

*Shri R.P. Tolani*  
SM

*Shamim Yahya*  
17 Am

ITA NO. 1506/DEL/08  
A.Y. 2003-04

IN THE INCOME TAX APPELLATE TRIBUNAL  
DELHI BENCH "C" NEW DELHI  
BEFORE SHRI R.P. TOLANI, JUDICIAL MEMBER

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AND

SHRI SHAMIM YAHYA, ACCOUNTANT MEMBER

I.T.A. No. 1506/Del/2008

A.Y. 2003-04

DY. COMMISSIONER OF INCOME TAX  
CIRCLE-17(1), CR Bldg., IP Estate,  
NEW DELHI

vs.

M/S VERTEX CUSTOMER  
SERVICES (INDIA) PVT LTD.,  
52, OKHLA INDUSTRIAL AREA,  
PHASE-III, NEW DELHI  
(PAN : AAGCSO438M)

**(Appellant)**

**(Respondent)**

Appellant by : SMT. RUCHIKA GOVIL, SR. DR

Respondent by : S/SH. KANCHUN KAUSHAL/JATIN JINDAL

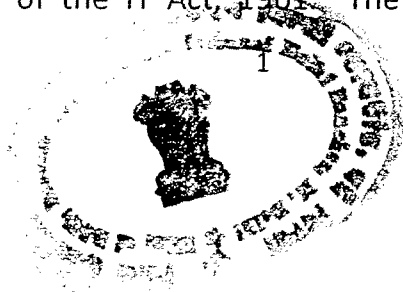
**ORDER**

PER SHAMIM YAHYA, AM

This appeal by the revenue is directed against the orders of the CIT(A) dated 30.1.2008 and pertains to assessment year 2003-04.

2. The issue raised is that the Id. CIT(A) has erred in deleting the penalty amounting to Rs. 90,07,004/- imposed by the Assessing Officer under section 271(1)(c).

3. In this case the Assessing Officer noted in assessment order that the assessee company has entered into international transactions with its associated enterprises. Since the amount of international transaction was in excess of Rs. 5 crores, a reference was made to the Transfer Pricing Officer (TPO) to determine the arm's length price in terms of section 92CA(3) of the IT Act, 1961. The TPO observed that the assessee



company was in the business of running a call centre. From the financial services provided, it was noted that there was substantial loss to the assessee during the year amounting to Rs. 4.27 crores. It was explained to the TPO that this was due to certain costs related to excess capacity and the certain cost related to the year being first year of operations and also there was provision for doubtful debt amounting to Rs. 22857529/-.

3.1 Among the reasons so provided, the TPO did not accept the provision of doubtful debts. He held that even after providing adequate latitude to the assessee regarding the first year of the company, excess capacity and start up expenses, there is no case for excluding the provisions for doubtful debts from the computation of operating costs. Pursuant to this TPO's report the Assessing Officer made the impugned addition of Rs. 25229708/- in the income of the assessee and penalty proceedings were also initiated.

3.2 In the penalty proceedings the assessee explained that it had made full disclosure in the facts of the case and in the returned filed and the provision of doubtful debts has been added back in the computation of income. Hence, there was no concealment or furnishing of inaccurate particulars. However these were not accepted and penalty under section 271(1)(c) was leveled by holding that assessee has not fully and truly disclosed the real operating cost and the comparable profit margin on the same as required under section 92(C) and this resulted in suppression of income as well as higher claim of loss.

4. Upon assessee's appeal the Id. CIT(A) noted that assessee had made adjustment in the operational profit due to excess capacities cost, start up cost and provision of doubtful debt. He further noted that the TPO while accepting the two adjustments of start up cost and unutilized capacity was not in favour of excluding the provision of doubtful debt from the computation of operation of cost. The Id. CIT(A) referred to the provision of Explanation VII of section 271(1)(c) and several case laws. The Id. CIT(A) observed that the facts relating to provision of doubtful debts were disclosed to the revenue authorities and there was enough reason for the assessee to treat the provision of doubtful debt as extraordinary item and for exclusion of the same from the operational cost. The Id. CIT(A) observed that ingredients of Explanation-VII section 271(1)(c) were not satisfied. Further, the CIT(A) noted that Assessing Officer has not brought on record any evidence to show that the assessee had not computed the transaction price in good faith and with due diligence. Ultimately, the Id. CIT(A) concluded that the assessee had disclosed the full facts of the case to the TPO as well as to the Assessing Officer. It was only on account of difference of opinion between the assessee and the TPO that provision for doubtful debt was considered as an ordinary operative expense forming part of the operating cost and resulting in TP adjustment. Hence, the CIT(A) held it was not a fit case for levy of penalty.

5. Against this order the revenue is in appeal before us.

6. The Id. DR contended that only question to be addressed in this case is whether the provision of doubtful debt on the facts of the case was an extraordinary item to be excluded from the operating cost. She claimed there was nothing extraordinary about the provision of doubtful debt and hence, there was no reason why the same was to be excluded. She claimed this was very much coming within the ambit of levy of penalty under section 271(1)(c) Explanation-7 and the penalty had been rightly imposed.



6.1 The counsel for the assessee on the other hand submitted that there was no case of concealment or furnishing of inaccurate particulars. The assessee has duly taken services of reputed consultants and on their considered advise the arms length price was determined. The assessee's actions were all in good faith and with due diligence. In the consultants opinion the provision for doubtful debt was an extraordinary item. The difference between the Assessing Officer and the assessee and its consultants was merely a difference of opinion and this cannot be taken to show any malafide act on the part of the assessee.

6.2 We have carefully considered the submission. Before proceeding further we can gainfully refer to the Explanation-7 to provision of section 271(1)(c) which reads as under:-

*"Where in the case of an assessee who has entered into an international transaction defined in section 92B, any amount is added or disallowed in computing the total income under sub-section(4) of section 92C, then, the amount so added or disallowed shall, for the purposes of clause (c) of this sub-section, be deemed to represent the income in respect of which particulars have been concealed or inaccurate particulars have been furnished, unless the assessee proves to the satisfaction of the Assessing Officer or the Commissioner (Appeals) [or the Commissioner] that the price charged or paid in such transaction was computed in accordance with the provisions contained in section 92C and in the manner prescribed under that section, in good faith and with due diligence."*

6.3 A reading from the makes it clear that any adjustment in the transfer pricing is done by the revenue, then it will be deemed to represent income in respect of which particulars have been concealed or inaccurate particulars have been furnished unless the assessee proves to the satisfaction of the Assessing Officer or the Commissioner (Appeals) that the price charged or paid in such transactions was computed in accordance with provisions contained in section 92(C) and in the manner prescribed under that section, in good faith and is due diligence.

6.4 Now let us examine what action the assessee has taken to compute the arms length price in this case. The assessee has taken the services of reputed consultants KPMG for the transfer pricing review. For the purpose of determining the arms length price the assessee had applied the transactional net marginally method as the most appropriate method. The TPO has not disturbed the method applied by the assessee. The assessee has identified comparable cases that are comparable to the assessee's call centre activities. The operating profit to operate cost has been calculated by the assessee at the average of 10.12%. This aspect also not being disturbed by the TPO or Assessing Officer. The assessee had incurred substantial loss amounting to Rs. 4.27 crores. Reason for the same was explained to be relating to (i) cost relating to first year operation; (ii) cost relating to excess capacity and (iii) provision for doubtful debts.

6.5 The first two adjustments were not questioned by the TPO, it was only with regard to the exclusion of bad debts, that it was claimed in the penalty order that Rule 10B(e)(iii) does not envisage making of any adjustments in the profit margin of the assessee. The said rule provides that for the purpose of sub-section(2) of section 92 (C) the arms length price in relation to international transaction can also be determined by transactional net margin method by which –

- i) the net profit margin realized by the enterprise from an international transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant bas;
- ii) the net profit margin realized by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;

- iii) the net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transactions action and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;
- iv) the net profit realized by the enterprise and referred to in sub-clause (i) is established to be same as the net profit margin referred to in sub-clause(iii);
- v) the net profit margin thus established is then taken into account to arise at an arm's length price in relation to international transaction.

6.6 Now in the light of above, we shall examine whether the exclusion of provision of doubtful debt in this case from the operating cost can be said to be an act not done in good faith and with due diligence.

6.7 The Id. CIT(A) in his appellate order has noted that necessary facts relating to the provisions of doubtful debts were disclosed to the revenue authorities in various forums. The facts relating the said provision were that 7C Limited UK, owed a sum of GBP 307,810 to the assessee in respect of services rendered for providing call centre. However, on November, 30, 2002, 7C Holdings Ltd. and 7 C Limited UK went into winding up, after being in debt to the assessee 7C Limited UK had also incurred an amount of GBP 529,000 with respect to the formation of the assessee (which had to be cross charged to the assessee). As part of the negotiations, the Administrator decided to cancel both the debts. Accordingly, the receivable of Rs. 22,857,524 was shown as a provision for bad and doubtful debt. Now under these circumstances, this provision for doubtful debit was not considered as a part of operation and cost. The CIT(A) has observed that treatment of this extraordinary item as not forming part of operational cost is clearly justifiable.



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7. Upon careful consideration, we are of the opinion that if the sums are owed by the parent company become bad the same cannot be conclusively said to be a matter falling in ordinary course of trade. The fact that the assessee has accepted the addition and not challenged the same will not change this aspect. In our considered opinion it is certainly a debatable point. A point on which admittedly there can be two opinions. As per the Accounting Standard-5 issued by the Institute of Chartered Accountant of India, extraordinary items are incomes or expenses that arise from events or transactions that are clearly distinct, from the ordinary activities of the enterprise and therefore, are not accepted to recur frequently or regularly. Hence, in the light of the aforesaid discussion whether the provision for doubtful debt on the facts of the case, can be said to be an extraordinary item warranting exclusion from operational cost is a debatable point.

8. It is further noted that as against the sums owed to the assessee, the parent company had incurred larger amount in the formation of the assessee company which was to be cross charged to the assessee. This sum was also cancelled alongwith the debt. If this sum was not cancelled against sums owed by the parent company, the assessee's cost would have been further loaded by a larger amount by the cross charge for formation expenses. In these circumstances, coupled with the fact that there was a full disclosure by the assessee of all the relevant facts, we hold that the assessee's computation cannot be said to have been done, not in good faith and with due diligence. Hence, no levy of penalty under section 271(1)(c) is called for. In this regard, we place reliance upon the decision of the Hon'ble Apex Court rendered by a large Bench comprising of three of their Lordships in the case of Hindustan Steel vs. State of Orissa in 83 ITR 26, wherein it was held that "An order imposing penalty for failure to

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carry out a statutory obligation is the result of a quasi-criminal proceedings, and penalty will not ordinarily be imposed unless the party obliged either acted deliberately in defiance of law or was guilty of conduct contumacious or dishonest, or acted in conscious disregard of its obligation. Penalty will not also be imposed merely because it is lawful to do so. Whether penalty should be imposed for failure to perform a statutory obligation is a matter of discretion of the authority to be exercised judicially and on a consideration of all the relevant circumstances. Even if a minimum penalty is prescribed, the authority competent to impose the penalty will be justified in refusing to impose penalty, when there is a technical or venial breach of the provisions of the Act, or where the breach flows from a bona fide belief that the offender is not liable to act in the manner prescribed by the statute." We further place reliance upon the decision of the Hon'ble High Court of Delhi delivered in the case of CIT Vs. Nath Bros. Exim International Ltd. in [2007] 288 ITR 670 (Delhi), where it was held that "where there was no need of enquiry by Assessing Officer there was only the need of application of law. And on legal position the Assessing Officer was not satisfied and did not agree with the assessee, but that itself could not be a ground to invoke the penalty provision of the statute".

9. Hence in the background of the aforesaid discussion and precedents, in our considered opinion on the facts and circumstances of the case the assessee cannot be held liable for penalty under section 271(1)(c) of the IT Act as his conduct is not



malafide or contumacious. Accordingly, we do not find any infirmity or illegality in the order of the Id. CIT(A). Hence we confirm the same. 127

10. In the result, the appeal filed by the revenue is dismissed.

Order pronounced in the open court on ..... September, 2009.

[R.P. TOLANI]  
JUDICIAL MEMBER

Date: 24 September, 2009

SRB

Copy forwarded to:-

1. Appellant
5. DR, ITAT

*By Hand*

2. Respondent

TRUE COPY

[SHAMIM YAHYA]  
ACCOUNTANT MEMBER

3. CIT 4. CIT (A)

By Order,

शुभाकर बंधुका

Assistant Registrar,

जयपुर, जिला Benches

Income Tax Appal

जयपुर