

WILLIS PROCESSING SERVICES (I) (P.) LTD. vs. DEPUTY COMMISSIONER OF INCOME-TAX

ITAT, BOMBAY TRIBUNAL (K)

Rajendra Singh, AM & VIJAY PAL RAO, JM.

IT Appeal Nos. 4429 & 4547 (Mum.) of 2012

1st March, 2013

(2013) 35 CCH 0472 MumTrib

(2014) 161 TTJ 0025 (Mumbai) : (2014) 100 DTR 0297 (Mumbai(trib)) : (2013) 57 SOT 0339 (Mumbai) : (2014) 30 ITR (Trib) 0039 (Mumbai)

Legislation Referred to

Section 10A, 92C(2)

Case pertains to

Asst. Year 2007-08

Decision in favour of:

Assessee (Partly)

Deduction u/s 10A—New industrial undertakings in free trade zones, etc.—Allowability—Assessee claimed deduction u/s 10A—AO noted from Form No.56F that assessee has computed deduction u/s 10A with reference to number of employees as it was done in last year and not as prescribed in sub-section (iv) of section 10A—AO disallowed claim—AO also excluded 'satellite link charges' and 'technical service fees' from export turnover for purpose of computing deduction u/s 10A—CIT(A) confirmed action of AO—Held, for A.Y. 2006-07, Tribunal held that AO was not justified in rejecting claim of assessee for deduction u/s 10A—AO had not examined apportionment of export turnover and expenses of units—Tribunal set aside issue to examine quantum of deduction after examination of actual apportionment and profit of units eligible for deduction u/s 10A and non-eligible unit respectively—If claim of assessee was allowed for first year, then without withdrawing claim granted for earlier A.Y., revenue cannot deny benefit of section 10A of subsequent years, if there is no change in facts and circumstances—There is no change in facts and circumstances subsequent to first year which could have rendered assessee ineligible for deduction u/s 10A—Claim of assessee cannot be denied in subsequent A.Y.—Satellite charges cannot be considered as 'telecommunication charges' so as to exclude from export turnover—Issue decided in favour of assessee

Held:

For the AY 2006-07, this Tribunal has held that the AO is not justified in rejecting the claim of the assessee for deduction u/s 10A. However, the AO has not examined the apportionment of export turnover and expenses of the units and accordingly, set aside

the issue to examine the quantum of deduction after examination of the actual apportionment and profit of the units eligible for deduction u/s 10A and non-eligible unit respectively.

(Para 5.2)

The CIT(A) has added one more reason for disallowance of the deduction u/s 10A that the assessee does not fulfil the condition as laid down u/s 10A(2) of the IT Act because the assessee has consolidated two existing units into one and thereby a consolidated unit came into existence by reconstruction of the already existing unit. Thus, the CIT(A) has made out a case that two existing units; one eligible for deduction u/s 10A; and another non-eligible unit were consolidated and by virtue of this consolidation, the new consolidated unit came into existence by reconstruction of the existing unit. Hence, it violates the conditions as prescribed under 10A(2)(ii)&(iii) of the Act.

(Para 5.3)

There is no dispute on the legal proposition on the issue of denial of the deduction, if the deduction was allowed in the first year, then for the subsequent AY, the AO cannot disallow the claim of the assessee without disturbing the order of the earlier year, more specifically first year, when eligibility of the new establishment/unit has to be tested.

(Para 5.4)

If the claim of the assessee was allowed for the first year, then without withdrawing the claim granted for the earlier AY, the revenue cannot deny the benefit of sec. 10A of the subsequent years, if there is no change in the facts and circumstances, which were in existence during the first AY and the assessment in which the claim has been denied. Hence, in case there is no change in the facts and circumstances subsequent to first year which could have rendered the assessee ineligible for deduction u/s 10A, the claim of the assessee cannot be denied in the subsequent AY when the claim is accepted for the first Asst. Year.

(Para 7)

However, in the case of the assessee, the CIT(A) has pointed out a new aspect to the issue for the first time during the AY under consideration that the assessee has formed a consolidated unit by restructuring of two existing units. But this fact is not clear from the record whether this new development had occurred during the year under consideration or it was already in existence right from the first year of assessment.

(Para 7.1)

Since it is not clear whether the non-eligible unit at Andheri was still in existence or closed by the assessee to bring into existence the alleged consolidated unit as held by the CIT(A); therefore, this fact is required to be examined by considering inter alia the number of employees working in the two units when the new unit was established by the assessee at vikroli only after comparing the number of employees and machinery installed in both the units, it can be determined whether the two existing units were merged and consolidated to bring into existence a new unit and thereby a new unit has been set up by restructuring of the existing unit during the year under consideration. Accordingly, on both the aspects; one considered by the Tribunal in the AY 2006-07; and the other one which has been brought out by the CIT(A) for the first time during the year under consideration, the matter was remanded to the records of the AO for

examination, verification and then decide the issue as per law.

(Para 8)

Though the AO denied the claim of deduction u/s 10A; however, alternatively, the AO has also reduced the satellite link charges of Rs. 50,00,615/- and technical service fee of Rs. 1,03,01,183 from export turnover while computing the deduction u/s 10A. The CIT(A) has held that once the issue of deduction u/s 10A has been decided against the assessee, then this ground of appeal has become consequential.

(Para 8.2)

This issue has been considered and decided by this Tribunal in assessee's own case for the AY 2006-07 wherein it was held that the satellite charges cannot be considered as 'telecommunication charges' so as to exclude from the export turnover. Following the earlier order of this Tribunal, this issue was decided in favour of the assessee and against the revenue.

(Para 9 & 9.1)

Conclusion:

If the claim of the assessee was allowed for the first year, then without withdrawing the claim granted for the earlier AY, the revenue cannot deny the benefit of sec. 10A of the subsequent years, if there is no change in the facts and circumstances, which were in existence during the first AY and the assessment in which the claim has been denied

Satellite charges cannot be considered as 'telecommunication charges' so as to exclude from the export turnover for the purpose of computing deduction u/s 10A.

In favour of:

Assessee (Partly)

Transfer pricing adjustment—Arm's Length Price—Selection of comparables—Assessee was providing information Technology enabled Services (ITES) to its overseas AEs namely Tyrinty Processing Services Ltd. (TPSL), UK and Willis Processing Services Inc., USA—Assessee furnished TP report in support of arm's length price (ALP) of 10.54% by adopting TNMM as most appropriate method and using PLI as operating profit to cost for benchmarking its international transactions after considering three years weighted average margins which comes to 9.90%—Assessee selected 11 companies as comparables and claimed that its cost plus margin is 10.54% which is more than comparables cost plus margin of 9.90% and accordingly, its international transition is at ALP—TPO did not agree with computation of margin of comparables by considering three years weighted average cost plus margin and proposed to consider updated single year data of comparable which gives average margin of 16.82%—Out of 11 comparables selected by assessee, TPO rejected 3 comparables on ground of functionally different; whereas one was rejected due to non availability of data—TPO was of the view that 8 companies provided in TP study were not adequate and accordingly selected a set of 25 comparables of ITES—Thereafter upward adjustment was made to ALP—CIT(A) confirmed action of TPO/AO as far as the inclusion of 21 comparables and rejected one comparable—Held, under TP regulations, there is no embargo on powers of TPO in carrying out fresh search for gathering more relevant

information, documents etc., while determining ALP in relation to international transactions—Under Transfer Pricing Regulations, number of comparables may be one or more than one; but there is no upper limit prescribed u/s 92C—Size of number of comparables has not been prescribed under provisions of TP Regulations—Sufficiency of number depend largely on availability of comparables—Where number of comparables available is large, then it is always better to consider as many as possible number of comparables which can give an adequate and proper representation of price prevailing in open market in said industry, business, trade etc., to which comparables and international transactions belong—Tribunal remitted matter back to AO/TPO for considering selection of some comparables as per its observations—Issue regarding risk adjustment and working adjustments were also remanded to record of AO/TPO for verification and adjudication as per law after considering rival submissions—Matter remanded

Held:

As per the provisions of sec. 92CA(3), the TPO has jurisdiction/power to gather and consider all relevant material and information apart from the evidence, information and documents produced by the assessee as required u/s 92D(3) to determine the ALP in relation to the international transaction.

(Para 14)

Sub sec. (7) of sec 92CA empowers the TPO for the purpose of determining the ALP to exercise any of the powers specified in clause (a) to (d) of sub. sec. (1) of sec 132 or sub. sec. (6) of sec 133 or 133A. Thus, under the TP regulations, there is no embargo on the powers of the TPO in carrying out fresh search for gathering more relevant information, documents etc., while determining the ALP in relation to international transactions.

(Para 14.1)

The assessee has challenged the action of the TPO on the ground that after accepting 8 comparables selected by the assessee, the TPO is not justified in carrying out fresh search and adding 22 more comparables. The contention of the Id. Sr. counsel is based on the logic that the 8 comparables, as selected by the assessee and accepted by the TPO, are more than sufficient for determination of the ALP and therefore, there was no requirement, which justified the fresh search carried out by the TPO in inclusion of 22 more comparables.

(Para 14.2)

The proposition advanced by the assessee cannot be accepted because there cannot be a fixed number of comparables to be considered as sufficient or appropriate number for determination of the ALP as a general parameter. The sufficient number of comparables depends upon the facts and circumstances of the each case and there cannot be a fixed criteria or parameter for number of comparables, which can be universally applied to each and every case for determination of the ALP. It is an accepted rule of sampling that larger size of sample would better and adequate represent the lot or population to which the sample belongs. Therefore, to get an adequate result and better representation, the size of sample must be large enough. The same rule is applicable in the case of number of comparables selected for representing the true and correct ALP in relation to the international transaction. The endeavour should be made to bring more and more comparables so that a proper and realistic price can be determined which represents the

price prevailing in the open market.

(Para 14.3)

Under the Transfer Pricing Regulations, the number of comparables may be one or more than one; but there is no upper limit prescribed u/s 92C of the I T Act. However, the first proviso to se.92(2) indicates that more than one price can be considered for determination of ALP and in such a case, the ALP shall be taken to be arithmetic mean of such price. Therefore, the size of number of comparables has not been prescribed under the provisions of TP Regulations provided under the I T Act. However, the sufficiency of number depend largely on the availability of the comparables where the number of comparables available is large, then it is always better to consider as many as possible number of comparables which can give an adequate and proper representation of the price prevailing in open market in the said industry, business, trade etc., to which the comparables and international transactions belong.

(Para 14.4)

Comparables selected by the TPO: Accentia Technologies Ltd:

The assessee has raised the objection against this company because of the alleged merger/amalgamation.

(Para 18)

If extra ordinary events like merger and de-merger or amalgamation took place during the financial year relevant to the AY under consideration, and because of the merger/de-merger the company became functionally different then the said company should be excluded from the comparables. However, if the merger of the two functionally similar companies took place then the event of merger itself cannot be taken a factor for exclusion of the said comparable.. Accordingly, the AO/TPO were directed to verify this fact and accordingly decide the comparability of this company.

(Para 18.3)

Allsec Technologies:

The AR has submitted that this company is having related party transaction constituting 17.77% of the total revenue. Therefore, this company should not be considered as a comparable.

(Para 20)

As per the TP regulations, the international transaction is required to be compared with a similar; but uncontrolled transaction between unrelated parties. Therefore, as a rule of prudence, so far as possible a comparable should be considered having no related party transaction. But as we are conscious and aware of the fact that such a situation is highly impractical and almost impossible to have a comparable without a single related party transaction. Therefore, related party transaction cannot be completely ruled out while selecting the comparables. The question arises as how much and to what extent related party transaction can be accepted for considering the company as a good comparable.

(Para 21)

The Benches of Tribunal have taken divergent view in various decisions and held that an

entity can be taken as uncontrolled, if its related party transaction ranging from 0 to 25% of the total revenue. In the majority of the cases, the range of related party transaction has been considered between 10 to 15% of the total revenue. It is discernible from the different views taken by the Tribunal in these decisions that there cannot be a fixed criteria/parameter which can be applied as a filter in respect of related party transactions for considering an entity as uncontrolled for the purpose of determination of the ALP.

(Para 21.7)

0% related party transaction is an impossible situation and therefore, it is practically not possible to find out a comparable having no related party transaction. Therefore, a reasonable percentage of the total revenue from the related party transaction can be considered for selecting an uncontrolled comparable. There cannot be a single criteria/parameter which can be applied as general rule in all the cases. The related party transaction ranging from 10 to 25% of the total revenue can be considered having regard to the facts and circumstances of the given cases, 10% is the lowest limit and can be taken in the case where abundance number of comparables are available. Therefore, when there is no difficulty in searching the comparables, then the entity having more than 10% of the related party transaction should be excluded because the comparable should be an uncontrolled transaction and therefore, so far as it is possible, its result should not be influenced by related party transaction. In the normal circumstances, where a good number of comparables are available, then the limit of related party transactions should be 15% of the total revenue and in such case, an entity can be considered as uncontrolled, if related party transactions do not exceed 15% of the total revenue.

(Para 21.8)

15% is an average and should be generally accepted in normal cases as a related party filter. In cases where comparables are not available in sufficient number, then this threshold limit of related party transaction can be relaxed to 20% of the total revenue.

(Para 21.9)

The relaxation upto 20% is purely with a view to make it possible that a larger number of entities are taken as comparable so that the ALP so determined should be based on a broad based and technically represents price in the free market. In a extreme case where only one or few comparables are available, then an entity having related party transactions not exceeding 25% of the total revenue can be considered so that the ALP should be determined having comparison broad based, though this extreme limit of 25% can be considered only in exceptional cases.

(Para 21.10)

In the case in hand, as it is evident that the TPO has found sufficient number of comparables and finally took 30 companies as comparables; therefore, this case does not fall under the category of exceptional cases where criteria of related party transactions can be relaxed more than 15% of the total revenue of the entity. Hence, in the case in hand, when there is no shortage of comparables, an entity can be considered as uncontrolled, if the related party transaction do not exceed 15% of the total revenue.

(Para 21.11)

Having applied this criteria, the company Allsec Technologies Ltd. having related party

transactions constituting 17.77% of the total revenue would be excluded from the comparables on this ground alone. The DR has pointed out that the percentage of related party transaction as given in the financial record of the company is in respect of the total business revenue and segment wise results from ITES segments are not available. Therefore, it cannot be said that whether related party transactions constituting 17.77% of the total revenue is proportionally equal in respect of the revenue from ITES segments. It is to be noted that the TPO has not taken segment results of this company; but margin and results are taken on the entity level; therefore, having more than 15% of the revenue from related party, this company deserves to be excluded from the comparable.

(Para 21.12)

Since this company is deriving income from export of software and ITES and segment results are not available; therefore, it is not possible to consider this company as a functionally comparable. Hence, in the absence of segment results, this company has to be excluded from the comparables.

(Para 24)

Apollo Healthstreet Ltd:

Undisputedly, in the case of Apollo Healthstreet Ltd., the related party transaction is about 81% of the total turnover; therefore, this company cannot be considered as comparable, solely on the ground of very high percentage of related party transactions to the total turnover. Accordingly, this company has to be excluded from the comparables.

(Para 25)

Asit C Mehta Financial Services Ltd:

The AR has submitted that this company is functionally not comparable with the assessee because it was into software products which included provision of software services. He submitted that the TPO itself has recorded the profile of the company, as software. Apart from this, the AR has submitted that this company had related party transactions of 15.17% of the total revenue. Therefore, this company should be excluded from the comparables.

(Para 26)

Though, the TPO has taken the entity level results in the case of this comparable; however, the DR has brought the details, which show that the income from ITES is about 96% of the total revenue. Therefore, as far as the functional comparability of this company is concerned, this company is functionally comparable with the assessee.

(Para 27)

Moreover, when segment results are available, then the same can be taken into consideration for the purpose of determination of the ALP. As regards the related party transactions are concerned, since the related party transactions are in respect of the total business and it is not clear as how much percentage of the related party transactions is in the ITES segment. Therefore, this matter is required verification and examination on the facts as brought by the DR. Accordingly, this comparable was remitted to the record of the AO/TPO to reconsider the same after taking into account

the segment results and related party transactions in ITES segments and accordingly decide the comparability of this company.

(Para 27.2)

Eclerx Services Ltd.

The AR has submitted that this company cannot be considered as comparable because of having super normal profit and Knowledge Processing outsourcing (KPO).

(Para 34)

The factors for determining inclusion or exclusion of any case in the list of comparables are specifically provided under Rule 10B(2). Therefore, unless and until there are specific reasons and factors as provide under the Rule 10B, an entity cannot be excluded or eliminated from the list of comparables solely on the basis of high profit making unit or loss making unit because no such factor finds place either in Rule 10B(2) or 10B(3) of IT Rule.

(Para 34.4)

Even the loss making or high profit making comparables that satisfy comparability analysis should not be rejected on the sale basis that they suffers loss or earned high profit.

Inclusion and exclusion of the comparables cannot be decided on the basis of the factors other than the factor specified under Rule 10B(2). Hence, the objections of the assessee cannot be accepted that because of the abnormal profit margin this company should be rejected as a comparable.

(Para 34.8)

Genesys International Corporation Ltd.

The AR of the assessee has submitted that this company was engaged in the business of software services and I T consultancy services and hence, should be rejected as a comparable. He has referred the order of the TPO and submitted that the TPO itself has recorded in the impugned order that this company has software service and IT consultancy services.

(Para 37)

As far as the functional comparability of this company is concerned, it is clear from the annual report of this company that this company is engaged in the business of GIS activity. As per the notification no. SO 890(E) dt 26.9.2000 of CBDT, GIS is one of the ITES notified by the Board. When GIS is notified ITES/product, then undisputedly, this comparable and the assessee both are engaged in the ITES services; therefore, there is no substance or merit in the contention of the AR that this company is functional different and cannot be considered as a comparable.

(Para 38)

Informed Technologies India Ltd.

The AR of the assessee has argued that this company undertakes substantial marketing expenditure and hence making it functionally not comparable with the assessee because the assessee does not incur any expenditure by way of marketing as the marketing activities are executed by parent company. He has further submitted that this company is having related party transactions constituting 14.99% of the total turnover.

(Para 44)

As far as related party transactions constituting at 14.99% of the total revenue, in view of our finding on this issue of related party transactions, it is within the range of 15%; therefore, this comparable cannot be excluded on this ground alone.

(Para 45)

Marketing expenditure shown by this company is otherwise not giving material effect on the price or cost charged or paid or profit arising from the operation of that company. Therefore, in the absence of any such factor or criteria provided under Rule 10B(2), a comparable cannot be excluded on the ground of marketing expenditure, which is not so material as to influence the profit margin significantly. Further, such a factor, if at all, may be considered for an appropriate adjustment as per Sub-rule 3 of Rule 10B subject to the fulfilment of the conditions provided therein.

(Para 45.1)

In the case in hand, the assessee has not brought out a case that advertisement and marketing expenditure is very high in relation to the turnover of the said company. Accordingly, this objection of the assessee is rejected.

(Para 45.3)

Infosys BPO Ltd & Wipro Ltd.

The AR submitted that due consideration should be given to the fact that the company possesses brand value which will directly impact the margins of the company. He has further submitted that the turnover of this company was very high in comparison to the assessee. Therefore, this company cannot be considered as a good comparable.

(Para 46)

In the case of Genesys Integrating Systems India P. Ltd.. (supra), the Tribunal has made a classification of company is having turnover of Rs. 1 crore to Rs 200 crores as the comparable range of size of companies and further from Rs. 200 crores to Rs. 2000 crores as another slab of turnover. This classification is based on Dun & Bradstreet having given different ranges of size of companies i.e. large, medium and smaller. Such classification by Dun & Bradstreet was not made in the context of comparables under TP Regulations.

(Para 47.2)

It is pertinent to note that as per this classification of the company on the basis of turnover from Rs. 1 crore to Rs. 200 crores, an entity having Rs. 1 crore can be compared with an entity having Rs.200 crores turnover ; but at the same time, an entity having Rs. 200 crores turnover cannot be compared with the entity having Rs. 201

crores turnover. Thus, this classification gives unrealistic result as far as the comparability of two entities having difference of Rs. one crore only cannot be compared. In our view for the purpose of comparing the profit margin of functionally similar entity the classification of such slab range is not practically workable. Therefore, as it is apparent from this classification that two entities can be compared having difference in the turnover upto Rs.199 crores; but at the same time, cannot be compared even if the difference of turnover of one cr. Therefore, with due respect, such classification of comparables on the basis of fixed slabs of turnover cannot be accepted.

(Para 47.3)

Further, as brought to our notice by the DR through the details and graphic chart there is no direct proportionate relation between the turnover and margin.

(Para 47.4)

The turnover is not a criteria as prescribed under the Rule 10B(2) for selecting the comparables. It is settled proposition that the decisive factor for determining inclusion or exclusion of any case as a comparable are prescribed under Rule 10B(2) which does not specify any such factor of turnover on the basis of which a particular case can be included or excluded in the list of comparables.

(Para 47.5)

When the assessee has not made out a case as how the high or low turnover has influenced operating margin and on the contrary there is no direct relation between the turnover and margin as clear from the details and graphic chart reproduced above, then a comparable cannot be rejected solely on the basis of high turnover. Even otherwise, the larger turnover and size of the entity may has an impact of economical cost of production in the manufacturing industry due to huge cost of fixed asset but not in service sector.

(Para 47.7)

Risk Adjustment And Working Capital Adjustments

The AR has submitted that the TPO as well as the CIT(A) did not consider the submissions regarding the risk adjustment and working in capital adjustment. He has further submitted that for the AY 2006-07, this Tribunal in assessee's own case has accepted that the adjustment with respect to risk and working capital were to be given but remanded the issue to the AO for quantification.

(Para 57)

It is thumb rule of business and commerce that more risk is related to more anticipated/expected profit. However, the actual return may or may not directly depend upon the degree of risk assumed in a particular business.

(Para 58)

As per UN manual of Transfer pricing risk adjustment must be made carefully and only when a reasonable and accurate adjustment is possible and not merely on the basis of notion or presumption.

(Para 58.1)

This Tribunal time and again has observed in the decisions as relied upon by the DR that any adjustment can be made only when it is proved on the basis of actual risk or any other factor by proper data and accurate calculation. No adjustment can be made on adhoc basis but it should be based on some tangible material and accurate calculation of quantification of the comparative risk.

(Para 58.2)

Accordingly, the issue regarding risk adjustment and working adjustments were remanded to the record of the AO/TPO for verification and adjudication as per law after considering the rival submissions.

(Para 58.3)

Revenue has raised a ground regarding deletion of comparable namely Vishal Information Technology Ltd., which has been deleted by the CIT(A). The CIT(A) has excluded this comparable on the ground that this company outsourcing its business and the employees cost is less than 1% of the total cost. The CIT(A) has followed the decision of the Tribunal in the case of Asstt. CIT v. Maersk Global Service Center (India) (P.) Ltd. wherein the Tribunal has observed that this company has outsourced a considerable portion of business and therefore, cannot be compared with an entity which is carried out the entire operation itself.

(Para 61)

As it is clear from the letter which was addressed to the TPO Chennai in response to the notice us 133(6) that the said information was not sought by the TPO of the assessee and therefore, this information has not been considered by the lower authorities.

(Para 63)

CIT(A) while rejecting this comparable has not examined the relevant evidence in respect of this fact whether this company has outsourced majority of its business or used 80% of seat capacity. Therefore, in the interest of justice, this comparable was remanded to the record of the AO/TPO for proper examination of the relevant facts and then decide the comparability of this company as per law.

(Para 63.1)

Conclusion:

Under the TP regulations, there is no embargo on the powers of the TPO in carrying out fresh search for gathering more relevant information, documents etc., while determining the ALP in relation to international transactions. Under the Transfer Pricing Regulations, the number of comparables may be one or more than one; but there is no upper limit prescribed u/s 92C.

In favour of:

Assessee (Partly)

Case referred to

CIT vs. Paul Brother (1995) 216 ITR 548

CIT vs. Western Outdoor Interactive (P.) Ltd.

CIT vs. P. Muncherji and Co. (1987) 167 ITR 671

Russell Properties Pvt. Ltd. vs. A. Chowdhury, Addl. CIT (1977) 109 ITR 229

Saurashtra Cement and Chemical Industries Ltd. vs. CIT (1980) 123 ITR 669)

Counsel appeared:

F.V. Irani for the Appellant.: Ajit Kumar Jain and Ms. Sasmita Misra for the Respondent.

ORDER

VIJAY PAL RAO, JM. :
