

IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCHES "B" : HYDERABAD

BEFORE SHRI B. RAMAKOTIAH, ACCOUNTANT MEMBER
AND
SHRI SAKTIJIT DEY, JUDICIAL MEMBER

ITA.No.1826/Hyd/2011
Assessment Year 2007-2008

HSBC Electronic Data
Processing India P. Ltd., vs. The ACIT, Circle 2(2)
Hyderabad – 500 081. Hyderabad – 500 004.
PAN AAACH8235M
(Appellant) (Respondent)

For Assessee : Mr. Rajan Vora
For Respondent : Mr. D. Sudhakar Rao

Date of Hearing : 03.09.2014
Date of Pronouncement : 24.10.2014

ORDER

PER B. RAMAKOTIAH, A.M.

This appeal is preferred by assessee against the order of AO dated 12-10-2011 passed under Sec 143(3) read with Sec.144C of the IT Act 1961 consequent to the directions of Disputes Resolution Panel, Hyderabad dated 26.09.2011 for the A.Y. 2007-08.

2. Briefly stated, HSBC Electronic Data Processing India Private Limited (hereafter referred to as 'HDPI') is a wholly owned subsidiary of HSBC Holdings Plc (together with its associates referred to as 'HSBC Group'), one of the leading banking and financial services organisations in the world. HDPI provides a range of back office services including contact centre, data entry, data processing and related services (together referred to as 'BPO services') to its Group

companies/Associated Enterprises ('AE') across the globe. The Assessee's service centres are registered as a 100% export oriented unit under the Software Technology Parks of India (STPI) scheme. Assessee has also established a branch in the UK to facilitate the identification and effective migration of work to India from AEs. The assessee renders services as a captive contract service provider and is remunerated on a cost plus mark-up basis for providing the services to its AEs. Assessee had filed return of income for the Assessment Year 2007-08 on October 29, 2007 disclosing a taxable income of Rs 3,46,26,667 after claiming deduction u/s 10A of the Income Tax Act, 1961 in respect of the profits from export of services from the STPI units.

3. During the course of assessment proceedings, The ACIT Circle-2(2) (herein after referred as 'Assessing Officer' or 'AO') selected the case for scrutiny assessment and issued a notice u/s 143(2) of the Act, and further made a reference u/s 92CA(1) of the Act to the Learned Additional Commissioner of Income-tax (Transfer Pricing) (herein after referred as 'Transfer Pricing Officer' or 'TPO') for determination of Arm's Length Price (,ALP') of the international transactions with AEs.

3.1 The international transactions of Assessee with AEs during the year are as under :

- Provision of BPO services - Rs 948,20,38,225;
- Reimbursements to AEs - Rs 16,02,86,194;
- Reimbursements by AEs - Rs 36,71,34,393;
- Payment of bank charges - Rs 15,06,946;
- Payment of Guarantee commission - Rs 5,49,391;
- and
- Interest received on Fixed deposits - Rs 3,10,24,444.

3.2 For the purpose of establishing the ALP of its international transaction with AE, the assessee had undertaken a transfer pricing study, carried out by an independent external consultant, in accordance with the provisions of the Act, read with the Income-tax Rules, 1962 ("Rules"). Based on the transfer pricing study, it was concluded that the international transactions of the assessee with AEs are at arm's length. The key features of the Transfer Pricing ('TP') study undertaken in respect of international relating to provision of BPO services are summarised below :

- As per the functional analysis, assessee was categorised as a risk mitigated contract service provider and selected as the tested party ;
- Transaction Net Margin Method ('TNMM') was determined as the most appropriate method to determine the ALP ;
- The search was conducted on Prowess database and Capitaline database to select comparable companies ('comparables');
- Operating margin i.e. operating profit/operating cost was selected as the Profit Level Indicator (PLI) for the purpose of determining ALP;
- Given the nature of the international transaction under review, economic conditions, differences in business or product life cycles and other similar factors and also the fact that audited financial data for the AY 2007-08 was not available in all cases, financial data of AY 2006-07 and AY 2005-06 was also considered, along with interim/unaudited results for AY 2007-08;
- The economic analysis yielded a set of 22 comparables with weighted average arithmetic mean of 12.31 %.
- There were functional and risk differences between the assessee and the comparables. However, no adjustments were undertaken in the TP report, since,

the assessee's net margin from the provision of services to its AEs (3.37%) during the year was within the arm's length range determined.

3.3 There were series of submissions made by assessee before the TPO in response to the notices, to justify the arm's length nature of its international transactions. While the TPO accepted TNMM as the most appropriate method and the PLI (operating profit/Operating cost) adopted therein, he rejected the economic analysis undertaken by assessee in the TP documentation inter alia stating that the multiple year data has been used and the comparability analysis is defective and filters adopted by assessee. TPO conducted a fresh search on the databases (i.e., Prowess and Capitaline) and also used powers u/s 133(6) of the Act to obtain information from certain companies and used the same for determining the ALP. TPO applied the following additional filters for comparative analysis:

- a) Rejection of companies having different financial year;
- b) Rejection of companies having diminishing revenues filter/persistent loss making;
- c) Rejection of companies having related party transactions in excess of 25% of revenue ; and
- d) Rejection of companies having foreign exchange earnings less than 25% of revenue.

3.4 TPO has selected the following 27 companies as comparables with average margin of 30.48% after making a negative working capital adjustment of 0.27%.

3.5. TPO also added the reimbursement related to travel costs received by assessee to the operating cost for determination of ALP. Accordingly, the TPO has made the TP adjustment of Rs.162,15,17,917 to the price received by assessee for the services rendered to its AEs. In respect of the transactions relating to short term deposits with HSBC Bank branch, TPO has re-characterised the transaction as loans to the AEs and computed the arm's length interest rate at 14% and accordingly made an adjustment of Rs 3,84,55,356 to the interest received by assessee. Other transactions viz., bank charges and guarantee fee have been accepted to be at arm's length under CUP method. AO adopted the same in his draft assessment order u/s 143(3) read with 144C(1) of the Act ('Draft Order') dated December 29, 2010 proposing the additions to the total income of the assessee. However while calculating deduction u/s 10A, AO reduced foreign exchange gain of Rs 6,73,55,469 from business profits and communication charges of Rs 5,53,90,914 from the export turnover, in applying the prescribed formula.

3.6 Assessee has filed its objections with the DRP on the additions proposed by the AO in the Draft Order. As per the directions issued the DRP has principally agreed with the approach adopted and contentions of the Ld. TPO/AO and has upheld the Draft Order on all issues except accepting objections of assessee on two comparables and providing relief on the TP adjustments on re-characterisation of interest on short term deposits. AO has passed the final assessment order dated October 12, 2011 considering the directions given by DRP computing the total income of assessee at Rs 170,50,55,178 and the tax payable thereon at Rs 81,59,52,255

(including interest). Aggrieved by the AO/DRP order, assessee has preferred before the Tribunal.

4. We have heard the learned counsel for the assessee, Shri Rajan Vora and the learned Departmental Representative Sri D Sudhakar Rao in detail. The assessee has placed paper-book 'A' containing pages 1 to 232 and Paper Book B containing pages 233 to 487 and paper-book C. The assessee is aggrieved in grounds No.1 to 12 on the TP adjustments made. In addition to the TP adjustments, there are other issues on the corporate tax matters which are considered in the course of this order.

5. Even though assessee has raised various objections on the rejection of its Transfer Pricing documentation, rejection of multiple year data, obtaining information under S.133(6), use of additional filters, etc., the arguments are confined to selection of comparables and risk adjustment. In the course of arguments, the learned counsel fairly restricted his arguments to only comparables selected by the TPO. Even though comparables selected by assessee but rejected by the TPO were also contested in ground 8, the same was not pressed in the course of arguments. The final list of comparables as per AO order are as under

S.No.	Company Name	PLI
1.	Accentia Technologies Ltd. (seg.)	28.14%
2.	Accurate Data Convertors P. Ltd.,	50.32%
3.	Aditya Birla Minacs Worldwide Ltd., (Transworks Information Services Ltd.)	12.92%
4.	Allsec Technologies Ltd.,	27.70%
5.	Apex Knowledge Solutions P. Ltd.,	14.95%
6.	Apollo Health Street Ltd.,	-9.96%

7.	Asit C. Mehta Financial Services Ltd., (Seg.) (Nucleus Netsoft & GIS India Ltd.,)	24.74%
8.	Bodhtree Consulting Ltd., (seg.)	31.62%
9.	Caliber Point Business Solutions Ltd.,	22.15%
10.	Cosmic Global Ltd.,	13.26%
11.	Datamatics Financial Services Ltd., (seg.)	11.19%
12.	Eclerx Services Ltd.,	88.60%
13.	Flextronics Software Systems Ltd., (seg.)	7.93%
14.	Genesys Intl. Corp. Ltd., (Seg.)	10.42%
15.	HCL Comnet Systems & Services Ltd., (seg.)	46.23%
16.	ICRA Techno Analytics Ltd., (seg.)	13.32%
17.	Informed Technologies India Ltd.,	36.89%
18.	Infosys BPO Ltd.,	30.66%
19.	Iservices India P. Ltd.,	50.78%
20.	Mold Tek Technologies Ltd., (seg.)	118.04%
21.	Nittany Outsourcing Services P. Ltd.,	12.41%
22.	R Systems International Ltd., (Seg.)	20.26%
23.	Spanco Telesystems & Solutions Ltd., (Seg.)	21.62%
24.	Vishal Information Technologies Ltd.,	44.45%
25.	Wipro Ltd., (seg.)	32.22%
Arithmetic Mean		30.43%

6. The objection is with reference to selection of comparables by the TPO with reference to the following companies-

1. Accentia Technologies Limited

6.1.1. The learned authorised representative of the assessee objecting to the aforesaid company being treated as comparable submitted that the aforesaid company is functionally different from the assessee as more than 64% of the operating cost of the company is towards overseas business expenses. The company receives substantial revenue from on-site services which is more than 75%, hence cannot be considered as comparable on account of differences in geographical locations of the services. It was submitted that the employee cost of company is only 14% of its revenue. It

was further submitted that the unaudited segmental information obtained u/s 133(6) of the Act has been used to compute margins which may not be authentic. It was further submitted that due to multiple acquisitions by the company during the year under dispute, it was an exceptional year impacting the profitability of the company. In this context, the learned authorised representative of the assessee referred to the annual report of Accentia Technologies Limited in the paper book. The learned authorised representative of the assessee also relied upon the decisions of Income-tax Appellate Tribunal, Hyderabad Bench in case of Avineon India P. Ltd., ITA.No.1989/Hyd/2011 dated 31.10.2013, Zavata India P. Ltd., Hyderabad vs. DCIT, Circle 3(3), Hyderabad ITA.No.1781/Hyd/2011 dated 07.06.2013 and M/s. Capital IQ Information Systems India Pvt. Ltd., Hyderabad vs. DCIT (Int. Taxation), Hyderabad (ITA No.1961/Hyd/2011 dated 23.11.2012).

6.1.2 The learned departmental representative, on the other hand, submitted that there is no reason to exclude the aforesaid company as the TPO has given justifiable reasons for treating it as a comparable company.

6.1.3 We have heard the contentions of the parties with regard to the aforesaid company and perused the material on record. From the facts and material available on record, it is seen that two companies viz., Iridium Technologies and Geosoft Technologies amalgamated with M/s. Accentia Technologies Limited which resulted in a higher profit for the company during the year. In case of Capital IQ Information Systems India Pvt. Ltd., the co-ordinate bench of this Tribunal

while considering the assessee's objection with regard to the aforesaid company held in the following manner:-

"10. It is the submission of the assessee that this company cannot be treated as a comparable because of un-comparable financial results arising out of amalgamation in the company. In this regard, the assessee has relied upon the order of the DRP for the assessment year 2008-09 in assessee's own case. It is seen that the DRP while considering similar objection placed by the assessee in the case of another company, viz. Mold Tek Technologies Ltd., in the proceedings relating to the assessment year 2008-09, has observed in the following manner-

"17.5. In addition to the above, the Director's Report of the company for the FY 2007-08 revealed the merger and the demerger. A company known as Techmen Tools Pvt. Ltd. had amalgamated with Mold-tek Technologies Ltd. with effect from 1st October, 2006. There was a de-merger of Plastic Division of the company and the resulting company is known as Moldtek Plastics Limited. The de-merger from the Moldtek Technologies took place with effect from 1st April, 2007. The merger and the de-merger needed the approval of the Hon'ble High Court of Andhra Pradesh and also the approval of the shareholders. The shareholders of the company gave approval for the merger and the de-merger on 25.01.2008 and the Hon'ble High Court of Andhra Pradesh had approved the merger and de-merger on 25th July, 2008. Subsequently, the accounts of Moldtek Technologies for FY 2007-08 were revised. On a perusal of the annual report it is noticed that Teckmen Tools Pvt. Ltd. and the Plastic Division of the company were demerged and the resulting company was named as Moldtek Plastics Ltd. The KPO business remained with the company. A perusal of the Annual report revealed that to give effect to the merger and demerger, the financial statements were revised and restated after six months from the end of the financial year 31.3.2008. The assessee filed Form No.21 under the Companies Act with the Registrar of Companies on 26th August, 2008. Thus the effective date of the scheme of merger and demerger was 26th August, 2008. The Annual Report supported the argument of the assessee that there were

merger and demerger in the financial year and it was an exceptional year of performance as financial statements were revised by this company much after the closure of the previous year. The Panel agrees with the contention of the assessee that it is an exceptional year having significant impact on the profitability arising out of merger and demerger.”

On careful consideration of the matter, we also agree with the aforesaid view of the DRP that extra-ordinary event like merger and de-merger will have an effect on the profitability of the company in the financial year in which such event takes place. It is the contention of the assessee that in case of the aforesaid company, there is amalgamation in December, 2006, which has impacted the financial result. This fact has to be verified by the TPO. If it is found upon such verification that the amalgamation in fact has taken place, then the aforesaid comparable has to be excluded.”

6.1.4 As can be seen from the order of the co-ordinate bench, the aforesaid company was excluded since ex-ordinary events like merger and demerger had taken during the relevant financial year which must have impacted the financial results of the company. That besides the high volume of on-site operation of Accentia Technologies Limited also makes it functionally dissimilar to the assessee. These facts are not considered either by the TPO or by the DRP. We therefore remit the matter to the file of the Assessing Officer who shall verify the fact whether merger has taken place during the year and if it found so, then the aforesaid company has to be excluded from the list of comparables. The Assessing Officer should also properly consider assessee's submissions with regard to functional difference also.

2. Accurate Data Convertors Private Ltd.

6.2.1. The learned authorised representative of the assessee objecting to the aforesaid company being treated as comparable submitted that this company was not identified in the search process either by the assessee or by the TPO. It was submitted that no opportunity was given to the assessee to examine whether these companies are comparable to the assessee. It was submitted that the TPO relying upon unaudited information has treated the aforesaid company as comparable only because the high margin of profit shown at 50.15%. The learned authorised representative of the assessee also relied upon the order of the Coordinate Bench decision of the Delhi Tribunal in the case of ACIT vs. M/s. Toshiba India P. Ltd., 2010-TII-14-ITAT-DEL-T.P.

6.2.2. The learned departmental representative however supported the orders of the revenue authorities in selecting the aforesaid company as comparable.

6.2.3 We have heard the contentions of the parties and perused the material on record. On a perusal of the observation made by the TPO of his order, it is seen that the aforesaid company was not initially selected as a comparable by the TPO. Subsequently, the TPO conducted search in the data bases for finding additional comparable by applying 25% employee cost filter. After examining the information obtained from the company u/s 133(6) of the Act the TPO treated it as comparable by observing that the company is engaged in IT enabled services and qualifies all the filters adopted by the TPO. It is very much clear from the order of the Assessing

Officer that the assessee was not given any opportunity/information to examine the comparability of the aforesaid company. Though the TPO is empowered under the provisions of the Act to obtain information with regard to selection of comparables, however before utilising the information obtained, he has to give fair opportunity to the assessee to have its say in the matter. The DRP has also over-looked this aspect. Another important aspect is the company has shown profit of 50.15% which may have weighed with the Assessing Officer for accepting this company as comparable. Be that as it may since the TPO has not given any opportunity to the assessee to raise its objections with regard to the aforesaid company, we are inclined to remit this issue to the file of the Assessing Officer who shall decide the acceptability or otherwise of the company as comparable after considering the assessee's objections.

3. Asit C Mehta financial services Ltd. (Seg).

6.3.1. The learned authorised representative of the assessee objecting to the aforesaid company being selected as comparable submitted that the employee cost of the company is only 24.78% of its revenue compared to assessee's 56%. The learned authorised representative of the assessee further submitted that in many other cases for asst. year 2008-09 the DRP has excluded this company from the list of comparables. The learned authorised representative of the assessee also relied upon the decisions of Income-tax Appellate Tribunal, Hyderabad Bench in assessee's own case ITA.No.1624/Hyd/10 and S.A.No.210/Hyd/2012 dated 28.06.2013, Avineon India P. Ltd., ITA.No.1989/Hyd/2011 dated 31.10.2013 and Zavata

India P. Ltd., Hyderabad vs. DCIT, Circle 3(3), Hyderabad
ITA.No.1781/Hyd/2011 dated 07.06.2013.

6.3.2 The learned Departmental Representative, on the other hand, supported the orders of the revenue authorities.

6.3.3 We have considered the submissions of the parties and perused the material on record. From the information obtained u/s 133(6) of the Act by the TPO, it is seen that the company has a employee cost of 24.78% compared to assessee's 56%. That besides it is also a fact that the DRP in many similar cases for asst. year 2008-09 has excluded this company. Therefore, considering the totality of facts and the circumstances, we direct the exclusion of the aforesaid company from the list of comparables.

4. Bodhtree Consulting Limited:-

6.4.1 With regard to the aforesaid company, the learned authorised representative of the assessee submitted that the company is functionally different as it is into software services and provide services using the developed products. It was further submitted that in the information submitted in response to the letter issued u/s 133(6) of the Act, it has submitted that the company has developed a software tool used for providing data cleansing services and it involves an element of software development. The company is also engaged in providing e-paper solutions. It was further submitted that the annual report of the company also reveals that it has only software development segment. It was further submitted that the company has undergone re-organisation and cross booking of expenses unlike previous year which has impacted the

profitability. It was submitted that un-audited segmental information has been used to compute margins which may not be authentic.

6.4.2 We have heard rival submissions of the parties and perused the material on record. From the annual report of the aforesaid company as submitted in the paper book, it is seen that the said company earns its revenue from software development. Therefore, as it appears the aforesaid company is functionally different from the assessee. This fact was not properly considered either by the TPO or DRP. We therefore remit the matter back to the file of the Assessing Officer who shall consider the acceptability or otherwise of the company after properly considering the objections of the assessee.

5. Eclerx Services Limited:-

6.5.1 Objecting to the aforesaid company being treated as comparable, the learned authorised representative of the assessee submitted that the company is engaged in providing knowledge process outsourcing (KPO). It was submitted that the assessee is providing data analytics, operations management and audit reconciliation. It was submitted that besides being functionally different from the assessee, the aforesaid company has shown extraordinarily high profit at 88.11% hence cannot be treated as comparable. In support of such contention, the learned authorised representative of the assessee relied upon the decisions of Co-ordinate Bench of Hyderabad Tribunal in cases of Avineon India P. Ltd., ITA.No.1989/Hyd/2011 dated 31.10.2013, Zavata India P. Ltd., Hyderabad vs. DCIT, Circle 3(3), Hyderabad ITA.No.1781/Hyd/2011 dated 07.06.2013, M/s. Capital IQ

Information Systems India Pvt. Ltd., Hyderabad vs. DCIT (Int. Taxation), Hyderabad (ITA No.1961/Hyd/2011 dated 23.11.2012 and also Special Bench decision of the Mumbai Tribunal in the case of Maersk Global Centres (India) P. Ltd., Mumbai vs. ACIT, Circle 6(3), Mumbai dated 07.03.2014.

6.5.2 The learned departmental representative however supported the orders of the revenue authorities with regard to the aforesaid company.

6.5.3 We have heard rival submissions of the parties and perused the material on record. It is seen that in case of Capital IQ Information Systems (supra), the co-ordinate bench accepted the objection of the assessee with regard to the aforesaid company being treated as a comparable by holding that not only the said company is functionally different being engaged in providing KPO services but it has also shown extraordinary high profits. Following the aforesaid decision of co-ordinate bench of Tribunal in case of Capital IQ Information Systems, we hold that this company cannot be treated as comparable.

7. Informed Technologies India Limited and

9. IserVICES India Private Ltd:-

6.6.1 Objecting to the aforesaid companies being treated as comparables, the learned authorised representative of the assessee submitted that both the companies have exceptional year of operation. With regard to Informed Technologies India Limited, it was submitted that the company had shown operating losses of (-)72.98% and (-) 43.96% in the financial year 2004-05 and 2005-06, whereas during the year under

dispute, it has shown operating margin of 35.56% which indicates that this has been an year of exceptional operations. So far as I-services India Private Ltd., is concerned, the learned authorised representative of the assessee submitted that the margin of the company is more than one and half times the arithmetic mean of the comparable companies selected by the TPO. It was further submitted that the company is a private limited company with no information for the prior and future years to evaluate trend is available. The learned Authorised Representative has relied on the order of the Coordinate Bench of Delhi Tribunal in the case of Actis Advisers P. Ltd., in ITA.No.527/Del/2011 for the proposition that companies with significant variation in margins are to be rejected.

6.6.2 The learned departmental representative however strongly supporting the orders of the revenue authorities submitted that the assessee has not raised any objection with regard to the aforesaid companies being treated as comparable either before the TPO or before the DRP. Hence, assessee's contention should not be entertained.

6.6.3 We have considered the submissions of the parties with regard to the aforesaid two companies and perused the material on record. On going through the orders of the TPO as well as DRP, we find the submissions made by the ld. DR to be valid. As can be seen from materials on record, the assessee has not raised any objection either before the TPO or before the DRP in respect of aforesaid companies. However neither the TPO nor DRP has examined why this year the company has exceptional profits. Whether due to mergers or any events or happenings the profit was exceptional require verification. The

assessee has also not made any objection before the authorities. Hence, we are of the view that these two companies are to be reexamined by TPO/AO before being selected as comparables. TPO/AO is directed to consider the objections of assessee and decide the issue afresh.

10. Mold-Tek Technologies Limited:-

6.7.1 Objecting to the aforesaid company being treated as comparable, the learned authorised representative of the assessee submitted that during the year, the company has shown super normal profit of 117.29% compared to the assessee as well as other comparable companies. It was further submitted that apart from having extraordinarily high profit Mold-Tek is also functionally different as it is engaged in providing structural engineering consulting services under the KPO division. It was submitted that M/s Mold Tek is providing highly technical and specialised engineering services and use of information technology is only incidental. The learned authorised representative of the assessee submitted that the Income-tax Appellate Tribunal, Hyderabad Bench considering these aspects has held M/s Mold Tek is not to be treated as comparable in case of M/s Capital IQ Information Systems Pvt. Ltd. (supra). The learned authorised representative of the assessee further submitted that even in assessee's own case for asst. year 2008-09, the DRP has directed for exclusion of M/s Mold-Tek from list of comparables. In support of such contention, the learned authorised representative of the assessee relied upon the decisions of Co-ordinate Bench of Hyderabad Tribunal in cases of Avineon India P. Ltd., ITA.No.1989/Hyd/2011 dated 31.10.2013, Zavata India P.

Ltd., Hyderabad vs. DCIT, Circle 3(3), Hyderabad ITA.No.1781/Hyd/2011 dated 07.06.2013, M/s. Capital IQ Information Systems India Pvt. Ltd., Hyderabad vs. DCIT (Int. Taxation), Hyderabad (ITA No.1961/Hyd/2011 dated 23.11.2012 and also Special Bench decision of the Mumbai Tribunal in the case of Maersk Global Centres (India) P. Ltd., Mumbai vs. ACIT, Circle 6(3), Mumbai dated 07.03.2014.

6.7.2. The learned departmental representative however supported the orders of the revenue authorities.

6.7.3 We have heard contentions of the parties and perused the material on record with regard to the aforesaid company being treated as comparable. As can be seen from the facts on record M/s Mold-Tek during the year had shown extraordinarily high profit of 117%. The activities of M/s Mold-Tek is also found to be functionally different as it is engaged in providing highly technical engineering consultancy services. In case of Capital IQ Information systems (supra) the co-ordinate bench of the Tribunal held as under:-

“13. On careful consideration of the submissions of the assessee we find that the DRP, as already stated earlier, in the proceedings for the assessment year 2008-09 has accepted the assessee’s contention that this company cannot be treated as comparable because of exceptional financial result due to merger/de-merger. In view of the aforesaid, we accept the assessee’s contention that this company cannot be treated as comparable. That apart, it is also a fact that this company has shown super normal profit working out to 113%. The Income-tax Appellate Tribunal, Mumbai Bench in the case of Teva India Pvt. Ltd.(supra) has observed that companies showing supernormal profit cannot be treated as comparable. The relevant observations of the Tribunal in that case are extracted hereunder for convenience-

“32. We have heard the arguments of both the sides and also perused the relevant material on record. It is observed that although a detail submission was made on behalf of the assessee before the learned CIT(A) on the basis of FAR analysis to show that the selection of M/s. Vimta Labs as comparable is not justified, the learned CIT(A) has not accepted the stand of the assessee on the issue without giving any cogent or convincing reasons. In its recent decision rendered in the case of Adobe Systems India Pvt. Ltd. (ITA No.5043/Del/2000 dtd. 21.01.2011) + (2011-TII-13-ITAT-DEL-TP), Delhi Bench of ITAT has held that exclusion of comparables showing supernormal profits as compared to other comparable is fully justified. We, therefore set aside the impugned order of the ld. CIT(A) on this issue and restore the matter to the file of the A.O. with a direction to decide the same afresh after taking into consideration the submissions made by the assessee before the learned CIT(A) and keeping in view the Delhi Bench of ITA in the case of Abode Systems India Pvt. Ltd. (supra).

In this view of the matter, we accept the contentions of the assessee that this company cannot be treated as a comparable. “

As can be seen from the aforesaid finding of the Tribunal M/s Mold-Tek was not treated as comparables as it has shown extraordinarily high profit. It is also a fact that the DRP in assessee's case for asst. year 2008-09 has directed for removal of the aforesaid company from the list of comparables. Therefore, following the decision of co-ordinate Bench in case of Capital IQ (supra), we direct the Assessing Officer to exclude M/s Mold-Tek Technologies Limited from the list of comparables.

11. Vishal Information Technologies Ltd.

6.8.1 Objecting to the aforesaid company being selected as comparable by the TPO, the learned authorised

representative of the assessee submitted before us that the aforesaid company is not only functionally different on account of employee cost filter as the employee cost of the company is only 2% of its revenue, but it also has huge vendor payment for data entry which is indicative of the fact that it does not provide IT enabled services by itself but outsources the work with a third party vendor. It was submitted that the DRP in assessee's own case for AY 2008-09 has rejected this company as comparables. The learned authorised representative of the assessee also relied upon the observation made by the Income-tax Appellate Tribunal, Hyderabad Bench with regard to aforesaid company in cases of In support of such contention, the learned authorised representative of the assessee relied upon the decisions of Co-ordinate Bench of Hyderabad Tribunal in cases of Avineon India P. Ltd., ITA.No.1989/Hyd/2011 dated 31.10.2013, Zavata India P. Ltd., Hyderabad vs. DCIT, Circle 3(3), Hyderabad ITA.No.1781/Hyd/2011 dated 07.06.2013, M/s. Capital IQ Information Systems India Pvt. Ltd., Hyderabad vs. DCIT (Int. Taxation), Hyderabad (ITA No.1961/Hyd/2011 dated 23.11.2012.

6.8.2 The learned departmental representative however supported the orders of the DRP and TPO.

6.8.3 We have heard rival submissions and perused the material on record. In case of Capital IQ Information Systems (India) Pvt. Ltd.,(supra) the co-ordinate bench after considering the objections of the assessee in respect of the aforesaid company held in the following manner :-

“17. After considering the submissions of the learned Authorised Representative for the assessee, we find that the DRP, in the proceedings for the assessment year 2008-09 in assessee’s own case, after taking note of the composition of the vendor payments of Coral Hub for the last three years, and the fact that it has also commenced a new line of business of Printing on Demand(POD), wherein it prints upon clients request, concluded as follows-

“18.4. In view of this major difference in functionality and the business model, this Panel is of the view that ‘Coral Hub’ is not a suitable comparable to the taxpayer and hence needs to be dropped form the final list of comparables.”

In case of ACIT V/s. M/s. Maersk Global service Centre (supra), the ITAT Mumbai Bench has also directed for exclusion of the aforesaid company, by observing in the following manner-

“Insofar as the cases of tulsyan Technologies Limited and Vishal Information Technologies Limited are concerned, it is noticed from their annual accounts that these companies outsourced a considerable portion of their business. As the assessee carried out entire operations by itself, in our considered opinion, these two cases were rightly excluded.”

In view of the observations made by the DRP as well as the decision of the ITAT Mumbai in the case of Maersk Global Service Centre, (supra), we accept that this company cannot be taken as a comparable”.

As could be seen from the findings of the co-ordinate bench, the aforesaid company unlike the assessee has outsourced considerable portion of its business to third party vendor. Hence, it cannot be considered as a comparable. That besides the DRP in assessee’s own case for asst. year 2008-09 has held that this company cannot be treated as a comparable. Therefore, considering the aforesaid fact, we are of the view

that M/s Vishal Information Technology Ltd., cannot be taken as a comparable and direct for excluding the same from the list of comparables.

6. HCL Comnet Systems & Services Limited,

8. Infosys BPO Limited and

12. Wipro Limited:-

6.9.1 Objecting to the aforesaid companies being treated as comparables, the learned authorised representative of the assessee submitted that HCL Comnet System is functionally different as it is engaged in the business of providing telecommunication and remote infrastructure management services. So far as Infosys BPO is concerned, it was submitted that this company cannot be compared with the assessee as there is differences in functions, risks and assets profile. It was submitted that Infosys brand has a premium and hence cannot be considered as comparables to risk mitigated contract service provider which do not own or take risks to develop intangibles. It was further submitted that Wipro Limited is also functionally different as the company owns significant intangibles and hence enjoys premium pricing. It was submitted that 28% of the BPO revenue is from product engineering services. It was further submitted that, manually corrected and unaudited data from its TP report has been considered which cannot be said to be authentic. In support of his contention for excluding the aforesaid three companies as comparables, the learned authorised representative of the assessee relied upon the decision of Capital IQ Information Systems India P. Ltd. vs. Addl. CIT, Circle 1(2), Hyderabad (ITA

No.124/Hyd/2014 and ITA.No.170/Hyd/2014 dated 31.07.2014.

6.9.2 We have heard rival submissions of the parties and perused the material on record. It is not disputed that these three companies are having huge turnovers like that of assessee during the year. Therefore turnover filter as considered in other cases does not apply here. However as submitted the functional profile of companies as such is different. But, if the BPO division is similar to assessee the same can be considered after proper FAR analysis. Therefore we are of the opinion that TPO/AO can reconsider the comparables after giving due opportunity to assess and fairly analyzing its objections. In case the data (segmental or unit) is incomplete or functional profile etc are different AO/TPO should exclude the same. With these observations the issue of selection of these companies as comparables is restored to TPO/AO to do the needful.

7. In ground no 10 assessee is seeking adjustment for differences in functions and risks undertaken. With reference to the risk adjustment, it was the submission of the assessee that assessee functioned under a limited risk environment with most of the risks being assumed by its AEs and comparables selected for analysis include companies which have fairly diversified areas of specialisation, bearing risks akin to any third party independent service provider. Since assessee is operating in a risk mitigated environment vis-à-vis the comparable companies performing entrepreneurial risk taking functions, the assessee seeks adjustment for the risk being taken by the comparable, whose profit would be more

dependent on the risk involved. Since the assessee does not bear any risk of incurring losses and since comparable companies work in the market environment, the margins earned by the comparable companies would be comparatively more to reflect the higher level of functions and risks. It was further submitted that in the TP documentation submitted by the assessee, no risk adjustment was made as comparables selected were within the arm's length range. The assessee relied on a host of cases to submit that adjustment needs to be made to the margins of the comparables to eliminate difference on account of different functions, assets and risks.

7.1. To the extent of principles involved, we agree with the assessee's submissions that some of the comparables may be undertaking market risks/entrepreneurial risks, which are not there in the case of the assessee. However, the issue boils down to quantification of such adjustment. In the written submissions, the assessee based on the decision of the ITAT Bangalore in the case of Philips Software Centre Private Ltd. Vs. ACIT (119 TTJ 721)(Bang), which provided for 4.5% of the risk adjustment as the difference between the average prime lending rate and average bank rate, as the basis. Since this working was not accepted by the ITAT Mumbai Bench in the case of Willis Processing Services India Private Ltd. Vs. DCIT, vide its order dated 17.12.2012 in ITA No.8772/Mum/2010 for assessment year 2006-07. This adjustment of 4.5% cannot be considered based on prime lending rate, which cannot be considered as a market risk adopted. However, the assessee is relying on two more cases of the coordinate Benches in the case of Sony India Ltd. (114 ITD 448)-Del, wherein the Tribunal determined the risk adjustment at 20% of the ALP for

a risk mitigated distributor. It also relied on the decision of the Delhi Bench in the case of Rolls Royce Plc V/s. DCIT (90 SOT 42), wherein it was determined at 35% of the company's profitability allocated towards marketing activities. Therefore, it was submitted that since assessee does not have any marketing activities, a 35% adjustment is warranted for the difference in risks. It also submits that risk adjustment can also be computed under the Capital Asset Pricing Model (CAPM)/Sharpe Model for risk adjustments. In the previous year also matter was restored to TPO/AO in assessee own case. Since the application of the above decisions and facts herein are to be examined vis-à-vis the assessee's business model, we, without giving any direction with reference to the risk adjustment and amount of risk adjustment required, restore the matter to the file of the Assessing Officer to re-examine this adjustment issue afresh, after considering the assessee's submissions and decide the issue in accordance with the principles on the subject.

8. Ground No.12, in TP issues, is with reference to inclusion of reimbursement transactions as part of operational cost. It was submitted that the assessee has paid certain amounts towards travel, air fare and site expenses relating to employees of AE travelling to India for business purposes. Similarly, the AEs also pay certain expenses of the assessee which were reimbursed to the AE. It was the submission of the assessee that these amounts were adjusted at cost, without mark up as the assessee or AE paid the amount on behalf of the other for administrative convenience and no significant additional functions are being performed in these transactions. Even though these transactions are considered as

international transactions for the purposes of TP, since there is no mark up on these reimbursements, it was the submission that TPO failed to appreciate that these transactions are to be excluded for working out the operative costs/operative margins, and it is the request that the amounts of reimbursement should be excluded for this purpose. Assessee relied on the decision of the Delhi Bench of the Tribunal in the case of DCIT V/s. Cheil Communications India P. Ltd. (2010 TII 60 ITAT DEL TP) and the coordinate bench decision of the Tribunal in the case of Four Soft Ltd. V/s. DCIT (ITA No.1495/Hyd/2010)(142 TTJ 358).

8.1 After considering the rival submissions and following the principles laid down in the decisions of the Tribunal cited above, we are of the opinion that reimbursement costs should be excluded as they do not involve any functions to be performed so as to consider it for profitability purposes. In the case of Four Soft Ltd. (supra), Hyderabad Bench of the Tribunal considered this issue and held as under-

“15. We have considered the rival submissions and perused the material on record. First, we will take up the issue relating to the adjustments made by the assessing officer in respect of the international transactions with its associated enterprises in the software development services. It is the contention of the assessee that bad debts incurred by the assessee company are in respect of transactions, which are not related to associated enterprises. This contention of the assessee has not been controverted by the Revenue by bringing any material on record before us. It is the contention of the learned counsel for the assessee that such bad debts cannot be taken into account for computing the margin of the assessee from the transactions with the associated enterprises in respect of software development services. The learned counsel for the assessee has also filed before us a comparative chart explaining the computation of Net Margin, excluding the bad debts and clearly demonstrated before us

that if the bad debts/reimbursements are excluded for the purpose of computing the margins on the transactions relating to the associated enterprises, the net margin comes to 19.07%, which is well comparable with the Arms Length Margin of 19% determined by the Transfer Pricing Officer. In our considered view, for computing the net margin of the assessee for the purposes of transfer pricing, only the cost related to the transaction with the Associated Enterprises has to be considered and accordingly, we approve that segmental financials is to be considered for the purpose of arriving at the net margin on the international transaction with the assessee's enterprise in respect of software development services. In that process, bad debts/reimbursements has to be excluded and segmental profitability has to be adopted. We find support in this behalf from various decisions of the Tribunal relied upon by the learned counsel for the assessee duly filing copies thereof in the paper-book, which have been noted hereinabove. That being so, the TPO should have determined the Arms Length Price for the international transactions with associated enterprises considering only the operating cost allocable to the Associated Enterprises segment. Since the assessing officer had no occasion to verify the veracity of the segmental financials prepared by the assessee company, for limited purpose, we direct the assessing officer to verify the segmental financials prepared by the assessee company and adopt the same for arriving at the net margin on the international transaction with AEs in respect of software development services. We direct accordingly.”

Similar view was also taken in assessee own case in AY2006-07. Respectfully following the same, we direct the Assessing Officer/TPO to exclude the reimbursement costs while working out the operating costs. This ground is considered allowed.

9. In aforesaid view of the matter, we direct the Assessing Officer to determine the ALP keeping in view the directions given by us hereinbefore in respect of each of the comparables specifically objected to by the assessee. Assessee's grounds 1 to 12 are partly allowed.

10. Some of the legal issues raised in the grounds on this TP issue are not agitated before us, as exclusion of some of the comparables only were contested and by excluding them, the PLI determined from the rest of the comparables may fall within permissible range as per proviso to S.92C(2). Some of the issues also become academic in nature, if the ultimate ALP determined is within the permissible range of the assessee's PLI. However, this aspect cannot be examined by us, as the TPO was directed to verify other adjustments required, and therefore, we hold that it is premature to consider the grounds raised in this behalf. The Assessing Officer/TPO is directed to give effect to the provisions of S.92C, after deciding the PLI and ALP and then arrive at proper conclusion. Needless to say, the Assessing Officer /TPO will allow a reasonable opportunity of being heard to the assessee in the fresh proceedings.

Corporate matters.

11. Re-characterisation of foreign exchange gain: During the year, the Assessee has foreign exchange gain of Rs.6,73,55,469 on account of foreign exchange fluctuations accounted in accordance with the Accounting Standard -11 issued by the Institute of Chartered Accountants of India and treated as business income of Unit. AO while computing deduction u/s. 10A of the Act allowed lesser deduction by reducing foreign exchange gain from the profits of the business. DRP in respect of the objections on computation of 10A has held that though they agree with Assessee's positions, relief is not provided so as to provide opportunity to the AO to keep the issue alive.

11.1. The issue is no longer *res integra* and the Hon'ble Special Bench in case of ITO vs Banyan Chemicals P. Ltd., (2009) 310 ITR (AT) 384 (Ahmedabad) has held that foreign exchange gain on account of fluctuation qua exports business is eligible for exemption u/s 10B. Co ordinate bench at Hyderabad Tribunal in assessee's own case for AY 2006-07 held as follows:

"27. Since this issue is no longer res integra and since foreign exchange gain is on account of fluctuations of the foreign exchange received for the services rendered by the assessee, this has to be treated as business income and it has to be considered as profits of the business for computing the deduction under s.10A of the Act. The Assessing Officer is directed to treat accordingly. The ground is considered as allowed. "

The facts being similar, we direct AO to treat Foreign exchange gain as business income and allow the deduction accordingly. Ground 13 is allowed.

12. In ground No.14, assessee has challenged the reduction of communication charges of Rs.5,53,90,914 from the export turnover without reducing it from the total turnover while computing deduction u/s 10A of the Act.

12.1. We have heard submissions of the parties and perused the material on record. This issue is squarely covered in favour of the assessee by the judgment of Hon'ble Bombay High Court in case of CIT vs. Gem Plus Jewellery Ltd (330 ITR 175) and the decision of Income-tax Appellate Tribunal, Chennai Special Bench in case of ITO vs. Sak Soft Limited (313 ITR 353 (AT)]. In fact, the DRP though accepts such position but has decided the issue against the assessee only to give an opportunity to the department to pursue the same. Therefore,

following the decision of Hon'ble Bombay High Court in the case of CIT vs. Gem Plus Jewellery (supra) and of the Income-tax Appellate Tribunal, Chennai Special Bench in case of ITO vs. Sak Soft Limited (supra), we direct the Assessing Officer to reduce communication charges both from the export turnover as well as the total turnover for computing exemption u/s 10A of the Act. This ground No 14 of the assessee is allowed.

13. In ground Nos. 15 and 16, the assessee has challenged levy of interest u/s 234B and 234C of the Act and initiation of penalty proceedings u/s 271(1)(c) of the Act. The issues raised in these grounds being consequential to the final determination of income, these grounds have become infructuous, hence dismissed.

14. In the result, appeal of the assessee is partly allowed for statistical purposes.

Order pronounced in the open Court on 24.10.2014.

Sd/-
(SAKTIJIT DEY)
JUDICIAL MEMBER

Sd/-
(B.RAMAKOTIAH)
ACCOUNTANT MEMBER

Hyderabad, Dated 24th October, 2014

VBP/-

Copy to

1.	HSBC Electronic Data Processing India P. Ltd., Plot No.8, Survey No.64, Hitech City, Hyderabad – 081.
2.	The ACIT, Circle 2(2), I.T. Towers, Masab Tank, 8 th Floor, Hyderabad – 500 004.
3.	Disputes Resolution Panel, Hyderabad
4.	DIT, International Taxation, Bangalore.
5.	D.R. ITAT “B” Bench, Hyderabad.