

<i>Month</i>	<i>Capacity (hrs)</i>	<i>Billable (hrs)</i>	<i>Non-billable (hrs)</i>
<i>April 2008</i>	<i>98,094</i>	<i>60,881</i>	<i>37,213</i>
<i>May 2008</i>	<i>93,616</i>	<i>65,648</i>	<i>27,968</i>
<i>June 2008</i>	<i>94,506</i>	<i>63,321</i>	<i>31,185</i>
<i>July 2008</i>	<i>100,415</i>	<i>62,278</i>	<i>38,137</i>
<i>August 2008</i>	<i>83,907</i>	<i>56,058</i>	<i>27,849</i>
<i>September 2008</i>	<i>92,348</i>	<i>68,690</i>	<i>23,658</i>
<i>October 2008</i>	<i>90,318</i>	<i>64,019</i>	<i>26,298</i>
<i>November 2008</i>	<i>92,646</i>	<i>60,700</i>	<i>31,946</i>
<i>December 2008</i>	<i>107,181</i>	<i>73,145</i>	<i>34,036</i>
<i>January, 2009</i>	<i>70,459</i>	<i>45,673</i>	<i>24,785</i>
<i>February, 2009</i>	<i>99,753</i>	<i>57,688</i>	<i>42,065</i>
<i>March, 2009</i>	<i>143,769</i>	<i>98,019</i>	<i>45,750</i>
<i>Total</i>	<i>1,167,011</i>	<i>776,120</i>	<i>390,891</i>

Contention of the Id. Authorised Representative was that idle capacity work out could not be given by the assessee, in respect of the comparable companies due to lack of such information in public domain. However, according to him by virtue of decision of Delhi Bench of the Tribunal in the case of *Transwitch India Pvt. Ltd vs. DCIT* (in ITA No.6083/Del/2010, dated 30.03.2012) idle capacity adjustment could be given in service segment. Relying on the decision of Mumbai Bench of the Tribunal in the case of *Pangea3 & Legal Database Systems Ltd vs. ITO* (in ITA No.2128/M/2014 and 1958/M/2014, dated 06.03.2017) Id. Authorised Representative submitted that even

when data for comparables were not available, if efforts were put in by the assessee for getting such data, a risk adjustment could be given. Reliance was also placed on the decision of Pune Bench of the Tribunal in the case of *Skoda Auto India (P) Ltd vs. ACIT (2009) 30 SOT 319* and that of Co-ordinate Bench in the case of *DCIT vs. M/s. Danfoss Industries Pvt. Ltd (in ITA Nos.1311, 1132 & 1582/Mds/2016, dated 23.02.2017)*. Further as per Id. Authorised Representative, the capacity utilization data of the assessee for the preceding and succeeding year would show that there was an abnormal capacity dip in the impugned assessment year.

14. With regard to his grounds seeking exclusion of M/s. TCE Consulting Engineers Ltd, Id. Authorised Representative submitted that the said company was functionally different. According to him, the said company undertook turn key projects whereas assessee was only providing engineering consultancy services. According to him, this objection of the assessee was brushed aside by the Id. DRP as well as Id. TPO without giving any reasons.

15. On the additional grounds raised by the assessee, Id. Authorised Representative submitted that assessee was seeking exclusion of M/s. Mahindra Consulting Engineers Limited. As per Id.

Authorised Representative, it was true that assessee had not sought exclusion of the company from the list of comparables before the lower authorities. However, according to him by virtue of decision of Special Bench of the Tribunal in the case of *Quark Systems (P) Ltd vs. DCIT, 38 SOT 37*, such additional ground had to be admitted. As per the Id. Authorised Representative the Transfer pricing provisions being comparatively new, assessee could take a ground for exclusion of a comparable selected by itself in TP study, if it could show that the company was otherwise not comparable. According to him, M/s. Mahindra Consulting Engineers Limited had a turnover ₹102.43 Crores whereas turnover of the assessee was only ₹8.48 Crores. Turnover of the M/s. Mahindra Consulting Engineers Limited was more than ten times of the assessee and according to him, by virtue of decision of Co-ordinate Bench in the case of *Visual Graphics Computing Services India Pvt. Ltd vs. ACIT (in ITA No.2340/Mds/2012, dated 10.02.2017) and that of DCIT vs. M/s. Wabco TVS Ltd (in ITA No.883/Mds/2015, dated 23.09.2016)* a company which was having a turnover ten times more or less than that of an assessee could not be considered as a good comparable. Thus, according to Id. Authorised Representative, M/s. Mahindra Consulting Engineers Limited was required to be excluded from the list of comparables.

16. Per contra, Id. Departmental Representative submitted that idle capacity adjustment could not be given since assessee was in service industry and assessee could never demonstrate what would be its 100% capacity level. Further as per Id. Departmental Representative, capacity details of the comparables selected by the assessee were not available and assessee could not demonstrate presence or absence of idle capacity for the comparables.

17. Viz-a-viz M/s. TCE Consulting Engineers Ltd, Id. Departmental Representative submitted that the said company was also in engineering service segment and functionally comparable with the assessee.

18. Viz-a-viz M/s. Mahindra Consulting Engineers Limited, Id. Departmental Representative submitted that said company was assessee's own comparable. Further as per Id. Departmental Representative Bangalore Bench of the Tribunal in the case of *Societe Generale Global Solution Centre (P) Ltd vs. DCIT (2016) 69 taxmann.com 336* had held that turnover could not be a relevant criteria in a service sector where fixed overheads were nominal. In any case according to him this was a new ground taken by the assessee and never raised before any of the lower authorities.

19. We have considered the rival contentions and perused the orders of the authorities below. Idle capacity adjustment sought by the assessee for working out its own profit margin is based on a 100% capacity level considered by the assessee as 1167011 billing hours for its Chennai region. For its NDPC office it had gone by a capacity work out based on number of persons. However, detailed monthly man hour capacity utilization given by the assessee at paper book page no. 166, which has been reproduced by us para 13 above show that the total capacity 11,67,011 hours has been spent on group and non group project. Thus at one place assessee states that it had large quantum of total net capacity hours of 1167011 which was not utilized, whereas at another place it say these man hours were spent on group and non group projects. Thus assessee was not able to place before lower authorities data showing total billable hours in a manner which could be objectively analyzed . For NDPC office it went by number of persons; whereas for Chennai region it went by number of hours. Standard followed by the assessee itself differed. To work out a capacity limit in a service industry where billing is done on man hour basis, would not always be a fruitful exercise unless clear empirical data is available. Contention of the assessee that idle capacity cost was an extra ordinary one justifying an adjustment for working out

its PLI, in our opinion, is not acceptable. No doubt, Id.AR has placed considerable reliance on Mumbai Bench decision in the case of *Pangea3 & Legal Database Systems Pvt Ltd (supra)*. But in the said case, what was considered was the nature of loss due to hedging abnormality and whether it could be considered an extraordinary event qua the tested party, when such phenomena was not there across the industry. However, here the claim of the assessee is not for hedging abnormality. It could also not show that idle capacity in service industry was not an across the industry feature. Thus the said decision will not help the assessee for its claim that idle capacity adjustment should be given for working out its PLI. Especially so, since assessee could not demonstrate existence nor nonexistence of idle capacity for the various comparables selected by it. No doubt, as held by Pune Bench of the Tribunal in the case of *Skoda Auto India (P) Ltd (supra)* it might always not be possible for an assessee to get all details of comparables, especially when such data not in public domain, and approximations could be made. However, the data provided by the assessee here, could not show the scientific basis on which it had worked out its own capacity level. The question of approximation in our opinion would not therefore arise. As for the reliance placed by the Id. Authorised Representative on the Delhi Bench decision of this Tribunal in the case of *Transwitch India Pvt.*

Ltd (supra) adjustment claimed by the assessee there were for relocation expenses, additional rent and salary paid for unproductive/ idle hours. In the first place the said company was providing software design and development service and not in engineering services. Further, the said company could convincingly demonstrate its normal utilization capacity was 87% to 94% in the relevant financial year. As against this, assessee here has not been able to demonstrate how it had arrived the capacity hours.

20. Now coming to the claim of the Id. Authorised Representative that during the financial year 2007-2008 assessee had capacity utilization of 75% and even in next year assessee had capacity utilization of 75%, where for financial year 2008-2009 its capacity utilization was only 65% thereby justifying an adjustment for idle capacity, in our opinion, this also cannot be accepted. Reasons are very same. It could not demonstrate how capacity levels were arrived at in a convincing manner using a reliable method. As already mentioned by us, assessee itself had followed different yardsticks for working out its capacity levels at Chennai and NDPC centers. We are therefore of the opinion that lower authorities were justified in not allowing the assessee any idle capacity adjustment while working out its own PLI.

21. Coming to the ground taken by the assessee for exclusion of M/s. TCE Consulting Engineers Ltd, assessee had before the Id. TPO as well as Id. DRP argued that said company was functionally different since it was doing turn key projects. In its letter dated 17.01.2013 addressed to the TPO, assessee had sought exclusion of the said company. But Id. TPO in its order had not dealt with such objection. Before Id. DRP also assessee had specifically raised the following contention.

“TCE provides consultancy services & undertake turnkey projects, they cannot be compared with engineering services rendered by Assessee due to differences in marketing strategies, competitive edge, operational efficiency, cash flow trends, cash flow trends, financial flexibility, government policies etc. In addition Companies operating on a large scale benefit from economies of scale, higher risk taking capabilities, robust global delivery and business models as opposed to the smaller or medium sized companies. Thereby where two companies are of dissimilar sizes they cannot be assumed to earn comparable margins. As it is difficult to quantify the impact of difference in size of business on the margins, companies of dissimilar sizes cannot be compared. Based on the above differences on account of functional dissimilarity and significantly higher turnover, the Assessee has submitted that TCE cannot be considered as comparables and therefore DRP should give directions to exclude it”.

Ld. DRP also did not deal with these objections of the assessee. In the circumstances, we are of the opinion that the question whether M/s.

TCE Consulting Engineers Ltd could be considered a good comparable requires a revisit by the TPO/Assessing Officer. We set aside the orders of the lower authorities, in so far as it relates to the question of comparability of M/s. TCE Consulting Engineers Ltd, and it remit back to the Id. Assessing Officer /TPO for consideration afresh in accordance with law.

22. As already mentioned by us, assessee has raised certain additional grounds seeking exclusion of M/s. Mahindra Consulting Engineers Limited from the list of comparables. No doubt this company appeared in the list of comparables selected by the assessee itself. Assessee had taken no grounds before TPO or Id. DRP for its exclusion. However, by virtue of decision of Special Bench in the case of *Quark Systems (P) Ltd* (supra) we are of the opinion that an assessee could not be estopped from seeking an exclusion of a comparable even before the appellate authority, if it could show that the selected comparable was not really a good comparable. As per assessee M/s. Mahindra Consulting Engineers Limited was having a turnover of ₹102.43 Crores whereas its own turnover was only ₹8.48 Crores. We are of the opinion, the question whether the turnover filter could be applied for exclusion of M/s. Mahindra Consulting Engineers Limited from the list of comparables, has to be considered by the Id.

Assessing Officer /TPO. We remit this issue back to Id. Assessing Officer/TPO.

23. Now, we take the appeal of the Revenue.

24. Revenue is aggrieved on the directions given by the Id. DRP for excluding foreign exchange loss on cancellation of forward contracts while working out operating margin of the assessee.

25. Ld. Departmental Representative submitted that a number forward contracts were cancelled by the assessee due to its inability to collect receivables from its Associated Enterprise abroad. As per Id. Departmental Representative, debtors of the assessee had went up by 260% over the year. Such forward contracts were entered by the assessee to cover the loss that could arise, if payments were delayed. According to Id. Departmental Representative it was clearly operational in nature. As per Id. Departmental Representative 88% of the assessee's revenue were from Associated Enterprises and the debtors were only Associated Enterprises. Thus, according to him, the directions given by the Id. Departmental Representative in this regard was incorrect.

26. Per contra, Id. Authorised Representative in support of the order of the Id. DRP submitted that the increase in debtors was not

the reason for the forex loss. As per Id. Authorised Representative, increase in receivables were due to the sales during the month of March, 2009 was came to ₹22.76 crores. As per Id. Authorised Representative, increase in debtors from ₹9,44,78,840/- to ₹33,92,88,509/- was because of the sale to Associated Enterprise sales during the month of March, 2009. Contention of the Id. Authorised Representative was that forex loss on forward contracts was correctly held as non operational by the Id. DRP. Forward contracts as per the Id. Authorised Representative had to be considered as an extraordinary item. For this contention, reliance was placed on Accounting Standards 11 of Institute of Chartered Accountants of India. Reliance was once again placed on the Mumbai Bench decision of this Tribunal in the case of *Pangea3 & Legal Database Systems Pvt. Ltd (supra)*.

27. We have perused the orders and heard the rival contention. The question before us is whether forex loss suffered by the assessee on account of cancellation of its forward forex contracts could be considered as operative or non operative in nature. There were two types of forex loss suffered by the assessee. The dispute is only regarding the treatment of the forex loss suffered by the assessee, on cancellation of forward contracts, which came ₹2,66,47,200/-. Contention of the assessee is that this was extra ordinary in nature

and hence to be excluded while working out its PLI. It is an admitted position that the forward contracts were entered by the assessee taking into consideration the quantum of US dollars, it could receive from the Associated Enterprises on its billings. Related chart of forward contract cancellation as appearing in paper book at page 138 is reproduced hereunder:-

<i>Month</i>	<i>Contract No.</i>	<i>Contract Date</i>	<i>Value Date</i>	<i>Forward cover taken (USD)</i>
<i>April 2008</i>	<i>0736206420385</i>	<i>12/28/2007</i>	<i>4/30/2008</i>	<i>1,500,000</i>
<i>May 2008</i>	<i>0736206420388</i>	<i>12/28/2007</i>	<i>5/30/2008</i>	<i>1,500,000</i>
<i>June 2008</i>	<i>0736206420387</i>	<i>12/28/2007</i>	<i>6/30/2008</i>	<i>1,000,000</i>
<i>July 2008</i>	<i>0736505910031</i>	<i>12/28/2007</i>	<i>7/31/2008</i>	<i>2,500,000</i>
<i>August 2008</i>	<i>0736505910017</i>	<i>12/28/2007</i>	<i>8/29/2008</i>	<i>1,700,000</i>
<i>September 2008</i>	<i>0736206420386</i>	<i>12/28/2007</i>	<i>9/29/2008</i>	<i>1,700,000</i>
<i>October 2008</i>	<i>0736206420383</i>	<i>12/28/2007</i>	<i>10/31/2008</i>	<i>1,800,000</i>
<i>November 2008</i>	<i>0736206420384</i>	<i>12/28/2007</i>	<i>11/28/2008</i>	<i>1,800,000</i>
<i>December 2008</i>				
<i>January, 2009</i>	<i>IND 2613346</i>	<i>1/9/2009</i>	<i>1/30/2009</i>	<i>2,000,000</i>
<i>February, 2009</i>	<i>IND 2613348</i>	<i>1/9/2009</i>	<i>2/327/2009</i>	<i>2,000,000</i>
<i>March, 2009</i>	<i>IND 2613350</i>	<i>1/9/2009</i>	<i>3/31/2009</i>	<i>3,200,000</i>
<i>Total</i>				<i>20,700,000</i>

<i>Month</i>	<i>Delivered (USD)</i>	<i>Not delivered</i>	<i>Forward Rate</i>	<i>spot rate</i>	<i>Charges (INR)</i>
<i>April 2008</i>	<i>1,466,918</i>	<i>33,082</i>	<i>39.72</i>	<i>40.44</i>	<i>(23,819)</i>
<i>May 2008</i>	<i>1,425,789</i>	<i>74,211</i>	<i>39.77</i>	<i>42.55</i>	<i>(206,493)</i>
<i>June 2008</i>	<i>482,494</i>	<i>517,506</i>	<i>39.80</i>	<i>43.10</i>	<i>(1,707,771)</i>
<i>July 2008</i>	<i>1,615,727</i>	<i>884,273</i>	<i>39.85</i>	<i>42.55</i>	<i>(2,391,958)</i>
<i>August 2008</i>	<i>346,217</i>	<i>1,353,783</i>	<i>39.88</i>	<i>43.81</i>	<i>(5,323,752)</i>
<i>September 2008</i>	<i>1,100,000</i>	<i>600,000</i>	<i>39.91</i>	<i>47.04</i>	<i>(4,278,000)</i>
<i>October 2008</i>	<i>935,939</i>	<i>864,061</i>	<i>39.93</i>	<i>49.10</i>	<i>(7,919,771)</i>
<i>November 2008</i>	<i>1,800,000</i>		<i>39.95</i>	<i>49.60</i>	
<i>December 2008</i>					
<i>January, 2009</i>	<i>2,000,000</i>		<i>48.93</i>		
<i>February, 2009</i>	<i>2,000,000</i>		<i>49.05</i>		
<i>March, 2009</i>	<i>635,489</i>	<i>2,564,511</i>	<i>49.16</i>	<i>51.03</i>	<i>(4,795,636)</i>
<i>Total</i>	<i>13,808,571</i>	<i>6,891,429</i>			<i>(26,647,200)</i>

Assessee was expecting to get US dollars on its billings to its Associated Enterprise and this was the reason why it entered into forward contracts. Substantial part of the forward contracts except for the month of June, August, 2008 and March, 2009 were satisfied by delivery of dollars. Hence to say that the forwards contracts were taken by the assessee as an independent activity unrelated to its business would be incorrect. Admittedly such contracts were not entered by the assessee as a part of any speculation business. Considering these aspects we are of the opinion that loss on closure of forward contract was not on account of any hedging abnormality. In the case of Pangea3 & Legal Database Systems Pvt. Ltd (supra) decided by Mumbai Bench of this Tribunal strongly relied by the Id. Authorised Representative, what was held at page 32 & 33 of the order is reproduced hereunder:-

'So far as entering into forward contracts to minimize such risks is absolutely no abnormal conduct on part of the assessee, because if the trade receivables or payables are in foreign currency, the parties generally resort to entering into forward contract and hence, it is to be reckoned as normal business transaction and any gain or loss in the normal course of business is to be accounted for in the accounts. However, if there is some hedging abnormality or any extraordinary event has occurred qua the tested party (assessee) which materially affects the cost or profit in the relevant financial year, which is not across the industry or is either absent or is of less magnitude in the case of comparable independent parties, then definitely such an abnormality or extraordinary event has to be factored in while computing the cost base or PLI. Before us, the assessee has demonstrated that in this particular

financial year there was an extraordinary fluctuation in the Forex rate which was at 27.47% as compared to the average fluctuation of 2.87% in the earlier three financial years (as per the chart reproduced in our earlier part of the order). In the earlier financial year, i.e., in the FY 2007-08 like a normal transaction the assessee had entered into majority of forward contracts when the exchange rate of INR vs. US \$ was steady or rather INR was appreciating; however, in the FY 2008-09 the value of INR depreciated so sharply that even the RBI had to intervene by pumping US \$ 84 billion in the Forex market. In order to save itself from such huge loss, the assessee cancelled the forward contract so that loss can be mitigated and accordingly, in that process assessee had suffered a loss of Rs. 2.22 cr. Such a loss even due to untoward incident generally would have gone into the operating cost, had it been demonstrated that it was the phenomenon across the industry or in the cases of comparable uncontrolled transactions, that is, independent comparable entities this was also the peculiar feature. If such a peculiarity is absent or its magnitude is less in the case of the comparables, then ostensibly such peculiarity or abnormality has to be treated as factors materially affecting the cost and consequently, the PLI of the tested party for which the reasonable accurate adjustment should be made to eliminate this effect, because it has to be reckoned as a difference between the international transaction and the comparable uncontrolled transactions”.

There is a clear observation that entering into forward contract for covering the risks of exchange rate fall, was a normal business transaction. Of course there indeed is an observation that extraordinary fluctuations could warrant an adjustment if it could be demonstrated that such a phenomena was absent for comparable cases. Nothing of this sort was demonstrated by the assessee here. In such circumstances we are of the opinion that Id. DRP fell in error in

directing the Id. TPO to exclude foreign exchange loss/gain, considering it to be non operating in nature, while computing operating margin of the assessee as well as that of comparables. Directions given by the Id. DRP in this regard are set aside.

28. To summarize the results, appeal of the assessee is partly allowed for statistical purpose, whereas that of Revenue is allowed. Cross objection of the assessee having not been pressed is dismissed.

Order pronounced on Wednesday, the 5th day of April, 2017, at Chennai.

Sd/-

(एन.आर.एस. गणेशन)

(N.R.S. GANESAN)

न्यायिक सदस्य/JUDICIAL MEMBER

Sd/-

(अब्राहम पी. जॉर्ज)

(ABRAHAM P. GEORGE)

लेखा सदस्य/ACCOUNTANT MEMBER

चेन्नई/Chennai

दिनांक/Dated: 5th April, 2017

KV

आदेश की प्रतिलिपि अग्रेषित/Copy to:

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