

SYMPHONY MARKETING SOLUTIONS INDIA P. LTD. vs. INCOME TAX OFFICER

ITAT, BANGALORE TRIBUNAL (C)

N. BARATHVAJA SANKAR, VP & N. V. VASUDEVAN, JM.

IT(TP)A No. 1316/Bang/2012

14th August, 2013

(2013) 37 CCH 0253 BangTrib

((2013)) 27 ITR (Trib) 0753 (Bangalore)

Legislation Referred to

Section 92, 10A

Case pertains to

Asst. Year 2008-09

Decision in favour of:

Assessee

Transfer Pricing—Arm's Length Price—Selection of comparables—Assessee, a wholly owned subsidiary of SMS, USA provides market analytics and data management services to the customers of SMS, USA—During the previous year, the assessee rendered ITES to its AE—Assessee in its TP study justifying the amount received from AE at arm's length, selected TNMM as most appropriate method and adopted net profit margin realized in relation to cost at 14.91%—Assessee identified 9 comparable companies to arrive at the arithmetic mean of 14.84%—Since PLI of Assessee was within +/- 5% range of arithmetic mean of the 9 comparable, assessee claimed price charged at arm's length—TPO accepted two companies out of 9 comparables chosen by assessee and rejected remaining seven comparables and proposed 18 more comparables—TPO after giving adjustments towards working capital adjustment arrived at an arithmetic mean of 22.28% and determined the adjustment to be made to income of assessee—DRP dismissed appeal of assessee—Held, considering the functionality of each of the comparables on individual basis, comparables selected by TPO were not functionally comparable to the assessee—Comparables providing KPO services or having abnormally higher profits because of extraordinary events are to be excluded—Comparables which are not only a market leader but also employing sheer breadth in terms of economies of scale and diversity and geographical dispersion of customers should be excluded from list of comparables—PLI of remaining comparable companies after excluding the above companies was only 7.97% as compared to that of assessee at 14.91%—Therefore no adjustment to ALP is called for Addition made by AO, as sustained by DRP was directed to be deleted—Assessee's appeal allowed.

Held:

(1) Accentia Technologies Ltd. (Sea.)

It is clear that during the previous year there were extra ordinary events that took place in this company which warrants exclusion of this company as a comparable. Therefore, this company cannot be considered as a comparable.

(Para 11)

(2) Acropetal Technologies Ltd. (Sea.)

On a perusal of the Note No.15 of notes to accounts which gives segmental revenue of this company, it is clear that the major source of income for this company is from providing Engineering Design Service and Information Technology Services. The functions performed by the Engineering Design Services segment of the company cannot be considered as comparable to the ITES/BPO functions performed by the Assessee. The performance of Engineering Design Services is regarded as providing high end services among the BPO which requires high skill whereas the services performed by the Assessee are routine low end ITES functions. Therefore, this company could not have been selected as a comparable, especially when it performs engineering design services which only a Knowledge Process Outsourcing [KPO] would do and not a Business Process Outsourcing [BPO].

(Para 13)

(3) Coral Hubs Ltd.

As far as this company is concerned, it is seen that this company was earlier known as Vishal Information Technologies Ltd. The comparability of this company in the case of an ITES company by name 24 x 7 Customer.com Pvt. Ltd. was considered by the Tribunal in ITA No.227/Bang/2010 and by order dated 09.11.2012 the Tribunal held that this company is not functionally comparable with ITES. Following the decision of the Tribunal referred to above, it was held that Coral Hubs Ltd. cannot be considered as a comparable. It is also further noticed that the employee cost/operating sales of this company is a mere 3%, whereas the threshold limit for acceptance as a comparable on the basis of employee cost to sales should be at least 25%. Accordingly, Coral Hubs Ltd. cannot be considered as a comparable.

(Para 14-17)

(4) Crossdomain Solutions Ltd.

The business of Cross Domain ranges from high end KPO services, development of product suites and routine low end ITES service. However, there is no bifurcation available for such verticals of services. Therefore the assessee contends that Cross Domain cannot be compared to a routine ITES service provider.

(Para 18)

In the absence of any reasons given to the contrary either by the TPO or the DRP for regarding this company as a comparable, this company should be excluded from the list of comparables, accepting the plea of the Assessee.

(Para 19)

(5) Eclerx Services Ltd.

This Tribunal in the case of Capital IQ Information Systems India Pvt. Ltd. (supra) had an occasion to deal with comparability of this company in the case of an ITES company such as the Assessee and the Tribunal held that this company cannot be taken as a comparable both for the reasons that it was having supernormal profit and it is engaged in providing KPO services, which is distinct from the nature of services provided by the assessee.

(Para 20)

In the light of the decision of the Hyderabad Bench, this company cannot be regarded as a comparable for the reason that it was functionally different.

(Para 21)

(6) Genesys International Corporation Ltd.

As far as this company is concerned, the stand of the assessee has been that this company is functionally not comparable and that it has a different employee skill set and that this company performs R&D services and also owns intangibles. This company is a geospatial services content provider specialising in land based technologies. From the notes to accounts of this company, it is seen that this company is engaged in providing geographical information services comprising of photogrammetry, remote sensing cartography, data conversion related computed based services and other related services. Further the business of this company requires skilled manpower and scientists, civil engineers, etc. The assessee is a routine ITES provider who does not require such highly skilled employees. Besides the above, this company also carries out R&D services and own intangibles. The aforesaid facts, will take this company out of the list of comparables. The objection of the assessee in this regard has been disregarded by the TPO by mere observation that it cannot be rejected on the basis that it is into different functional line within ITES.

(Para 22)

Among the ITES companies there is a hierarchy in terms of skill required to provide services. It ranges from providing routine services where no skills are required and providing services where highly professionalized skills are required. Depending on the skills required to perform ITES the comparability has to be done. In view of the above, this company cannot be regarded as a comparable and deserves to be excluded from the list of comparables.

(Para 23)

(7) Infosys BPO Ltd

Infosys BPO is an established player who is not only a market leader but also a company employing sheer breadth in terms of economies of scale and diversity and geographical dispersion of customers. The presence of the aforesaid factors will take this company out of the list of comparables. Therefore this company cannot be regarded as a comparable.

(Para 24)

(8) Mold-tek Technologies Ltd.

This company is also engaged in providing a host of engineering services like civil and structural engineering services, mechanical product design, plant engineering, IT services and GIS services. This company is to be classified as KPO and cannot be compared with the assessee. Therefore, it was directed to exclude this company from the list of comparables.

(Para 25)

(8) Wipro Ltd.

This company owns substantial intellectual property on software products. This company cannot therefore be regarded as a comparable. For the reasons given while disregarding Infosys BPO Ltd. as a comparable, this company was also directed to be excluded from the list of comparables.

(Para 26)

It can be seen that the arithmetic mean of profit margin to cost of the remaining comparable companies chosen by the TPO after excluding the aforesaid companies is only 7.97%. The profit margin to cost of the Assessee is 14.91% which is much higher than the arithmetic mean of the comparable companies chosen by the TPO (after exclusion of some of the comparable companies chosen by the TPO for reasons set out in the earlier paragraphs). Therefore no adjustment to ALP is called for. Therefore, the addition sustained by the DRP deserves to be deleted and is accordingly directed to be deleted.

(Para 28)

Conclusion:

Functionally different companies and companies providing KPO services or having abnormally higher profits, companies which are market leader and with economies of scale and diversity and geographical dispersion of customers should be excluded from list of comparables.

In favour of:

Assessee

Case referred to

Capital IQ Information Systems India Pvt. Ltd. vs. DCIT (2013) 32 Taxman.com 21 (Hyd. Trib)
Asstt. CIT vs. Maersk Global Service Centre (India) (P.) Ltd. (2011) 133 ITD 543/16 taxmann.com 47 (Mum.)
CIT vs. Tata Elxsi Ltd (2012) 349 ITR 98 (Karn)

Counsel appeared:

K. R. Vasudevan, Advocate for the Appellant.: Priscilla Singsit, CIT-III(DR) for the

Respondent

ORDER

N. V. VASUDEVAN, JM. :

1. This appeal by the assessee is against the order dated 31.07.2012 passed by the ITO, Ward 12(2), Bangalore u/s. 143(3) r.w.s. 144C of the Income-tax Act, 1961 [hereinafter referred to as "the Act" in short"] relating to assessment year 2008-09.

2. Ground No.1 is general in nature and calls for no adjudication. Grounds 2.1 to 2.9 raised by the assessee are with regard to the adjustment to the Arm's Length Price (ALP) of an international transaction entered into by the assessee with its Associated Enterprises [AE] under Sec.92 of the Act.

3. The assessee is a company which is wholly owned subsidiary of SMS, USA and was formed through a spin off from **Symphony** Services Corporation Pvt. Ltd. [SSCPL]. The assessee provides market analytics and data management services to the customers of SMS, USA. During the previous year, the assessee rendered Information Technology Enabled Services [ITES] to its AE. As required under the provisions of section 92 of the Act, income arising from international transaction with AE has to be computed having regard to the arm's length price [ALP].

4. The assessee filed a transfer pricing [TP] study justifying the amount that it received for providing ITES to its AE as one at Arm's Length. The assessee received a sum of Rs.43,88,05,684 from its AE for providing ITES. The assessee in its TP study justifying the amount received from its AE is at arm's length, selected the Transactional Net Margin Method [TNMM] as the most appropriate method. The assessee adopted net profit margin realized by it in relation to the cost at 14.91%, which is as per

Annexure-I to this order. The assessee identified 9 comparable companies to arrive at the arithmetic mean of 14.84% as follows:-

Sl. No.	Name of the company	Unadjusted Margins			
		2006	2007	2008	Average
1	B N R Udyog Ltd.	19.86%	7.95%	NA	13.91%
2	Cosmic Global Ltd.	16.92%	12.04%	NA	14.48%
3	Datamatics Technologies Ltd.	7.13%	30.67%	NA	18.90%
4	Informed Technologies India Ltd.	44.85%	32.34%	NA	- 6.25%
5	Maple Esolutions Ltd.	31.74%	34.32%	NA	33.03%
6	Nittany Outsourcing Services Pvt. Ltd.	13.12%	11.58%	NA	- 0.77%
7	Sparsh B P O Services Ltd.	2.18%	5.63%	NA	3.90%
8	Transworks Information Services Ltd.	19.73%	12.81%	NA	16.27%
9	MCS Ltd.	18.00%	13.58%	NA	15.79%
	Arithmetic Mean (Simple Average)	6.40%	17.88%	NA	12.14%
	Lower Quartile	2.18%	11.58%	NA	3.90%
	Median	16.92%	12.81%	NA	14.48%
	Upper Quartile	19.73%	30.67%	NA	16.27%

5. Since the net profit margin to cost of the Assessee was within +/- 5% range of the arithmetic mean of the 9 comparable, the Assessee claimed that the price charged by the assessee for providing ITES to its AE should be considered as at arm's length.

6. The TPO accepted two companies viz., Cosmic Global and Datamatic Technologies Ltd. out of the 9 comparable companies chosen by the assessee as comparable. With regard to the other 7 companies, the TPO rejected the claim of the assessee that those companies were comparable with that of the assessee. The TPO finally proposed 18 more comparables and despite objection by the assessee with regard to its comparability, adopted them as comparable companies. The final set of 20 comparables chosen by the TPO and their arithmetic mean of net profit margins on cost of those comparable was as follows:-

Sl.No.	Name of the company	OP/TC %
1	Accentia Technologies Ltd. (Seg.)	41.77
2	AcropetalTechnologies Ltd. (Seg.)	35.30
3	Aditya Birla Minacs Worldwide Limited (Earlier known as Transworks Information Services Ltd.)	- 4.00
4	Asit C Mehta Financial Services Ltd. (Seg.)	9.42
5	Caliber Point Business Solutions Ltd.	10.97
6	Coral Hubs Ltd. (Earlier known as Vishal Information Technologies Ltd.)	50.68
7	Cosmic Global Ltd.	23.30
8	Crossdomain Solutions Ltd.	27.03
9	Datamatics Financial Services Ltd. (Seg.)	29.11
10	e4e Healthcare Solutions Ltd. (Formerly known as Nittany Outsourcing Services Pvt. Ltd.)	18.54
11	Eclerx Services Ltd.	58.80
12	Genesys International Corporation Ltd.	47.40
13	Infosys BPO Ltd.	19.66
14	IServices India Pvt. Ltd.	10.77
15	Jindal Intellicom Pvt. Ltd.	- 10.29
16	Mold-Tek Technologies Ltd.	96.66
17	R Systems International Ltd. (Seg.)	4.30
18	Spanco Ltd. (Seg.) [Earlier known as Spanco Telesystems & Solutions Ltd.]	8.81
19	Wipro Ltd. (Seg.)	30.05
20	Allsec Technologies Limited	- 13.29
	AVERAGE	24.75

7. The TPO after giving adjustments towards working capital adjustment arrived at an arithmetic mean of 22.28% and determined the adjustment to the ALP as follows:-

4.4 Computation of Arms Length Price:

The arithmetic mean of the Profit Level Indicators is taken as the arms length margin. (Please see Annexure B for details of computation of PLI of the comparables). Based on

this, the arms length price of the software development services rendered by the taxpayer to its AE(s) is computed as under:

Arm's Length Mean Margin on cost	24.75%
Less: Working Capital Adjustment (as per Annexure-C)	2.47%
Adjusted mean margin of the comparables	22.28%
Operating Cost	38,81,85,932
Arms Length Margin	122.28% of the Operating Cost
Arms Length Price (ALP) @ 122.28% of Operating Cost	Rs.47,46,73,758
Price Received	Rs.43,88,05,684
Shortfall being adjustment u/s. 92CA	Rs.3,58,68,074

The above shortfall of Rs.3,58,68,074/- is treated as transfer pricing adjustment u/s. 92CA in respect of software development segment of the taxpayer's international transactions.

8. The above adjustment suggested by the TPO was incorporated in the draft assessment order by the AO as an addition to the Total income. Against the draft assessment order of the AO incorporating the adjustment to the ALP as proposed by the TPO as an addition to the total income, the assessee filed objections before the DRP. The DRP did not agree with the objections raised by the assessee and confirmed the adjustment to the ALP as made in the draft assessment order. The AO passed the final assessment order as per the directions of the DRP against which the assessee has filed the present appeal before the Tribunal.

9. We have heard the submissions of both the parties. The Id. counsel for the assessee filed before us submissions on each of the companies that were considered as comparable by the TPO and has also explained as to why those companies cannot be considered as comparable. The Id. DR, on the other hand, relied on the order of the TPO and the directions of the DRP, wherein the DRP has given reasons as to why the objections of the assessee to adopt comparable proposed by the TPO should not be accepted. We will deal with these objections while we take up the individual comparable companies for consideration.

(1) Accentia Technologies Ltd. (Sea.)

10. This was considered as a comparable by the TPO and listed at Sl.No.1 of the comparable companies chosen by the TPO. The Id. counsel for the assessee drew our attention to the fact that there are extra ordinary events that occurred during the previous year in this company. Our attention was drawn to the annual report of this company for the A.Y. 2007-08 wherein the fact that this company had acquired Thunga Software Pvt. Ltd., GSR Physicians Billing Services Inc., GSR Systems Inc. and Denmed Inc. is mentioned. Our attention was also drawn to the decision of the Hyderabad ITAT Bench in the case of Capital IQ Information Systems India Pvt. Ltd. v. DCIT (2013) 32 Taxman.com 21 (Hyd. Trib). In the aforesaid decision, the Hyderabad Bench of the Tribunal had to deal with a case of determination of ALP in the case of an assessee who was providing ITES business support services for the A.Y. 2007-08. The TPO had considered Accentia Technologies Ltd. as a comparable. The DRP however held that the said company cannot be compared as a comparable owing to extra ordinary events that took place during the previous year. The Tribunal upheld the order of the DRP observing

as follows:-

"I. Accentia Technologies Ltd.

10. It is the submission of the assessee that this company cannot be treated as a comparable because of uncomparable 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."

11. 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."

11. We have considered the submissions of the Id. counsel for the assessee and are of the view that the ratio laid down by the Hyderabad Bench of the ITAT is squarely applicable to the present case also. It is clear that during the previous year there were extra ordinary events that took place in this company which warrants exclusion of this company as a comparable. We therefore hold that this company cannot be considered as a comparable.

(2) Acropetal Technologies Ltd. (Sea.)

12. This company is listed at Sl.No.2 of the comparables chosen by the TPO. As far as this company is concerned, the objection of the assessee is that this company is not functionally comparable. The assessee is a BPO company that provides market analytics and data management services. To provide market analytics solutions, the assessee gives strategies that impact on client revenue including data based **marketing** strategies for customer acquisition, devising customer retention strategies and excluding loss mitigation strategies through cutting edge forecasting tools. The data management services provided by the assessee include routine business data reporting and management, website management, **marketing** data analysis and top line reporting. As far as Acropetal Technologies Ltd. is concerned, this company does the business of export of software services. It is also seen from the segmental revenue of this company (Note 15 to the notes on accounts to Annual Report for 07-08) that it derives income from engineering design services and software development services. It is also pertinent to point out that before the TPO, the assessee raised an objection that this company performs different functions and mainly engaged in the area of software development services and engineering design services. The TPO in his order has observed that the services rendered by this company fall in the definition of ITES.

13. We have considered the submissions of the learned counsel for the Assessee. On a perusal of the Note No.15 of notes to accounts which gives segmental revenue of this company, it is clear that the major source of income for this company is from providing Engineering Design Service and Information Technology Services. The functions performed by the Engineering Design Services segment of the company cannot be considered as comparable to the ITES/BPO functions performed by the Assessee. The performance of Engineering Design Services is regarded as providing high end services among the BPO which requires high skill whereas the services performed by the Assessee are routine low end ITES functions. We therefore hold that this company could not have been selected as a comparable, especially when it performs engineering design services which only a Knowledge Process Outsourcing [KPO] would do and not a Business Process Outsourcing [BPO].

(3) Coral Hubs Ltd.

14. This company is listed at Sl.No.6 of the list of comparable companies chosen by the TPO. As far as this company is concerned, it is seen that this company was earlier known as Vishal Information Technologies Ltd. The comparability of this company in the case of an ITES company by name 24 x 7 Customer.com Pvt. Ltd. was considered by the Tribunal in ITA No.227/Bang/2010 and by order dated 09.11.2012 the Tribunal held that this company is not functionally comparable with ITES for the following reason:-

"17.3 Vishal Information Technologies Ltd. (VIT) - In the case of this comparable, we find that the Mumbai Tribunal in the case of Mearsk Global Services (I) Pvt Ltd in ITA No.3774/Mum/2011 by order dt.9.11.2011 has held that since Vishal Information Technologies Ltd is outsourcing most of its work it has to be excluded from the list whereas the assessee in the cited case was carrying out the work by itself. In the instant case of the assessee also the assessee was carrying out its work by itself whereas in the case of VITL, it is outsourcing most of its work. We are therefore of the considered opinion that the decision of the ITAT, Mumbai in the cited case on the issue of excluding VITL as a comparable squarely applies. This decision was followed by the decision of the co-ordinate bench of this Tribunal in the case of Netlinx India(P) Ltd in ITA No.454/Bang/2011 dt.19.10.2012 wherein it was held that Vishal Information Technologies Ltd cannot be considered as a comparable. We, therefore, respectfully following the decision of the Mumbai Tribunal in the case of Mearsk Global Services (I) Pvt Ltd, direct the Assessing Officer / TPO to exclude Vishal Information Technologies Ltd. from the list of comparables."

15. Following the decision of the Tribunal referred to above, we hold that Coral Hubs Ltd. cannot be considered as a comparable. It may also be relevant to point out that the TPO in his order has observed that this company is retained as a comparable on the basis of detailed discussion in the TP order for the A.Y. 2007-08. In fact in A.Y. 2007-08, there was no determination of ALP and therefore there was no occasion for any order being passed by the TPO. It is also seen that this company entered into an area of business known as New Vertical Digital Library & Print on Demand in F.Y. 2007-08. In the case of Capital IQ Information Systems India Pvt. Ltd. (supra), the ITAT Hyderabad Bench in the case of ITES company considered the comparable of this company as an ITES company and held as follows:-

"IV. Coral Hub Limited (Earlier known as Vishal Information Technologies Ltd.):

16. The assessee has objected for this company being taken as comparable mainly on the ground that the activities of the company is not only functionally different, but the business model of the company is also different as it sub-contracts majority of its ITES works to third party vendors and has also made significant payments to those vendors. The payments made to vendors towards the data entry charges also supports the fact that the company outsources its works. In the circumstances, it cannot be taken as a comparable to the ITES functions performed by the assessee. Since this company is acting as agent only by outsourcing its works to the third party vendors. In this context, the assessee relied upon the order of the DRP in assessee's own case for the assessment year 2008-09, wherein the DRP, after taking into consideration, the aforesaid aspect, has accepted the claim of the assessee. The assessee further submitted that the Income-tax Appellate Tribunal Mumbai Bench in the case of Asstt. CIT v. Maersk Global Service Centre (India) (P.) Ltd. (2011) 133 ITD 543/16 taxmann.com 47 (Mum.), a copy of which is submitted before us, has also directed for the exclusion of the aforesaid company since it has outsourced a considerable portion of its business.

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 from the final list of comparables."

In case of Maersk Global service Centre India (P.) Ltd. (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."

16. It is also further noticed that the employee cost/operating sales of this company is a mere 3%, whereas the threshold limit for acceptance as a comparable on the basis of

employee cost to sales should be at least 25%. This Tribunal in the case of First Advantage Offshore Services Ltd. v. CIT, IT(TP)A No.1086/Bang/2011, order dated 30.4.2013, has taken the following view:-

"36. Having heard both the parties and having considered their rival contentions and the material on record, we find that this issue had arisen in the assessee's own case for the assessment year 2006-07. This Tribunal has held that employee cost filter is to be the same even for ITES segment also. The learned DR's argument that the employee cost filter is applicable only to software development segment and not to ITES segment is not acceptable. Though it is without any dispute that the software development would require skilled employees and, therefore, the employee cost would definitely be more than 25% of the total expenses, it cannot be said that the said filter is not applicable to ITES segment, where comparably less skilled employees are employed. In the ITES segment, the entire work is to be done by the employees and, therefore, even though they may be less skilled compared to software development segment, the number of employees would definitely be more and thus the employee cost would be high and thus application of employee cost filter to the ITES sector is also justified. In view of the same, we direct the TPO to apply the employee cost filter to exclude companies with employee cost of less than 25% from the list of comparables for the computation of ALP."

17. Applying the aforesaid decisions, we are of the view that Coral Hubs Ltd. cannot be considered as a comparable.

(4) Crossdomain Solutions Ltd.

18. This company was considered as a comparable and listed at Sl.No.8 of the comparables chosen by the TPO. It is the stand of the assessee that this company is not functionally comparable. As observed in the case of Coral Hubs Ltd., the TPO rejected the plea of the assessee on the basis of a non-existent TP order passed for the A.Y. 2007-08. It is seen that the business profile of this company is re-engineered payroll service. This company is also engaged in the development of information systems. These activities are totally different from the activities of the assessee which perform very limited/low end functions back office services. The review and business functions of Cross Domain is as follows:-

"With a decade of experience in Payroll Outsourcing, Crossdomain has created a re-engineered payroll service EFFIPAY - that processes and delivers accurate payroll to clients with headcount up to 1000 employees in just 4 hours*. With Effipay Lite and Effipay Lite Plus, our bouquet of services cover end to end payroll, retrials, reimbursement, tax proof verifications upto issue of Form 16 for employees of our clients across different industry verticals. Our processes are highly scalable and provide end to end payroll solutions to clients with headcount ranging from 5 to 65,000."

"Crossdomain's IT knowledge and domain competence has provided the edge to develop information systems to implement process innovation and continuously increase efficiency and turn-around-time for business critical processes."

Source: <http://www.cross-domain.com>

As can be seen from the above, the business of Cross Domain ranges from high end KPO services, development of product suites and routine low end ITES service. However, there is no bifurcation available for such verticals of services. Therefore the assessee contends that Cross Domain cannot be compared to a routine ITES service provider.

19. We are of the view that in the absence of any reasons given to the contrary either by

the TPO or the DRP for regarding this company as a comparable, this company should be excluded from the list of comparables, accepting the plea of the Assessee. We hold accordingly.

(5) Eclerx Services Ltd.

20. This company is listed at Sl.No.11 in the list of comparable companies chosen by the TPO. It is the stand of the assessee that this company offers solutions that include data analytics, operations management, audits and reconciliation and therefore has to be classified as high end KPO. In support of the stand of the assessee, extracts from the annual report of this company have been pointed out. It has further been submitted that extra ordinary events and peculiar circumstances prevail in the case of the assessee in as much as this company acquired a UK based company which has significantly contributed to the increase in the customer and revenue base of the company. This Tribunal in the case of Capital IQ Information Systems India Pvt. Ltd. (supra) had an occasion to deal with comparability of this company in the case of an ITES company such as the Assessee and the Tribunal held as follows:-

"14. The assessee has objected for this company being taken as comparable mainly on the ground that it was having a supernormal profit of 89%, and as such it cannot be taken as a comparable in view of the decision of the Mumbai Bench of the tribunal in the case M/s. Teva India Ltd. (supra). That apart, relying upon the annual report of the company, the learned Authorised Representative for the assessee has contended that that the concerned company is engaged in providing Knowledge Process Outsourcing(KPO) Services.

15. On considering the objections of the assessee in relation to this company, we accept the contention of the assessee that this company cannot be taken as a comparable both for the reasons that it was having supernormal profit and it is engaged in providing KPO services, which is distinct from the nature of services provided by the assessee."

21. We are of the view that in the light of the decision of the Hyderabad Bench referred to above, this company cannot be regarded as a comparable for the reason that it was functionally different.

(6) Genesys International Corporation Ltd.

22. This company is listed at Sl. No.12 in the list of comparable companies chosen by the TPO. As far as this company is concerned, the stand of the assessee has been that this company is functionally not comparable and that it has a different employee skill set and that this company performs R&D services and also owns intangibles. This company is a geospatial services content provider specialising in land based technologies. From the notes to accounts of this company, it is seen that this company is engaged in providing geographical information services comprising of photogrammetry, remote sensing cartography, data conversion related computed based services and other related services. Further the business of this company requires skilled manpower and scientists, civil engineers, etc. The assessee is a routine ITES provider who does not require such highly skilled employees. Besides the above, this company also carries out R&D services and own intangibles. The aforesaid facts, in our view, will take this company out of the list of comparables. We may also point out that the objection of the assessee in this regard has been disregarded by the TPO by mere observation that it cannot be rejected on the basis that it is into different functional line within ITES. In this regard, we may refer to the decision of the ITAT Bangalore Bench in the case of First Advantage Offshore Services Ltd. (supra), wherein it was observed as under:-

"39. Having heard both the parties and having considered their rival contentions, we find

that the assessee had raised elaborate objections to each of the comparables in group 3 before the TPO. The TPO has also reproduced the said objection in his order para 6.5.1. of page 178 of his order. He has rejected the contention of the assessee by holding that every function within BPO sector can be from low end to high end and the activities of the assessee such as accounting, web management, network management are BPO services using technology but these services are not categorized as KPO. He held that a call centre may offer support services like telemarketing to high end services like technical support services, where not only the level of knowledge, skill required would be high, but the technical knowledge as well would be high. According to him, back office transaction process services may be as remarkable and as complicated as insurance/market transaction processing services. He, therefore, rejected the contention of the assessee and treated the BPO as equivalent to KPO services.

40. We have to now consider whether a BPO and KPO are functionally similar and are comparable to each other. BPO is a sub-set of outsourcing and involves the contracting of the operations and responsibilities of specific business functions or process to a third party services provider. Often business processes outsourcing are information technology based and referred to as ITES-BPO. KPO is one of the sub-segment of the BPO industry. It involves outsourcing of core information related business activities which are competitively important or form an integral part of a company's value chain. It thus requires advanced analytical and technical skills as well as a high degree of specialist expertise. The KPO services include all kinds of research and information gathering. Thus it can be seen that even though both BPO and KPO are offering information Technology based services, the skill and expertise and may be even the tools required are different which may result in different economic results of both the segments. Thus, in such circumstances, we are of the opinion that they cannot be compared with each other and have to be excluded from the list of comparables."

23. It is thus clear from the aforesaid decision of the Tribunal that among the ITES companies there is a hierarchy in terms of skill required to provide services. It ranges from providing routine services where no skills and required and providing services where highly professionalized skills are required. Depending on the skills required to perform ITES the comparability has to be done. In view of the above, we are of the view that this company cannot be regarded as a comparable and deserves to be excluded from the list of comparables.

(7) Infosys BPO Ltd

24. This company is listed at Sl.13 in the list of comparable companies chosen by the TPO. As far as this company is concerned, it is the submission of the Id. counsel for the assessee that this company has a brand value and therefore there would be significant influence in the pricing policy which will impact the margins. Schedule 13 to the profit & loss account of this company for the F.Y. 2007-08 shows that this company incurred huge selling and **marketing** expenses. Page 133 of the annual report of this company for the F.Y. 2007-08 shows that this company realizing its brand value has chosen to value the same on the basis of its earnings and that of Infosys. The brand value of the Assessee and Infosys has been valued at Rs.31,863 Crores. Infosys BPO, being a subsidiary of Infosys, has an element of brand value associated with it. This is also clear from the presence of brand related expenses incurred by this company. Presence of a brand commands premium price and the customers would be willing to pay, for the services/products of the company. Infosys BPO is an established player who is not only a market leader but also a company employing sheer breadth in terms of economies of scale and diversity and geographical dispersion of customers. The presence of the aforesaid factors will take this company out of the list of comaparables. We therefore accept the contention of the assessee that this company cannot be regarded as a

comparable.

(8) Mold-tek Technologies Ltd.

25. This company is listed at Sl.No.16 of the list of comparable companies chosen by the TPO. As far as this company is concerned, the submission of the assessee before us is that it is in the business of Knowledge Process Outsourcing and cannot be considered as a comparable. The functional profile of this company is as follows:-

As per the annual report for the F.Y. 2007-08, the company primarily operates in two business segments:

Plastic division: The plastic division is engaged in the manufacture of tube & oils, paints, pet products, consumer products, etc. The company demerged the said segment effective 1 April, 2007 and transferred the business unit to the Company Plastics Lt. The extract from the annual report confirms the fact that the Company had restructured its operations resulting in demerging the plastic segment business.

Information Technology (IT) division: The IT division (also referred to as the KPO division by the company) of the company specializes in providing structural design and detailing services which can be categorized as structural engineering services. The structural engineering services provided by the IT division of the company cannot be classified as falling with the scope and ambit of ITES services. On the contrary, the said services would fall under the category of engineering services.

Excerpts from the Annual Report of the company

Page 10 of the Annual Report for the FY 2007-08 contains the following observation regarding the KPO division of the Company:

'The Company has achieved about 56.49% growth in 2007-08 to register a turnover of Rs.17.86 crore. The company having established its credentials in structural engineering services to US clients is devising aggressive **marketing** strategy to achieve rapid growth. "

This company is also engaged in providing a host of engineering services like civil and structural engineering services, mechanical product design, plant engineering, IT services and GIS services. As we have already seen, this company is to be classified as KPO and cannot be compared with the assessee. The decision of the Bangalore Bench of the ITAT in the case of First Advantage Offshore Services Ltd. (supra) which we have referred to in the earlier part of this order will clearly apply to this company. We therefore direct this company to be excluded from the list of comparables.

(8) Wipro Ltd.

26. This company is listed at Sl.No.18 in the list of comparable companies chosen by the TPO. As far as this company is concerned, the discussion made while deciding Infosys BPO Ltd. as a comparable will equally apply to this company also. This company owns substantial intellectual property on software products. This company cannot therefore be regarded as a comparable. For the reasons given while disregarding Infosys BPO Ltd. as a comparable, this company is also directed to be excluded from the list of comparables.

27. With the exclusion of the aforesaid companies as comparables, the following are the 11 companies chosen by the TPO as comparable only remain and their arithmetic mean

is as follows:-

Sl.No.	Name of the company	TPO Margins (Return on Total Cost) for the year ended 2008
1	Aditya Birla Minacs Worldwide Limited	- 4.00%
2	Asit C Mehta Financial Services Ltd. (Seg.)	9.42%
3	Caliber Point Business Solutions Ltd.	10.97%
4	Cosmic Global Ltd.	23.30%
5	Datamatics Financial Services Ltd. (Seg.-BPO)	29.11%
6	e4e (Nittany Outsourcing Ltd.)	18.54%
7	IServices India Pvt. Ltd.	10.77%
8	Jindal Intellicom Pvt. Ltd.	- 10.29%
9	R Systems International Ltd. (Seg.-BPO)	4.30%
10	Spanco Ltd. (Seg.- Call Centre division)	8.81%
11	Allsec Technologies Limited	- 13.29%
	Arithmetic Mean	7.97%
	Margin of Genpact India (Assessee)	14.91%

28. It can be seen that the arithmetic mean of profit margin to cost of the remaining comparable companies chosen by the TPO after excluding the aforesaid companies is only 7.97%. The profit margin to cost of the Assessee is 14.91% which is much higher than the arithmetic mean of the comparable companies chosen by the TPO (after exclusion of some of the comparable companies chosen by the TPO for reasons set out in the earlier paragraphs). Therefore no adjustment to ALP is called for. We therefore hold that the addition sustained by the DRP deserves to be deleted and is accordingly directed to be deleted. We may also add that arguments were made on market risk adjustments and also working capital adjustment. We have not dealt with those arguments for the reason that on the basis of comparability, the arithmetic mean of the comparables is less than the margin of the assessee.

29. Grounds 3.1 to 3.3 raised by the assessee is with regard to the action of the revenue authorities in excluding expenses incurred in foreign currency comprising of a sum of Rs.39,55,638 on account of foreign currency expenses incurred in travelling and a sum of Rs.17,66,175 on account of internet connection charges, from the export turnover while computing deduction u/s. 10A of the Act. As a result of the action of the AO the deduction u/s.10A of the Act was allowed at a lesser sum than what was claimed by the Assessee. The Plea of the Assessee is that the aforesaid expenditure need not be excluded from the export turnover as per the definition of the said term given in Sec.10A of the Act. The plea of the assessee, in the alternative, is that if the aforesaid amount is excluded from the export turnover, the same should also be excluded from the total turnover.

30. As far as the alternative claim is concerned, we find that the Hon'ble High Court of Karnataka in the case of CIT v. Tata Elxsi Ltd (2012) 349 ITR 98 (Karn) has held that while computing deduction under section 10A of Act, expenditure incurred by the

assessee, if excluded from the export turnover should also be excluded from the total turnover. In view of the aforesaid decision of the Hon'ble High Court of Karnataka, the AO is directed to reduce the expenses incurred for travelling and internet connection charges from the export turnover as well as the total turnover, while computing deduction u/s. 10A of the Act. We hold and direct accordingly.

31. Ground No.4 with regard to charging of interest u/s. 234B and 234D is purely consequential. The AO is directed to give consequential relief.

32. In the result, the appeal by the assessee is allowed.
