MOOT PROPOSITION

DRAFT PROBLEM

The assessee, M/s. Vulcantech BPO India Private Limited, has filed an appeal before the Hon'ble High Court of Madras under Section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal, Chennai ("Tribunal") passed in the case of M/s. Vulcantech BPO India Private Limited Vs ACIT for the Assessment Year 2010-11. The assessee raised the following substantial questions of law which have been admitted by the Hon'ble High Court of Madras and fixed for final hearing:

1. *Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that Section 206AA applies to non-residents and overrides the provisions of S.139A(8) and S.90(2) as well as the Articles of the India-USA DTAA?*
2. *Whether on the facts and in the circumstances of the case, the Tribunal was right in law in upholding the adoption of functionally different companies being high-end, value-adding service companies (KPO) as comparables while ignoring the fact that the appellant is a low-end service provider in the ITES (BPO) space?*
3. *Whether on the facts and in the circumstances of the case, the Tribunal was right in law in upholding the adoption of high profit margin ("super profit") comparables while ignoring the substantial arguments backed by facts, documents and material put forth by the Appellant?*

In relation to the matter at hand, the following Annexures form part of the record:

Annexure A: The impugned order of the Tribunal

Annexure B: Grounds of appeal filed before the Tribunal

Annexure C: Final Assessment Order

Annexure D: Directions of DRP

Annexure E: Objections before DRP

Annexure F: Draft Assessment Order

Annexure G: Transfer Pricing Officer's Order

Annexure A

IN THE INCOME TAX APPELLATE TRIBUNAL "A" BENCH, CHENNAI

BEFORE SHRI F.D.LEGELLO, JUDICIAL MEMBER AND

SHRI ANTHONY VARDON, ACCOUNTANT MEMBER

ITA No. 1027/Mds/2015

Assessment Year : 2010-11

M/s Vulcantech BPO India Private Limited. ---------- Appellant

- Vs -

The Assistant Commissioner of Income-Tax ---------- Respondent

Appellant by : Shri. Aziz Alam

Respondent by : Shri. Raman Gopalakrishnan

Date of Hearing : 1st September, 2015

Date of Pronouncement : 10th September, 2015

ORDER

PER ANTHONY VARDON, ACCOUNTANT MEMBER

1. This appeal by the assessee is directed against the order of assessment passed by the Income Tax Officer, Company Circle – II(4), Chennai u/s 143(3) r.w.s 144(13) of

the Act, dt 30.01.2015 in pursuance of the directions issued by the Dispute Resolution Panel (DRP in short), vide its order dt 12.12.2014 passed u/s 144C(5) r.w 144C(8) of the Act. The relevant assessment year is 2010-11.

2. The facts of the case, in brief, are as under:

2.1 The assessee company is engaged in rendering data conversion services to its ultimate parent company, Vulcantech BPO Inc, USA, mainly in the area of forms processing involving data conversion from one format to another. The assessee is basically a low end BPO service provider carrying out activities involving form processing activities relating to insurance, publishing and shared financials. These low-end BPO services are provided by unskilled, lower-end workforce.

2.2 The assessee filed its Return of Income (ROI) electronically, declaring 'Nil' income for the Assessment Year (AY) 2010-11. The ROI was processed u/s 143(1) of the Income Tax Act (the Act). The case was selected for scrutiny and notice u/s 143(2) of the Act was issued to the assessee. The case was referred to the Transfer Pricing Officer for computation of the Arms Length Price as the assessee had made international transactions exceeding Rs. 15 crores.

2.3 The TPO, based on the Transfer Pricing study which was made in the case of the assessee, passed the order u/s 92CA of the Act on 30.01.2014. The AO prepared the draft assessment order on 18.03.2014 incorporating the adjustment suggested by the TPO as well as an addition u/S 206AA and forwarded a copy thereof to the assessee. The assessee filed its objections before the Dispute Resolution Panel (DRP) on 07.04.2014. The DRP heard the assessee and passed an order on 12.12.2014 confirming the additions/disallowances made by the TPO and thereby rejecting the objections raised by the assessee. In consequence thereof, the Income Tax Officer passed the final Order of Assessment on 30.01.2015 u/s 143(3) r.w.s 144C(13) of the Act.

3. Aggrieved by the above said order of assessment dt 30.01.2015, the assessee is on appeal before us raising the following grounds:

"""A. Corporate tax grounds:

1. The DRP/AO erred in applying the provisions of S.206AA to non-resident taxpayers and ignored the provisions of S.139A(8) r.w. Rule 114C(1)

2. The DRP/AO erred in not applying S.90(2) of the Act which holds that provisions of Act are applicable to the extent that they are more beneficial to the taxpayer and hence given that the India-USA DTAA prescribed lower withholding rate than S.206AA, the Articles of the India-USA DTAA are solely applicable to the taxpayer

3. The DRP/AO failed to appreciate that application of DTAA Articles cannot be unilaterally amended by the contracting country, especially by Section 206AA which is not a charging section under the Act.

4. The DRP/AO ought to have appreciated that Section 90(2) starts with non-obstante clause also and hence cannot be overridden by S.206AA

B. Transfer pricing related grounds:

1. General ground: The DRP/AO/TPO erred in law and in facts by not accepting the transfer pricing analysis undertaken by the appellant in accordance with the provisions of the Act read with the Rules, and holding that the appellant's international transaction is not at Arms Length

2. The DRP erred in accepting the comparability analysis carried out by the AO/TPO though it was not in conformance with the provisions of the IT Act/Rules:

2.1 The DRP erred in upholding TPO's selection of functionally different, high-end value-add service companies as comparables while ignoring the substantiated fact that the appellant company is a very low-end service provider in the ITES (BPO) Space

2.2 The DRP erred in upholding TPO's selection of abnormally high margin/super-profit comparable companies while ignoring the substantial arguments backed by facts, documents and material put forth by the Appellant""""

The assessee has filed detailed submissions in support of the above.

4. The **Corporate-tax ground of appeals** all revolve around the levy of tax u/s 206AA and we take up all the grounds together. The Learned Department Representative submitted that the assesse deducted tax as per DTAA towards Fees for Technical Services (Fees for Included Services) in case of certain non-resident recipients, who didn't have Permanent Account Number (PAN). As a consequence, Revenue treated such payments, as cases of 'short deduction' of tax in terms of the provisions of section 206AA of the Act. Section 206AA prescribes that if the recipient of any sum or income fails to furnish his PAN to the person responsible for deduction tax at source, the tax shall be deductible at the rate specified in the relevant provisions of the Act or at the rates in force or at the flat rate of 20% - whiciever is higher. On the strength of section 206AA of the Act, Revenue treated payments to those non-residents who did not furnish the PAN as cases of 'short deduction' being difference between 20% and the actual tax rate on which tax was deducted in terms of the relevant DTAAs. As a consequence, demands were raised on the assessee for the short deduction of tax. The aforesaid dispute was carried by the assessee in appeal before the DRP.

5. Per contra, the Learned Authorized Representative for the assessee raised varied arguments. The AR submitted that the provisions of section 206AA are not applicable to payments made to non-residents. In support, the Authorized Representative pointed out that provisions of section 139A(8) of the Act r.w. rule 114C(1) of the Income Tax Rules, 1962 (in short "the Rules") prescribe that non-residents are not required to apply for PAN. According to the AR, section 206AA of the Act prescribed that the recipient shall furnish the PAN and such furnishing would be possible only where the recipient is required to obtain PAN under the relevant provisions. Thus, where the non-residents are not obliged to obtain a PAN, the

requirement of furnishing the same in terms of section 206AA of the Act does not arise. Secondly, it was also pointed out by the counsel that the tax rate applicable in terms of section 206AA of the Act cannot prevail over the tax rate prescribed in the relevant DTAA, as the rates prescribed in the DTAAs were beneficial. In support of such a stand, the AR relied upon the provisions of section 90(2) of the Act, which provides that provisions of the Act are applicable to the extent that they are more beneficial to the assessee and since section 206AA of the Act prescribed higher rate of withholding tax, it would not be beneficial to the assessee vis-à-vis the rates prescribed in the DTAAs.

6. The Authorised Representative submitted that non-residents are not required to obtain PAN u/s 139A(8) of the Act r.w. rule 114C(1) of the Rules.

7. We are unable to accept the contention of the assessee. Section 206AA uses the terms "*any person entitled to receive any sum or income or amount*". Hence it cannot mean to exclude non-residents as contended by the assessee. The above interpretation gains substantiation by amendment to Finance Act, 2013 which specifies exclusion of non-residents with respect to section 194LC. Also, Section 139A(8) of the Act r.w. Rule 114C(1)(b) is general provision which might not stand good against the specific provision of section 206AA. Hence, that contention of the assessee on this ground cannot be accepted.

8. With respect to the second limb of the argument being the overriding effect of section 206AA, DRP came to the conclusion that section 206AA of the Act would override other provisions of the Act including the DTAA. The Ld. AR has vehemently argued against the order of the DRP that section 206AA of the Act cannot override the provisions contained in section 90(2) of the Act and reiterated the submission made before the DRP and relied on various cases which state that DTAA presides over the provisions of the Income Tax Act. According to the Learned AR, the DRP erred in holding that section 206AA of the Act was applicable even to cases governed by the DTAA. According to him, section 206AA of the Act would not override provision of DTAA and therefore the tax deduction at 20% is not warranted. The AR relied upon the

decision of the Pune Tribunal in the case of ***DCIT Vs Serum Institute of India Ltd. (ITA No.792/PN/2013)*** wherein it has been held as under:

> *"Therefore, in our view, where the tax has been deducted on the strength of the beneficial provisions of section DTAAs, the provisions of section 206AA of the Act cannot be invoked by the Assessing Officer to insist on the tax deduction @ 20%, having regard to the overriding nature of the provisions of section 90(2) of the Act."*

9. We are in agreement with the DRP that Section 206AA starts with a non-obstante clause and hence overrides the other provisions the Act which includes Section 90(2). Even otherwise, a harmonious construction of the relevant provisions would make it clear that application of section 206AA cannot be negated as the issue has not be dealt with specifically under the relevant DTAA. For example, if there are specific terms not explained in the DTAA and are explained in the Act, then the issue is not about DTAA overriding the Act but takes a different character altogether. Therefore, where PAN has not been furnished under the Act, lower tax rate under the DTAA cannot be availed in light of the specific provision of the Act u/S 206AA.

10. The Learned AR also relied on various cases which according to us are not relevant to the facts of the case. None of the cases were in relation to section 206AA or provisions which overrides any other provision of the Act. The principle of *Obiter dicta* is applicable only in cases where the facts and the law are similar. No straight jacket can be applied for such cases and it has to be seen on case to case basis. With regard to decision of the Pune Tribunal in the case of ***DCIT Vs Serum Institute of India Ltd. (supra***), the Hon'ble Tribunal held as under:

> *"Therefore, in view of the aforesaid schematic interpretation of the Act, section 206AA of the Act cannot be understood to override the charging sections 4 and 5 of the Act. Thus, where section 90(2) of the Act provides that DTAAs override domestic law in cases where the provisions of DTAAs are more beneficial to the assessee and the same also overrides the charging sections 4 and 5 of the Act and hence, also section 206AA of the Act."*

The Tribunal was of the view that section 206AA of the Act does not override the charging sections 4 and 5 of the Act. However, section 90(2) of the Act provides that DTAAs override domestic law in cases where the provisions of DTAAs are more beneficial to the assessee and the same also overrides the charging sections 4 and 5 of the Act and hence, also Section 206AA of the Act.

11. We respectfully differ from the view taken by the Hon'ble ITAT, Pune in this regard. It is a settled position of law that provisions of DTAA will prevail over the provisions of the Act. However, where the provision, inserted later in time, specifically states '*Notwithstanding anything contained in any other provisions of this Act*', it has an overriding effect on all the provisions of the Act including the Charging sections of the Act. On the other hand, the legal proposition that DTAA prevails over the Act is substantiated by the assessee by judicial precedents which are not relating to the specific provision under consideration. Even otherwise, the legislation stands in a better footing when compared to judicial precedents when looked at the hierarchy and the legal nomenclature. Therefore, we do not agree with the view expressed by the AR on non-application of section 206AA and sustain the order of DRP and dismiss the assessee's appeal with respect to Corporate Grounds.

12. We now consider **the Transfer-pricing related grounds of appeal**. The approach of the TPO vis-à-vis that of the assessee is briefly summarized as under:

13. The assessee's approach: the assessee is a low-end BPO providing services in the area of forms processing, data conversion etc. The assessee in its TP Study selected Transactional Net Margin Method (TNMM) as the Most Appropriate Method (MAM). The assessee adopted 'Operating Profit' to 'Total Cost' as the 'Profit Level Indicator' (PLI) and has come up with the following comparables:

S. No.	Name of the company	Operating margin/Total Cost %
1	Aditya Birla Minacs Worldwide	1.85
2	Microgenetics Systems Ltd	9.56
3	R Systems International (Seg)	14.09

	Average	**8.5**

The average arithmetical profit margin of the above comparables is 8.5%. Since the profit margin of the assessee computed at 10.76% was within the +/- 5% margin of the allowed variation from the arithmetical mean margin of the comparables, the assessee held that its international transaction was at Arms Length.

14. The TPO's approach: The TPO issued a show cause notice proposing to reject "R Systems" from the assessee's list of comparables and also proposed induction of "Cosmic Global Ltd" to the final list of comparables. As a result, the final set of comparables and the PLI is as under:

S.No.	**Name of the company**	**OP/TC %**
1	Aditya Birla Minacs Worldwide	1.85
2	Microgenetics Systems Ltd	9.56
3	Cosmic Global Ltd	48.10
	Average	**19.84**

As per the calculation above, the TPO arrived at the arithmetical mean margin of 19.84% on cost. After considering the objections of the assessee, the TPO used the above 3 companies as the final set of comparables. Based on the above arithmetical mean margin, the TPO arrived at an adjustment of Rs. 8,01,88,892/-as detailed in his order.

15. We have heard both the parties, carefully perused and considered the order of the TPO u/s 92CA of the Act, the orders of assessments, the directions of the DRP, the detailed submissions of the Authorised Representative and the judicial decisions relied on. In the light of the above, we now briefly examine the grounds of appeal raised by the assessee.

16. We feel that the TPO has adequately addressed the reasons for adding "Cosmic Global" by ignoring the granularity of low-end BPO (assessee) and high-end KPO (Cosmic Global) comparables and considering them both as ITeS activities and hence comparable. At the outset, we do NOT find any infirmity in this approach as has been detailed by the TPO.

17. The Learned Counsel, however, has brought to our attention the recent decision of the ITAT Mumbai for AY 2008-09 in ***Maersk Special Bench*** that the Tribunal which went into the very same question of whether there should be a distinction between KPO and BPO companies of ITeS segment when it comes to TNMM. The Learned Counsel strongly submitted that the Special Bench held ultimately in favour of the assessee in as much as it directed exclusion of 2 comparables "eClerX Services" and "Mold-Tek Technologies" on the basis of not being functionally similar and it is the assessee's contention that the functional dissimilarity in that case was only that of eClerX and Mold-Tek being KPO's whereas Maersk was a BPO. The assessee submitted the following paras in the ***Maersk Special Bench (supra)*** judgment to substantiate its claim:

> *"""82. In so far as M/s eClerx Services Limited is concerned, the relevant information is available in the form of annual report for financial year 2007-08 placed at page 166 to 183 of the paper book. A perusal of the same shows that the said company provides data analytics and data process solutions to some of the largest brands in the world and is recognized as experts in chosen markets- financial services and retail and manufacturing. It is claimed to be providing complete business solutions by combining people, process improvement and automation. It is claimed to have employed over 1500 domain specialists working for the clients. It is claimed that eClerx is a different company with industry specialized services for meeting complex client needs, data analytics KPO service provider specializing in two business verticals – financial services and retail and manufacturing. It is claimed to be engaged in providing solutions that do not just reduce cost, but help the clients increase sales and reduce risk by enhancing efficiencies and by providing valuable insights that*

empower better decisions. M/s eClerx Services Pvt. Ltd. is also claimed to have a scalable delivery model and solutions offered that include data analytics, operations management, audits and reconciliation, metrics management and reporting services. It also provides tailored process outsourcing and management services along with a multitude of data aggregation, mining and maintenance services. It is claimed that the company has a team dedicated to developing automation tools to support service delivery. These software automation tools increase productivity, allowing customers to benefit from further cost saving and output gains with better control over quality. Keeping in view the nature of services rendered by M/s eClerx Services Pvt. Ltd. and its functional profile, we are of the view that this company is also mainly engaged in providing high-end services involving specialized knowledge and domain expertise in the field and the same cannot be compared with the assessee company which is mainly engaged in providing low-end services to the group concerns. 83. For the reasons given above, we are of the view that if the functions actually performed by the assessee company for its AEs are compared with the functional profile of M/s eClerx Services Pvt. Ltd. and Mold-Tec Technologies Ltd., it is difficult to find out any relatively equal degree of comparability and the said entities cannot be taken as comparables for the purpose of determining ALP of the transactions of the assessee company with its AEs. We, therefore, direct that these two entities be excluded from the list of 10 comparables finally taken by the AO/TPO as per the direction of the DRP."""

18. The Learned Counsel also submitted a very recent decision of the Delhi High Court which discusses the issue of KPO vs. BPO for comparability analysis. In ***RampGreen Solutions Pvt. Ltd. vs. CIT (ITA No.102/2015 dated 10.08.2015)***, the Hon'ble Delhi High Court observed as follows:

"32. It has been pointed out that whilst the Tribunal in Willis Processing Services (India) Pvt. Ltd. v. DCIT (supra) held that no distinction could be made between KPO and BPO service providers, however, a contrary view had been

taken by several benches of the Tribunal in other cases. In Capital IQ Information System India (P.) Ltd. v. Dy. CIT, (IT) [2013] 32 taxmann.com 21 and Lloyds TSB Global Services Pvt. Ltd. v. DCIT, (ITA No. 5928/Mum/2012 dated 21th November 2012), the Hyderabad and Mumbai Bench of the Tribunal respectively accepted the view that a BPO service provider could not be compared with a KPO service provider.

33. The Special Bench of the Tribunal in Maersk Global Centers (India) Pvt. Ltd. (supra) struck a different cord. The Special Bench of the Tribunal held that even though there appears to be a difference between BPO and KPO Services, the line of difference is very thin. The Tribunal was of the view that there could be a significant overlap in their activities and it may be difficult to classify services strictly as falling under the category of either a BPO or a KPO. The Tribunal also observed that one of the key success factors of the BPO Industry is its ability to move up the value chain through KPO service offering. For the aforesaid reasons, the Special Bench of the Tribunal held that ITeS Services could not be bifurcated as BPO and KPO Services for the purpose of comparability analysis in the first instance. The Tribunal proceeded to hold that a relatively equal degree of comparability can be achieved by selecting potential comparables on a broad functional analysis at ITeS level and that the comparables so selected could be put to further test by comparing specific functions performed in the international transactions with uncontrolled transactions to attain relatively equal degree of comparability.

34. We have reservations as to the Tribunal's aforesaid view in Maersk Global Centers (India) Pvt. Ltd. (supra). As indicated above, the expression 'BPO' and 'KPO' are, plainly, understood in the sense that whereas, BPO does not necessarily involve advanced skills and knowledge; KPO, on the other hand, would involve employment of advanced skills and knowledge for providing services. Thus, the expression 'KPO' in common parlance is used to indicate an ITeS provider providing a completely different nature of service than any other BPO service provider. A KPO service provider would also be functionally

different from other BPO service providers, inasmuch as the responsibilities undertaken, the activities performed, the quality of resources employed would be materially different. In the circumstances, we are unable to agree that broadly ITeS sector can be used for selecting comparables without making a conscious selection as to the quality and nature of the content of services. Rule 10B(2)(a) of the Income Tax Rules, 1962 mandates that the comparability of controlled and uncontrolled transactions be judged with reference to service/product characteristics. This factor cannot be undermined by using a broad classification of ITeS which takes within its fold various types of services with completely different content and value. Thus, where the tested party is not a KPO service provider, an entity rendering KPO services cannot be considered as a comparable for the purposes of Transfer Pricing analysis. The perception that a BPO service provider may have the ability to move up the value chain by offering KPO services cannot be a ground for assessing the transactions relating to services rendered by the BPO service provider by benchmarking it with the transactions of KPO services providers. The object is to ascertain the ALP of the service rendered and not of a service (higher in value chain) that may possibly be rendered subsequently.

35. As pointed out by the Special Bench of the Tribunal in Maersk Global Centers (India) Pvt. Ltd. (supra), there may be cases where an entity may be rendering a mix of services some of which may be functionally comparable to a KPO while other services may not. In such cases a classification of BPO and KPO may not be feasible. Clearly, no straitjacket formula can be applied. In cases where the categorization of services rendered cannot be defined with certainty, it would be apposite to employ the broad functionality test and then exclude uncontrolled entities, which are found to be materially dissimilar in aspects and features that have a bearing on the profitability of those entities. However, where the controlled transactions are clearly in the nature of lower-end ITeS such as Call Centers etc. for rendering data processing not involving domain knowledge, inclusion of any KPO service provider as a

comparable would not be warranted and the transfer pricing study must take that into account at the threshold."""

19. Thus the Learned Counsel submitted the case was squarely covered by the judgments it had brought before the TPO, which we do not see the need to reproduce here, as well as the recent decision of the ***Maersk Special Bench (supra)*** and the Hon'ble Delhi High Court in ***RampGreen Solutions (supra)*** on this very same issue

20. The Learned DR however disagreed vehemently with the assessee's viewpoint and walked us through the ***Maersk Special Bench decision*** **(supra)** pointing out the following observations of the Special Bench:

"73. …….. Although the BPO services are generally referred to as the low end services while KPO services are referred to as high end services, the range of services rendered by the ITES sector is so wide that a classification of all these services either as low end or high end is always not possible. On the one hand, KPO segment is referred to as a growing area moving beyond simple voice services suggesting thereby that only the simple voice and data services are the low end services of BPO sector while anything beyond that are KPO services. The definition of ITES given in the safe harbour rules, on the other hand, includes inter alia data search integration and analysis services and clinical data-base management services excluding clinical trials. These services which are beyond the simple voice and data services are not included in the definition of KPO services given separately in the safe harbour rules. Even within KPO segment, the level of expertise and special knowledge required to undertake different services may be different.

74. One of the key success factors of the BPO industry is stated to be its ability to move up the value chain through KPO service offering. While KPO is termed as an upward shift of the BPO industry in the value chain, it is also stated that the evolution of majority of Indian BPO sector has given rise to KPO. The KPO thus is an evolution of BPO and upward shift in the value chain. BPO trying to

upgrade it as KPO is likely to render both BPO as well as KPO services in the process of evolution and such entity therefore cannot be considered strictly either as a BPO or KPO. Going by the nature of mixed services rendered by it, it may be difficult to classify it either as BPO or KPO and going by its functional profile, it may fall somewhere in between. Again, the determination of exact portion of BPO and KPO services may also not be possible in the absence of relevant data maintained by the entity and in these circumstances, it may not be possible even to create a third category which is somewhere in between BPO and KPO.

75. Keeping in view the large number of services falling under ITES, the difficulty in classifying these services either as low end BPO services or high end KPO services, the difficulty in creating a third category of entities falling in between BPO and KPO and lesser degree of comparability even within BPO and KPO sector, we are of the view that the ITES services cannot be further bifurcated or classified as BPO and KPO services for the purpose of comparability analysis. In our opinion, there could exist significant overlap between the ITES activities or functions with some activities/functions being very fact-sensitive and introducing an artificial segregation within ITES may lead to creation of more problems in the comparability analysis than solving the same.

76. Having held that ITES services cannot be further bifurcated as BPO and KPO services for the purpose of comparability analysis, the next question that arises is what could be the basis of such dissection, bifurcation or classification of ITES services to facilitate relatively equal degree of comparability when the broad functional analysis based on ITES sector is taken into account by applying TNMM. In our opinion, this purpose of attaining a relatively equal degree of comparability can be achieved by taking into consideration the functional profile of the tested party and comparing the same with the entities selected as potential comparables on broad functional analysis taken at ITES level. The principal functions

performed by the tested party should be identified and the same can be compared with the principal functions performed by the entities already selected to find out the relatively equal degree of comparability*. If it is possible by this exercise to determine that some uncontrolled transactions have a lesser degree of comparability than others, they should be eliminated. The examination of controlled transactions ordinarily should be based on the transaction actually undertaken by the AE and the actual transaction should not be disregarded or substituted by other transaction*

77. A useful reference in this regard can be made to the OECD guidelines on Transfer Pricing (including paragraph No. 2.68 to 2.75 thereof relied upon by Shri Porus Kaka) to establish the comparability. As suggested therein, determining a reliable estimate of arm's length outcome requires flexibility and the exercise of good judgment. It is to be kept in mind that the TNMM may afford a practical solution to otherwise insoluble transfer pricing problems if it is used sensibly and with appropriate adjustments to account for differences. When the comparable uncontrolled transactions being used are those of an independent enterprise, a high degree of similarity is required in a number of aspects of the AE and the independent enterprise involved in the transactions in order for the controlled transactions to be comparable. Given that often the only data available for the third parties are company-wide data, the functions performed by the third party in its total operations must be closely aligned to those functions performed by the tested party with respect to its controlled transactions in order to allow the former to be used to determine an arm's length outcome for the latter. The overall objective should be to determine a level of segmentation that provides reliable comparables for the controlled transaction, based on the facts and circumstances of the particular case. The process followed to identify potential comparables is one of the most critical aspects of the comparability analysis and it should be transparent, systematic and verifiable. In particular, the choice of selection criteria has a significant influence on the outcome of theanalysis and should reflect the most meaningful economic characteristics of

the transactions compared. Complete elimination of subjective judgments from the selection of comparables would not be feasible but much can be done to increase objectivity and ensure transparency in the application of subjective judgments. Keeping in mind all these factors, it is necessary in the present context that all the relevant facts peculiar to ITES sector should be taken into account including particularly the problems discussed by us in para 73 to 75 of this order and accordingly the relatively equal degree of comparability should be sought to be achieved by taking into consideration the functional profile of the tested party and comparing the same with functional profile of the potential comparables selected at ITES level.

78. To sum up, we hold that the potential comparables of ITES sector level can be selected by applying broad functional test at first stage and although the comparables so selected can be put to further test, depending on facts of each case, by comparing the specific functions performed in the international transactions with that of uncontrolled transactions to attain the relatively equal degree of comparability as discussed above, the classification of ITES into low-end BPO services and high-end KPO services for comparability analysis would not be fair and proper. The first question referred to this Special Bench is whether for the purpose of determining the arm's length price of international transactions of the assessee company providing back office support services to their overseas associated enterprises, companies performing KPO functions should be considered as comparable ?. In our opinion, the answer to this question will depend on the facts and circumstances of each case inasmuch as if the assessee company, on the basis of its own functional profile, is found to have provided to its AE the low-end back office support services like voice or data processing services as a whole or substantially the whole, the companies providing mainly high-end services by using their specialized knowledge and domain expertise cannot be considered as comparables." (emphasis supplied)

21. The Learned DR also pointed out that it would be incorrect to blindly apply the Special Bench decision in excluding "eClerx Services" and "Mold-Tek" without considering the above paras. The Learned DR strongly held that the rejection of "eClerx" and "Mold-Tek" cannot be applied to the case of "Cosmic Global". The Learned DR strongly pressed the overarching rationale of the Special Bench decision was clear in that there cannot be any bifurcation between BPO and KPO when it comes to TNMM on ITeS and hence the exclusion of other comparables by the Special Bench does not have bearing on this case which is in a different AY and for different comparables.

22. With respect to the Delhi High Court in ***RampGreen Solutions (supra),*** the Learned DR said that the Delhi High Court judgment while prima facie upholding the assessee's contentions of not comparing KPO and BPO, has also clearly said that there may be cases where such comparability is possible. More specifically, the DR relied on the following para:

> *"35. As pointed out by the Special Bench of the Tribunal in Maersk Global Centers (India) Pvt. Ltd. (supra), there may be cases where an entity may be rendering a mix of services some of which may be functionally comparable to a KPO while other services may not. In such cases a classification of BPO and KPO may not be feasible. Clearly, no straitjacket formula can be applied"*

23. Furthermore, the DR insisted that a non-jurisdictional High Court is not binding on other High Courts or Tribunals outside its territory and quoted ***CIT vs. Thane Electrical Supply (206 ITR 727 Bom. HC), Geoffrey Manners & Co. Ltd. vs. CIT (221 ITR 695 Bom.), Consolidated Pneumatic Tool Co (India) vs. CIT (209 ITR 277 Bom.), Visvas Promoters vs. ITAT (323 ITR 114 Mad.), Suresh Desai & Associates vs. CIT (230 ITR 912 Delhi)*** decisions in support of his claim that the Delhi HC judgment ought not to be followed and the overarching rationale of the Special Bench's observation fortifies the stand of the Revenue

24. We have studied all the submissions and decisions carefully. We find the above findings made by the *Hon'ble Special Bench in* ***Maersk decision (supra)*** hold

considerable merit. To further dissect ITeS segment as BPO and KPO makes it pointless for TNMM to be applied as TNMM posits functional similarity and always is the method wherein broadly similar entities in an industry are considered. Hence, we are of the considered opinion that a broad sweep of the category of service (in this case, ITeS) is required to be looked into rather than minutely checking the sub-category for the purpose of including or excluding the comparables. It would be just and proper to consider the area of service and not the specific distinction for the purpose conveniently including or excluding the comparable to suit the requirements of the assessee. We are with the Learned DR that the Special Bench has discussed the issue in detail and given its finding and applied a basic functionality test for rejecting "eClerx" and "Mold-tek" specifically and we cannot agree with the rationale of the Special Bench to be applied for rejection of "Cosmic Global". We are also of the view that the Delhi HC has not taken the correct view in this issue and rely on the ***CIT vs. Thane Electrical Supply (206 ITR 727 Bom. HC)*** judgment with respect to non-binding nature of non-jurisdictional HC decision. Furthermore, without prejudice, the Delhi HC itself has given enough leeway to interpret the comparability test, based on facts and circumstances of the case. In conclusion, we do not find any infirmity in the order of the TPO, AO and DRP in taking "Cosmic Global" as a comparable. The transfer pricing ground of appeal of the assessee in this regard is hence dismissed.

25. The next ground of appeal of the assessee is with regard to use of super profit company as a comparable. The assessee vehemently argued against the same and relied on various decisions. We feel these have been adequately addressed by the TPO in his order and do not feel the need to address the arguments again in detail.

26. Furthermore, the Learned DR also brought to our attention the recent decision of the Delhi High Court in the case of ***Chryscapital Investments Advisors (India) Pvt. Ltd Vs DCIT (ITA No. 417 of 2014) dated 27th April 2014*** wherein the Hon'ble Delhi High Court entered into a detailed discussion about using the super-profit/abnormal margin turnovers and concluded as follows:

"""44. In light of the above findings, this Court concludes as follows:

a. The mere fact that an entity makes high/extremely high profits/losses does not, ipso facto, lead to its exclusion from the list of comparables for the purposes of determination of ALP. In such circumstances, an enquiry under Rule 10B(3) ought to be carried out, to determine as to whether the material differences between the assessee and the said entity can be eliminated. Unless such differences cannot be eliminated, the entity should be included as a comparable……"""

27. Hence, following the above rationale of the Delhi High Court in *Chryscapital Investments (supra)* as well as the *Trilogy Bangalore ITAT decision (ibid)*, we are unable to accept the contention of the assessee and dismiss the grounds raised by the assessee. Therefore, we find no reason to interfere with the order of the TPO and consequently the order of AO/DRP and uphold the same with respect to transfer-pricing issues.

28. The assessee's appeal is thus dismissed.

Order pronounced in the open court on 10th day of September, 2015

Sd/-	Sd/-
……	…….
Accountant Member	Judicial Member

ANNEXURE- B

Vulcantech BPO India Pvt Ltd

Assessment Year 2010-11

PAN : AACBD4392M

APPEAL BEFORE THE INCOME-TAX APPELLATE TRIBUNAL AGAINST THE ORDER PASSED UNDER SECTION 143(3) READ WITH SECTION 144C(13) IN PURSUANCE OF THE DIRECTIONS GIVEN BY THE DISPUTE RESOLUTION PANEL (DRP) CHENNAI

GROUNDS OF APPEAL

A. Corporate tax grounds:

1. The DRP/ITO erred in applying the provisions of S.206AA to non-resident taxpayers and ignored the provisions of S.139A(8) r.w. Rule 114C(1)

2. The DRP/ITO erred in not applying S.90(2) of the Act which holds that provisions of Act are applicable to the extent that they are more beneficial to the taxpayer and hence given that the India-USA DTAA prescribed lower withholding rate than S.206AA, the Articles of the India-USA DTAA are solely applicable to the taxpayer

3. The DRP/ITO failed to appreciate that application of DTAA Articles cannot be unilaterally amended by the contracting country, especially by Section 206AA which is *not a charging section under the Act*.

4. The DRP/ITO ought to have appreciated that Section 90(2) starts with non-obstante clause also and hence cannot be overridden by S.206AA

B. Transfer pricing related grounds:

1. General ground: The DRP/ITO/TPO erred in law and in facts by not accepting the transfer pricing analysis undertaken by the appellant in accordance with the

provisions of the Act read with the Rules, and holding that the appellant's international transaction is not at Arms Length

2. The DRP erred in accepting the comparability analysis carried out by the ITO/TPO though it was not in conformance with the provisions of the IT Act/Rules:

2.1 The DRP erred in upholding TPO's selection of functionally different, high-end value-add service companies as comparables while ignoring the substantiated fact that the appellant company is a very low-end service provider in the ITES (BPO) Space

2.2 The DRP erred in upholding TPO's selection of abnormally high margin/super-profit comparable companies while ignoring the substantial arguments backed by facts, documents and material put forth by the Appellant

C. The Appellant prays leave of the Hon'ble ITAT for elaborating the aforesaid grounds and craves leave to adduce additional grounds at the time of hearing.

Director
For Vulcantech BPO India Pvt Ltd
Dated: 24.03.2015
Chennai

Annexure C

Income Tax Department

No. 121, M.G.Road, Nungambakkam, Chennai – 34

1	Name of the Assessee	M/s.Vulcantech BPO India Private Limited
2	Address	New No 75, Dr.R.K.Salai, Mylapore, Chennai, Tamil Nadu
3	PAN/G.I.R. No.	AACBD4392M
4	Circle	Company Circle – II(4), Chennai
5	Status (Domestic/Public/Private, If Applicable)	Company
6	Assessment Year	2010-11
7	Whether Resident/Resident But Not Ordinarily Resident/Non-Resident	Resident
8	Method of Accounting	Mercantile
9	Previous Year	2009-10
10	Nature of Business	ITES
11	Date of Order	30.01.2015
12	Section under which assessment order is passed	143(3) r.w.s 144C(13)

FINAL ASSESSMENT ORDER

The assessee is a wholly owned subsidiary of Vulcantech BPO Inc, USA. The assessee is engaged in rendering data conversion services to its ultimate parent company

Vulcantech BPO Inc, USA in the area of forms processing, E-publishing, support systems and software services. The assessee company had e-filed its Return of Income for the AY 2010-11 declaring 'Nil' income. The Return was processed under sub-section (1) of section 143 of the Income Tax Act, 1961.

The case was selected for scrutiny and notice u/s 143(2) of the Act was issued to the assessee. Subsequently, the case was assigned by the Commissioner of Income Tax, Chennai-I to the Income Tax Officer, Company Range II, for completion of assessment u/s 143(3) of the Act.

The case was referred to the Transfer Pricing officer for computation of Arms Length Price as the assessee has made international transactions exceeding Rs. 15 crores. The TPO passed an order u/s 92CA(3) on 30.01.2014, making an upward adjustment of Rs. 8,01,88,892/- The ITO, Company Range-II, Chennai issued a Draft Assessment Order u/s 143(3) r.w.s 144C dt 18.03.2014, incorporating the adjustment suggested by the TPO.

The assessee preferred an appeal before the Dispute Resolution Panel (DRP) on 24.04.2014. The DRP passed an order u/s 144C(5) r.w 144C(8) on 12.12.2014 upholding the order of the TPO.

Addition on account of Transfer Pricing Adjustment

As per the directions of the DRP vide its Order dt 12.12.2014, the order of the Deputy Commissioner of Income Tax, Transfer Pricing Officer –II is confirmed. Accordingly, the upward adjustment of Rs. 8,01,88,892/- is hereby added to the returned income.

Addition: Rs.8,01,88,892/-

Payment made towards FTS (FIS)

During the course of assessment proceedings, it was noticed that assessee has claimed expenditure of Rs.91,32,564/- being the amount paid to non-residents for payments

made towards Royalty and Fees for Technical Services. The assessee was asked to furnish details and break-up of the same. From the details furnished, it was found that assessee has made short deduction towards these payments in light of section 206AA of the Act. The assessee preferred an appeal before the Hon'ble DRP and Hon'ble DRP vide Order dt. 12.12.2014 dismissed the appeal of the assessee. Hence the addition made under the head is sustained.

Addition: Rs.9,13,260/-

Income Tax Officer

Company Range – II(4), Chennai

Copy to:

Assessee

Annexure - D

Income Tax Department
Dispute Resolution Panel (DRP)
No. 121, M.G.Road, Nungambakkam, Chennai – 34

Proceedings to issue directions under sub-section 5 of section 144C read with sub-section 8 of Section 144C the Income Tax Act 1961		
1	F. No. DRP/CHE/98/2014-15	Date of Directions: 12.12.2014
2	Name of the Assessee & Address	M/s.Vulcantech BPO India Pvt. Ltd. New No 75, Dr.R.K.Salai, Mylapore, Chennai -4
3	PAN	AACBD4392M
4	Assessment Year	2010-11
5	Date of Filing of Objections by the Assessee before the DRP	24.04.2014
6	Date of Direction	12.12.2014
7	Section & Sub-section under which the directions are given	144C(5) r.w 144C(8)

The assessee company had e-filed its Return of Income for the Assessment Year 2010-11 declaring 'Nil' income. The Assistant Commissioner of Income Tax (ACIT) referred the case of Vulcantech BPO India Private Limited (in short the assessee) under section 92CA of the Act on 24.12.2012 to the Transfer Pricing Officer (TPO) for determining the Arms Length Price (ALP) in relation to the following international transactions entered into by the assessee with its Associated Enterprise (AE) Vulcantech BPO Inc, USA.

S No	Nature of Transaction	Amount (in Rs)	Method
1	Rendering of ITES	97,81,63,186	TNMM

The TPO, based on the Transfer Pricing Study which was made in the case of the assessee, passed the order under section 92CA of the Act on 30.01.2014. The ITO prepared the draft assessment order on 18.03.2014 incorporating the adjustment suggested by the TPO and forwarded a copy thereof to the assessee. The assessee filed its objections before the Draft Resolution Panel (DRP) and subsequently, a notice was issued under section 144C(11) and served upon the assessee for providing an opportunity of being heard. The DRP heard the assessee.

We have carefully gone through the order passed by the TPO under section 92CA of the Act, draft of the proposed assessment order passed by the AO, objections filed by the assessee and other relevant records in this case for the relevant assessment year. This Panel proceeds to decide the application of the assessee as follows:

The ITO served upon the assessee a Draft Assessment Order u/s 143(3) r.w section 144C(1) of the Act making the following additions/disallowances in computing the taxable income of the assessee:

DISALLOWANCE	QUANTUM
Transfer Pricing Adjustment	ALP adjustment of Rs. 8,01,88,892/-
Corporate Tax Addition	u/S 206AA - Rs. 9,13,260/-

Transfer pricing Objections: The assessee has raised the following grounds of Objections with respect to the Transfer pricing issues before the DRP, Chennai:

> *"""1. General ground: The AO/TPO erred in law and in facts by not accepting the transfer pricing analysis undertaken by the appellant in accordance with*

the provisions of the Act read with the Rules, and holding that the appellant's international transaction is not at Arms Length

2. The AO/TPO has not carried out proper comparability analysis as required by the provisions of the IT Act/Rules while ignoring the substantiations and data provided by the appellant

2.1 The AO/TPO fundamentally erred in adopting functionally different, high-end value-add service companies as comparables while ignoring the substantiated fact that the appellant company is a very low-end service provider in the ITES (BPO) Space

2.2 The AO/TPO fundamentally erred in adopting abnormally high margin/super-profit comparable company as comparables while ignoring the substantial arguments backed by facts, documents and material put forth by the Appellant""""

Panel : This Panel does not find anything new which has not been considered by the TPO. The TPO has already considered all important aspects and then only taken the decision to either exclude or include the uncontrolled comparables. Assessee must appreciate that ITeS is one specific sector of information technology industry. It may include whole gamut of service providers. They may be catering to the needs of different companies engaged in different business. As the requirements of these companies may be different, service providers are not providing exactly same services. But still they are all grouped together and referred to as ITES companies. It is because all these service providers are performing almost the same functions. The kind of assets used by these service providers and the risk they face are almost the same. If some of the service providers get higher price for the services rendered then the expenditures in their case will be more and therefore, the profit margin will be almost in the same range for all ITES companies. On the basis of this fact, no company can be excluded from the set of uncontrolled comparables. In the light of the above discussion, this Panel reviews the suitability of each uncontrolled comparable excluded or included by the TPO.

(i) "Cosmic Global Ltd": the assessee company has submitted that this company is engaged in translation, audit and medical transcription business. As against it, the assessee is engaged in data processing service. This company has developed a web portal incurring expenditure in earlier years for the development, launch, sustained maintenance and upgradation of the portal but no income is generated from it.

This Panel finds that the company is into translation and transcription services which it considers as an ITeS activity and comparable with the ITeS activity of the assessee, irrespective of nomenclature assigned to the activities as KPO or BPO. Hence, Objection 2.1 is decided in favour of the Department and against the assessee.

The TPO has also considered in detail the ground of the assessee with respect to rejecting Cosmic Global as a super-profit/abnormal margin comparable. We wholly agree with the TPO's conclusion and hold that comparables cannot be excluded due to the mere fact that they earned a high profit and that in the instant case the assessee failed to substantiate why Cosmic Global must be excluded on this ground and hence the Objection 2.2 is decided in favour of the Department and against the assessee.

This Panel therefore finds that all the objections raised by the assessee do not vitiate the comparability and hence, no direction is given to the TPO.

Corporate Tax related Objections: The assessee raised the following Objections before this Panel with respect to corporate-tax related issues:

> *"""1. The AO erred in applying the provisions of S.206AA to non-resident taxpayers and ignored the provisions of S.139A(8) r.w. Rule 114C(1)*
>
> *2. The AO erred in not applying S.90(2) of the Act which holds that provisions of Act are applicable to the extent that they are more beneficial to the taxpayer and hence given that the India-USA DTAA prescribed lower withholding rate than S.206AA, the Articles of the India-USA DTAA are solely applicable to the taxpayer*

3. The AO failed to appreciate that application of DTAA Articles cannot be unilaterally amended by the contracting country, especially by Section 206AA which is not a charging section under the Act.

4. The AO ought to have appreciated that Section 90(2) starts with non-obstante clause also and hence cannot be overridden by S.206AA""""

Panel : This Panel has carefully considered the submissions and deals with all the Objections 1-4 together. Section 206AA of the Act has been included in Part B of Chapter XVII dealing with *Collection and Recovery of Tax – Deduction at source*. Section 206AA of the Act deals with requirements of furnishing PAN by any person entitled to receive any sum or income on which tax is deductible under Chapter XVII-B, to the person responsible for deducting such tax. In so far as the present controversy is concerned, it would suffice to note that section 206AA of the Act prescribes that where PAN is not furnished to the person responsible for deducting tax at source then the tax deductor would be required to deduct tax at the higher of the following rates, namely, at the rate prescribed in the relevant provisions of this Act; or at the rate/rates in force; or at the rate of 20%. In the present case, assessee was responsible for deducting tax on payments made to non-residents on account of fees for technical services ('fees for included services' under the India-USA DTAA terminology). The dispute before us relates to the payments made by the assessee to such non-residents who had not furnished their PANs to the assessee. The case of the Revenue is that in the absence of furnishing of PAN, assessee was under an obligation to deduct tax @ 20% following the provisions of section 206AA of the Act. However, assessee had deducted the tax at source at the rates prescribed in the respective DTAA between India and the relevant country of the non-residents; and, such rate of tax being lower than the flat rate of 20% mandated by section 206AA of the Act. Assessee claimed that Section 139A(8) read with Rule 114C(1) applies and that non-residents need not furnish PAN and hence S.206AA cannot be applied to non-residents; furthermore it is the contention of the assessee that Section 90(2) of the Act provides that the domestic Act will apply only to the extent that it is more beneficial to the assessee and in the instant case the Article 12 of the DTAA would prevail as it posits a

lower withholding of tax. The assessee's counsel argued vehemently that DTAA's applicability cannot be unilaterally overridden by inserting provisions such as S.206AA and that S.206AA is not a charging section for it to prevail in the instant case. The assessee relied on the following cases:

a. DIT Vs. Ishikawjima Harima Heavy Inds Co Ltd (212 Taxman 273 Bom)
b. CIT Vs Siemens AK (310 ITR 320 Bom)
c. DIT Vs Nokia Networks (253 CTR 417 Del).
d. Sanofi Pasteur Holdings SA Vs CIT (354 ITR 316 AP)
e. DIT Vs Ericsson (343 ITR 470 Del)
f. Solid Works Corporation (17 ITR (TRIB) 510)
g. CIT Vs Dynamic Vertical Software India P. Ltd. (332 ITR 222)

In our considered opinion, it would be incorrect to say that charging section 4 of the Act and section 5 of the Act dealing with ascertainment of total income are subordinate to the principle enshrined in section 90(2) of the Act. The provisions of Chapter XVII-B governing tax deduction at source are not subordinate to section 90(2) of the Act. Notably, section 206AA of the Act which is the centre of controversy before us is also a charging section but is a part of the procedural provisions dealing with collection and deduction of tax at source. The provisions of section 195 of the Act which casts a duty on the assessee to deduct tax at source on payments to a non-resident cannot be looked upon as a mere procedural provision.

The assessee relied on the decision of the Hon'ble Supreme Court in the case of ***CIT vs. Eli Lily & Co., (2009) 312 ITR 225 (SC)*** which observed that the provisions of tax withholding i.e. section 195 of the Act would apply only to sums which are otherwise chargeable to tax under the Act. It is not disputed that amount is chargeable under the provisions of the Act. The only dispute here is in relation to rate of taxation. The relevant DTAA demands tax at the rate of 10% whereas section 206AA demands tax at

20% due to absence of PAN. The provision starts with a non-obstante clause and presides over any other provision of the Act which also includes section 90(2) of the Act and the charging sections as well. Hence, we are of the considered opinion that action of the ITO is correct and does not warrant any interference.

Even otherwise, it is beyond doubt that tax would be at the rate specified in DTAA and the same would have been claimed by the Revenue if PAN had been furnished. However, DTAA does not specify the case where PAN is not furnished. Section 206AA specifically deals with cases where PAN has not been furnished by the assessee. Therefore, a harmonious construction of the relevant provisions would make it clear that section 206AA does not override the provisions of DTAA in any manner whatsoever.

Therefore, in view of the aforesaid schematic interpretation of the Act, where the tax has been deducted on the strength of the beneficial provisions of section DTAAs, the provisions of section 206AA of the Act can be invoked by the Assessing Officer to insist on the tax deduction @ 20%, having regard to the specific nature of the provision. Thus, we hereby agree with the Assessing Authority in relation to tax demand relatable to difference between 20% and the actual tax rate on which tax was deducted by the assessee in terms of the relevant DTAA. As a result, assessee's appeal on this ground is rejected.

To conclude, the Panel finds no infirmity in the order of the ITO/TPO with regards to corporate-tax and transfer-pricing grounds and upholds the adjustments therein proposed.

_____	_____	_____
DIT (Int Taxation) Member, DRP, Chennai	DIT (Int Taxation) Member, DRP, Chennai	CIT Member, DRP, Chennai

Copy Forwarded to :

1. **ITO**
2. **Depty Commissioner of Income Tax (TPO)**
3. **Assessee**
4. **The Guard File**

Annexure - E

Vulcantech BPO India Private Limited

Assessment Year 2010-11

Summary of Objections before the DRP

A. Corporate tax grounds:

1. The ITO erred in applying the provisions of S.206AA to non-resident taxpayers and ignored the provisions of S.139A(8) r.w. Rule 114C(1)

2. The ITO erred in not applying S.90(2) of the Act which holds that provisions of Act are applicable to the extent that they are more beneficial to the taxpayer and hence given that the India-USA DTAA prescribed lower withholding rate than S.206AA, the Articles of the India-USA DTAA are solely applicable to the taxpayer

3. The ITO failed to appreciate that application of DTAA Articles cannot be unilaterally amended by the contracting country, especially by Section 206AA which is not a charging section under the Act.

4. The ITO ought to have appreciated that Section 90(2) starts with non-obstante clause also and hence cannot be overridden by S.206AA

B. Transfer pricing related grounds:

1. General ground: The ITO/TPO erred in law and in facts by not accepting the transfer pricing analysis undertaken by the appellant in accordance with the provisions of the Act read with the Rules, and holding that the appellant's international transaction is not at Arms Length

2. The ITO/TPO has not carried out proper comparability analysis as required by the provisions of the IT Act/Rules while ignoring the substantiations and data provided by the appellant

2.1 The ITO/TPO fundamentally erred in adopting functionally different, high-end value-add service companies as comparables while ignoring the substantiated fact that the appellant company is a very low-end service provider in the ITES (BPO) Space

2.2 The ITO/TPO fundamentally erred in adopting abnormally high margin/super-profit comparable company as comparables while ignoring the substantial arguments backed by facts, documents and material put forth by the Appellant

C. The Appellant prays leave of the Hon'ble Dispute Resolution Panel for elaborating the aforesaid grounds and craves leave to adduce additional grounds at the time of hearing.

Authorised Signatory
For Vulcantech BPO India Pvt Ltd
Dated: 24.04.2014
Chennai

Annexure - F

Income Tax Department

1	Name of the assessee	M/s.Vulcantech BPO India Private Limited
2	Address	New No. 75, Dr.RK Salai, Mylapore, Chennai – 600004, Tamil Nadu, India
3	PAN/G.I.R. No.	AACBD4392M
4	Circle	Company Circle – II(4), Chennai
5	Status (Domestic/Public/ Private, If Applicable)	Company
6	Assessment Year	2010-11
7	Whether Resident/Resident But Not Ordinarily Resident/Non-Resident	Resident
8	Method of Accounting	Mercantile
9	Previous Year	2009-10
10	Nature of Business	ITES
11	Date of Order	18.03.2014
12	Section under which Assessment Order is passed	143(3) r.w.s 144C

DRAFT ASSESSMENT ORDER

The assessee is a wholly owned subsidiary of M/s. Vulcantech BPO Inc, USA. The assessee is engaged in rendering data conversion services in the area of forms processing.

The assessee company had e-filed its Return of Income for the Assessment Year 2010-11 declaring 'Nil' income. The Return was processed under sub-section (1) of section 143 of the Income Tax Act, 1961.

The case was selected for scrutiny and notice u/s 143(2) of the Act was issued to the assessee. The case was referred to the Transfer Pricing officer for computation of Arms Length Price as the assessee has made international transactions exceeding Rs. 15 crores.

Subsequently, the case was assigned by the Commissioner of Income Tax, Chennai-I to the Income Tax Officer, Company Range II, for completion of assessment u/s 143(3) of the Act.

In response to the notices issued, Sri. Ramachandran, CFO and Sri. Venkatraman, Dy. Sr. Manager (Fin) appeared from time to time on various dates. He filed the Power of Attorney to appear before the Income-Tax Authorities. Details relevant to the Return of Income were called for from the assessee and were filed. The case was discussed with the assessee's representative and the scrutiny assessment is completed as under:

Addition on account of Transfer Pricing Adjustment:

With regard to the reference made to the Transfer Pricing Officer for determining Arms Length Price in respect of international transactions made by the assessee company, the Deputy Commissioner of Income Tax, Transfer Pricing Officer – II, Chennai vide Order u/s 92CA(3) of the Act dt 30.01.2014 had computed the Arms Length Price (ALP) by increasing the value of the international transactions relating to ITES, to Rs. 105,83,52,078/- and arriving at an adjustment of Rs.8,01,88,892/-

Addition Rs. 8,01,88,892/-

Payment made towards Royalty and FTS

During the course of assessment proceedings, it was noticed that assessee has claimed expenditure of Rs.91,32,564/- being the amount paid to non-residents for payments made towards Fees for Technical Services in terms of a survey report obtained from M/s Data Research Inc., USA. The assessee was asked to furnish details and break-up of the same. From the details furnished, it could be seen that for the payment, TDS was deducted @ 10% as per the India-USA DTAA (Article 12 / Fees for Included Services).

However, the non-resident payee's PAN was not furnished/not available and hence the instant case is squarely hit by the provisions of S.206AA of the IT Act, 1961. The relevant provision reads as under:

> ***"206AA**. (1) Notwithstanding anything contained in any other provisions of this Act, any person entitled to receive any sum or income or amount, on which tax is deductible under Chapter XVIIB (hereafter referred to as deductee) shall furnish his Permanent Account Number to the person responsible for deducting such tax (hereafter referred to as deductor), failing which tax **shall be deducted at the higher of the following rates**, namely:—*
>
> *(i) at the rate specified in the relevant provision of this Act; or*
>
> *(ii) at the rate or rates in force; or*
>
> *(iii) at the rate of twenty per cent."*

The provision is abundantly clear that higher of the rates should be imposed where the non-resident recipient's PAN is not furnished/available, overriding any other provisions of the Act.

The assessee took the argument before this office that S.206AA does not apply to non-residents due to application of S.139A(8) r.w Rule 114C(1). However, I do not find merit in the same as the Sec.206AA clearly starts with a non-obstante clause and was

inserted later than S.139A(8) and does not make a distinction between resident/non-resident.

The assessee also sought refuge under the Article 12 ('Fees for Included Services') of the India-USA DTAA r.w S.90(2) of the Income Tax Act which allows the application of the DTAA Articles for a taxpayer. However, again I see no merit in the assessee's arguments as S.206AA's non obstante clause overrides the India-USA DTAA Articles which derive power from S.90(2). It is also pointed out that this S.206AA was inserted recently ie. much after S.90(2) and hence the intention of the legislature is clear. When there is a specific provision inserted by the legislature, it has to be applied and hence S.206AA is clearly applicable in the instant case.

Thus, the payments made to non-residents amounting to Rs. 91,32,564/- has to be taxed at the flat rate of 20% under section 206AA of the Income Tax Act. Since tax has already been deducted at 10%, the balance 10% is hereby disallowed.

Addition Rs.9,13,260/-

Penalty proceedings are to be initiated separately for both TP and corporate tax additions.

(G. Krishnamurthy)
Income-tax Officer
Company Circle-II(4), Chennai

Annexure-G

Income Tax Department

Proceedings of the Transfer Pricing Officer – II
Room No. 203, II Floor, Main Building,
No. 121, M.G.Road, Nungambakkam, Chennai – 34

ORDER U/S. 92CA OF THE INCOME-TAX ACT, 1961

PRESENT : Dr. John Galt

Deputy Commissioner of Income-tax

No. V-303/TPO-II/AY 2010-11 **Date : 30.1.2014**

1	Name and address of the company	:	M/s.Vulcantech BPO India Private Limited New No. 75, Dr.RK Salai, Mylapore, Chennai – 600004, Tamil Nadu, India
2	Assessment Year	:	2010-11
3	Permanent Account Number	:	AACBD4392M
4	Reference From	:	ACIT, Company Circle – II(4), Chennai
5	Date of Reference	:	24.12.2012
6	Nature of business	:	ITES
7	Quantum of International Transaction as per 92B	:	Rs. 97,81,63,186
8	Name & address of the Associate Enterprise and the country in which it is resident	:	M/s. Vulcantech BPO Inc, USA
9	Transfer Pricing as taken by the tax payer	:	Rs. 97,81,63,186
10	Nature of Association as per Section 92A	:	Participation in capital, control & management
11	Method adopted by the assessee	:	TNMM

12	Section & sub-section under which order is made	:	92CA(3)

ORDER U/S 92CA(3) OF THE INCOME-TAX ACT, 1961

1. A reference u/s 92CA(1) of the I.T. Act 1961 in the case of M/s. Vulcantech BPO India Private Limited, (hereinafter referred to as the assessee) for AY 2010-11 was received from the ACIT Company Circle – II(4), Chennai for the computation of the Arms Length Price (ALP) of the international transactions detailed in audit report in Form No. 3CEB (hereinafter called the audit report). A copy of the audit report was received along with the reference.

2. Accordingly, a notice u/s 92CA(2) of the I.T.Act was issued to the assessee on 13.03.2013. The assessee was requested to furnish all the relevant details with regard to the international transactions entered into by the assessee with its Associated Enterprises (AEs). During the course of the proceedings, Sri. Ramachandran, CFO and Sri. Venkataraman, Dy. Sr. Manager (Fin) of the assessee attended and presented the case.

3. The assessee Vulcantech BPO India Private Limited is engaged in rendering data conversion services to its ultimate parent company M/s. Vulcantech BPO Inc, USA, (the assessee's AE), in the area of forms processing. Forms based processing is presenting handwritten, typed or printed form in a suitable digital format. For the purposes of benchmarking its international transactions, the assessee has followed TNMM with external comparables and has used operating profit over total cost as the profit level indicator (PLI) arriving at its PLI as follows:

Sno	Nature of Transaction	Amount	Method (PLI)
1	Rendering of ITES	97,81,63,186	TNMM (10.76%)

4. **FAR Analysis of the assessee as per the TP Study Report submitted by it is as under:**

4.1 Introduction

On identification of the international transactions of Vulcantech BPO India Private Limited with its AE, it is important to analyze the nature of these transactions by performing the Functions, Assets and Risk Analysis (FAR Analysis). The FAR Analysis represents the most important aspect of the transfer pricing study. For the purpose of justification of the ALP, the functional analysis identifies the functions undertaken by each party, the risks assumed and the assets used by each party to the transaction. It also assists in determining the economic value added by each party to the transaction(s).

4.2 Functional Analysis of Vulcantech BPO India Pvt Ltd (Vulcantech BPO) vis-à-vis AE's

Description of Functions	**Vulcantech BPO**	**AE's**
Customer		
Identification of customers		✓
Negotiation of contractual terms with customers		✓
Entering into MOUs / Service Level Agreements		✓
Rendering/Delivery of Services	✓	
Human Resource		
Identification of requirements	✓	
Recruitment of manpower	✓	
Appointment of contractors	✓	

Training to employees	✓	
Assignment of qualified professionals on projects	✓	
Loss of man-power	✓	
Infrastructure		
Provision for the availability of infrastructure facilities (buildings, workstations with supporting infrastructure like cabling, network equipments etc)	✓	
Supervision and Quality Function		
Quality assurance for clients		✓

4.3 **Assets Analysis**

While performing a comparison of the functions performed it is relevant to take into account the type of assets used in rendering services. The primary assets used in the course of rendering services to AEs are summarized below:

Description of Assets	**Vulcantech BPO**	**AEs**	**Comments**
Employees	✓		Functions listed above are performed by personnel / sub contractors employed by Vulcantech BPO to arrange suitable infrastructure
Infrastructure	✓		

4.4 Risk Analysis

In a transfer pricing study, it would be crucial to understand the risks borne by an entity vis-à-vis its AE to arrive at the Arms Length transfer price. However, the assessee could not quantify any additional risk adjustment before us. Therefore, we feel that there is no need for any adjustment in this regard and the assessee accepts the same.

4.5 FAR Conclusion

Based on the above FAR Analysis, Vulcantech BPO can be characterized as contract IT Enabled Service (ITES) provider.

5. The details/documents submitted during the course of the proceedings were examined and the benchmarking done by the assessee of its international transactions were not found to be acceptable and accordingly a show cause notice was issued to the assessee vide this office letter No. F. No. H-325/TPO-II/AY 2010-11 dt 23.9.2013. The relevant paras of the show cause notice are reproduced herein under:

> *"1. Rendering of IT Enabled Data Management services - During the year under consideration you have rendered ITES worth Rs. 97,81,63,186/- to your AE. From the transfer pricing study report submitted by you it is seen that you have selected TNMM as the most appropriate method to benchmark international transaction relating to rendering of ITES. In TNMM analysis, the operating profits earned by comparables have been computed on operating cost. For benchmarking the international transaction, you have identified comparable companies on the basis of FAR analysis i.e function performed, risk assumed and asset utilized.*
>
> *1.1 The search criteria and the acceptance/rejection matrix applied by the assessee for arriving at a final comparable set are as under:*
>
> - *Companies with turnover between 1 crore and 500 crores are selected*

- *Companies with other operating income/net sales more than 25% with the objective of selecting companies predominantly engaged in rendering of services activities are selected*
- *Companies having R&D expenses/net sales <= 3% are selected*
- *Companies with positive net worth are selected*
- *Companies performing non-comparable functions are rejected*
- *Companies with dissimilar products and services are rejected*
- *Companies with insufficient data to carry out an analysis of the functions/products are rejected*

1.2 *Finally, three companies were identified by the assessee as being comparables to the assessee. Margin analysis of the companies providing ITES is as under:*

S. No.	***Name of the company***	***Operating margin/Total cost %***
1	*Aditya Birla Minacs Worldwide*	*1.85*
2	*Microgenetics Systems Ltd*	*9.56*
3	*R Systems International (Seg)*	*14.09*
	Average	***8.5***

6. Based on the above analysis, the assessee in its TP study arrived at 10.76%. The weighted mean of its comparable companies at 8.5%, while its operating margin is 10.76%. Assessee hence came to the conclusion that the transactions with the AEs can be considered at arms' length, given that it is earning a higher net profit margin under the TNMM method.

7. On verification of the comparables selected by the assessee for the purpose of benchmarking the international transactions, the following companies do not

appear to be comparable with the assessee for the reasons given under and are accordingly proposed to be excluded from the set of comparables adopted:

S.No.	Name of the company	Reasons for rejection by the TPO
1	R Systems Segmental	Dissimilar functions

8. During the proceedings, the assessee has not objected to the exclusion of R Systems Segmental. Therefore, the company is excluded from the final list of comparables.

9. Furthermore, the assessee in its TP Study Report has given the search process and accept reject matrix to select comparable companies in respect of transactions pertaining to ITES. On verifying the filters, as well as the TP study carried out by the assessee, it is found that the assessee conveniently has NOT included **"Cosmic Global Ltd"** in its list of comparables.

10. A look at the Annual Report of this comparable company, ie Cosmic Global, makes it clear that the company is trying to expand the customer base by its specialization in translation services and also by pursuing other IT enabled services such as BPO services. As the company is functionally similar to the assessee and also satisfies the various search criteria /filters applied, it is proposed that the same be added to the assessee's final list of comparables.

11 The assessee objected to the above said inclusion on the ground that the company Cosmic Global is functionally different. The assessee's contentions are broadly summarized as under:

i. Low-end BPO (assessee) cannot be compared with high-end KPO (Cosmic Global):

a. The services provided by Cosmic Global are translation, localization, voiceovers, multi-lingual desktop publishing, transcription, accounts processing etc. It can be seen from the Annual Report of M/s. Cosmic

Global Ltd. that its main source of remuneration is from *translation of documents*. It provides translation services in over 75 languages and it requires a translator with strong written communication skills to discharge its function whereas the only service provided by the appellant is *page processing* which can be done by a person who has basic knowledge in English.

b. Medical transcription is highly technical and can be done ONLY by persons who have thorough technical knowledge related to various medicines and diseases and the eligible candidates should have undergone professional training in medical transcription. Again this is in contrast to the assessee company which does not require any technical expertise as a low-end service provider for its data entry operation.

c. Hence, Cosmic Global Ltd. is in to varied business and its work-force requires technical expertise in discharging its functions which can classify it as a high-end value added ITES service provider whereas the assessee's is nothing but a data entry service provider and its employees do not require any technical expertise for discharging its functions.

ii. **Super-profit companies to be excluded as comparable:**

a. Without prejudice to the above contentions, the assessee also submitted that the comparable company, Cosmic Global Ltd., was earning abnormally high profits i.e super-profit and hence should be excluded as comparable

12. With respect to the first contention made above, that KPO should not be compared with BPO companies though both are classified as ITeS, the assessee relies on the following:

A. Bangalore ITAT judgment in the case of ***M/s.Symphony Marketing Solutions India Pvt. Ltd Vs ITO [IT(TP)A No. 1316/ Bang/2012],*** where

it was held that KPO and BPO are two different streams of industries and cannot be a comparable company. The relevant extract is as follows:

"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 is only a KPO would do and not a BPO."

B. The assessee also relied on the ***Notification No. SO 2810(E) issued by the CBDT on 18th September, 2013*** making Rules 10-TA to Rule 10-TG as Safe Harbour Rules. In clause (e) of Rule 10TA, the term *"information technology enabled services"* is defined as under:- *"'(e) "information technology enabled services" means the following business process outsourcing services provided mainly with the assistance or use of information technology, namely:- (i) back office operations; (ii) call centres or contact centre services; (iii) data processing and data mining; (iv) Insurance claim processing (iv) legal databases; - (v) creation and maintenance of medical transcription excluding medical advice; (vi) translation services; (vii) payroll; (ix) remote maintenance (x) revenue accounting; (xi) support centres; - (xii) website services; (xiii) data search integration and analysis; (xiv) remote education excluding education content development; or (xv) clinical database management services excluding clinical trials, But does not include any research and development services whether or not in the nature of contract research and development services;"*

The term "knowledge process outsourcing services" is defined in clause (g) of 10-TA as under:- *"(9) knowledge process outsourcing services" means the following business process outsourcing services provided mainly with the assistance or use of information technology requiring application of knowledge and advanced analytical and technical skills,*

namely: (i) geographic information system; (ii) human resources services; (iii) engineering and design services; (iv) animation or content development and management; (iv) business analytics; (v) financial analytics; or (vi) market research, but does not include any research and development services whether or not in the nature of contract research and development services;"

Therefore, it was contended by the assessee that there is a very clear difference between BPO and KPO and a company providing high-end value added services cannot be compared with a company providing routine low end ITES work.

C. The assessee also relied on the case of ***Vodafone India Services Pvt. Ltd. vs. DCIT (ITA No.7140/Mum/2012 dated 26.4.2013, 157 TTJ 513)*** wherein it was held that:

"21.6 COSMIC GLOBAL LTD.

The assessee has objected to the inclusion of this comparable on the ground that the company is not comparable as it is mainly engaged in translation business in addition to medical transcription, accounts BPO and consultancy. The learned DR has placed on record the annual report of the company which shows that the main revenue i.e. 4.05 crore is from translation business where as revenue from medical transcription is only 9.72 lakh and from BPO at Rs. 12.41 lakh. The translation business is not comparable to the case of the assessee. Therefore, in our view, this company has to be excluded from the list of comparables. We accordingly direct the Assessing Officer to exclude this comparable."

13. On this ground, the contention of the assessee is unacceptable for the reasons discussed in detail herein below.

14. It is to be noted that TNMM is governed by Rule 10B(1)(e) of the IT Rules which reads as follows:

"""10B(1)(e) transactional net margin method, by which,—

(i) the net profit margin realised by the enterprise from an international transaction 55c[or a specified domestic transaction] entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;

(ii) the net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;

(iii) the net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction 55c[or the specified domestic transaction] and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;

(iv) the net profit margin realised by the enterprise and referred to in sub-clause (i) is established to be the same as the net profit margin referred to in sub-clause (iii);

(v) the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction [or the specified domestic transaction];"""

15. The application of TNMM posits a broad brush comparability of similar functional area i.e ITES companies together. A finer distinction made between low-end ITES and high-end ITES would, in my opinion, go against the very application of TNMM which seeks to arrive at an overall comparability analysis unlike CUP which deals with specific transactions. In other words, arguing on the minutiae of the functionality of the comparables would end up in a place

where no TNMM can ever be applied because always some distinction or the other can be made between companies, which if resorted would result in the breakdown of TNMM as no comparables would survive in such an exercise.

16. This rationale has been more clearly dealt with in ***Vodafone India Services (P) Ltd Vs DCIT 157 TTJ (Mumbai) 513*** where the Mumbai Tribunal observed as follows:

> *"20.1 The assessee has followed TNMM method for making the transfer pricing adjustment in relation to the international transaction entered into by the assessee. Therefore, the arithmetic mean of the margins of the comparables is required to be compared with that of the assessee for the purpose of making TP adjustment. The selection of comparables is important, which must be operating in the same field in order to insure that accurate adjustment as provided under the law is made. The assessee is providing IT enabled services as call centre about which there is no dispute. The assessee conducted the search for companies engaged in ITES which is clear from the note submitted by the assessee before the TPO on TP study in para 3.3.1 at page 193 of the paper book. In para 6 of the note at page 181 of paper book, the assessee has mentioned that it belongs to ITES/BPO industry. The learned DR has also placed on record the NASSCOM member directory, in the relevant portion of which the assessee has been described as ITES/BPO company. It is thus clear that the assessee is providing ITES/BPO services. The case of the assessee that ITES/BPO industry is divided into several segments and, therefore, assessee had selected only those companies which were pre-dominantly engaged in call centre business. It has also been submitted that ITES/BPO industry has several segments starting from low segment such Call centre, Customer Care to high end segments such as KPO, content development etc. in which there is wide variation in the billing rates. NASSCOM report on billing rate for different*

segments has been placed on record. It has thus, been argued that high end services are not comparable to the case of the assessee.

20.2 The comparability of transaction or the selection of comparables in our view has to be examined in terms of the rules framed in this regard. The Rule 10B (2) provides that the comparability of international transaction with uncontrolled transactions has among other things to be judged with the reference to characteristics of services provided, functions performed, asset employed and risk assumed. It has therefore to be ensured that functions of the comparables and characteristics of services rendered are similar. Viewed from this angle, we find that all companies which are in ITES segment are providing similar services and difference is in the internal working which is reflected through difference in qualifications and skills of the employees. In all these cases employees are the main assets who are providing various services using Information Technology (IT). The main difference is the skills/qualification of the employees engaged who are providing the services. The employees are the main assets of these companies and therefore, the difference is mainly in the assets employed. Therefore, we have to examine whether difference in the skill/qualification of the employees or their payment structure is going to affect the comparability in any significant manner. TNMM method is tolerant to minor differences and, therefore, even if there are some differences unless they materially affect the margin, the comparables could not be excluded. This is clearly provided in the Rule 10 B (3) as per which an uncontrolled transaction has to be taken as comparable to the international transaction if none of the differences between the transactions compared or the enterprises entering into such transactions are likely to materially affect the price charged, cost incurred or profit earned and even if there are material differences, the uncontrolled transaction can still be considered as comparable if

reasonably accurate adjustments could be made by eliminating the material affects of such differences.

In this case as we have pointed out earlier that difference in various segments i.e. low end to high end in ITES services is mainly on account of differences in the skill/qualification and pay structure of employees and, therefore, the main point to be considered is whether such differences between employees is going to materially affect the margin of the comparables. The learned AR for the assessee has placed before us the NASSCOM report showing billing rates in different segments of the ITES sector to point out that there is wide variation between low end and high end segments. However only on the basis of billing rates no conclusion could be drawn that margins in different segments of ITES services is also different. This is because if the billing rate is high in the high end services, the cost of the employees who are highly qualified/skilled also goes up steeply and, therefore, the margins are not much affected. In fact, no evidence has been produced before us to show that margins in the high end segments of ITES services is high compared to low end services. Therefore, we are unable to accept the argument advanced by learned AR that the comparables belonging to high end segments such as content development, KPO, Medical Transcription etc. should be excluded from the comparability list on this ground alone. In fact, this view is supported by the latest decision of Mumbai bench of Tribunal in case of ***M/s Willis Processing Services India (P) Ltd. in 161 TTJ 0025*** *for assessment year 2007-08 dated 1.3.2013 in which the Tribunal after considering the various submissions and decisions of Tribunal relied upon by the assessee held that KPO was a term given to a branch of BPO in which apart from processing data, knowledge is also applied. The Tribunal therefore, held that the KPO could not be excluded from the comparability list. The Tribunal in the case of Actis Advisors (P) Ltd.(Supra) have also held that any further dissections of ITES will not be proper as it would be a very subjective*

exercise. Even in the case of CRM services (P) Ltd (Supra) on which the assessee has relied, there is no finding that margin in case of high end segment of ITES is higher.

20.4 We also note that even in the case of comparables selected by the assessee details of which have been given in para 3 of the order earlier, there is wide fluctuation in the margins of the companies; the lowest margin i.e. 0.34% in case of Ask Me Info Hub Ltd. and the highest margin as 27.98% in case of Allsec Technologies Ltd. Obviously the cases selected by the assessee are not identical otherwise there would not have been so wide variation. Excluding the highest margin and the loss case, the average margin of other comparables of the assessee comes to only 4.5% which is 1/6th of the highest margin. Compared to this, the average margin of the comparables of the TPO is within two times the highest margin in case of the assessee. Thus, if the comparables with 1/6th of the highest margin are acceptable to the assessee then, there is no reason for the assessee to be aggrieved with the comparables of TPO where average margin is within twice the highest margin, case selected by the assessee. The objection of the assessee will be valid only if there is material to show that high margin in case of high end services is because of nature of activities. But as it has been pointed out earlier, no such material had been produced. Therefore, we reject the argument advanced based on low end/high end services in the ITES activities."

17. While it is true that the non-jurisdictional ITAT Mumbai in ***Vodafone (supra)*** finally excluded "Cosmic Global", I believe that if the rationale of ***Willis Processing (supra)*** read with the provisions of the Rule 10B(1)(e) of IT Rules, 1962 is correctly applied and interpreted, the translation as well as the transcription services of "Cosmic Global" are functionally comparable with the assessee under TNMM as much as all of these come under ITeS services and hence Cosmic Global should not be excluded as a comparable.

18. With respect to the second contention made above, that super-profit/abnormally high margin companies should not be considered as a comparable, the assessee relies on the following:

A. The assessee relies on the judgment given in ***DCIT Vs Quark Systems Pvt. Ltd 38 SOT 0307*** where the Special Bench observed as follows:

> *"Even if the taxpayer or its counsel had taken Datamatics as comparable in its T.P. audit, the taxpayer is entitled to point out to the Tribunal that above enterprise has wrongly been taken as comparable. In fact there are vast differences between tested party and the Datamatics. The case of Datamatics is like that of "Imercius Technologies" representing extreme positions. If Imercius Technologies has suffered heavy losses and, therefore, it is not treated as comparable by the tax authorities, they also have to consider that the Datamatics has earned extraordinary profit and has a huge turnover, besides differences in assets and other characteristics referred to by Shri Aggarwal."*

B. Similarly in the case of ***M/s. Sap Labs India Pvt. Ltd. 2010-TII-44-ITAT Bang-TP***, the Bangalore Tribunal had observed as follows:

> *"86. At the cost of repetition, we have to say that extreme cases should not be included in samples and extreme comparables mean not only the positive higher side but also the lower side. In the list of 22 comparables, many of them are having very low margin rate, not only less than 10 or 5, even below that. We have already considered that the agreement entered into by the assessee with its German associate concern has contemplated a compensation of cost plus 6 per cent, or 1.5 times of the total wages bill, whichever is higher. This point we have to consider in the light of the fact that the assessee is working in a risk*

mitigated environment. That is why we have agreed with the argument of the assessee-company that there may not be extreme profits in the case of the assessee. When extremes are excluded from the samples, all sorts of extremes should be avoided. Otherwise, samples selected for comparative study may not be representative."

C. The assessee also relied on the rationale of the decision of ***Capital IQ Information Systems India Pvt. Ltd. (India) vs. DCIT (57 SOT 14, Hyd Tribunal)*** which held as follows:

"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."

19. On this ground, the contention of the assesse is unacceptable for the reasons discussed in detail herein below.

20. In the case of ***M/s Trilogy E-Business Software India Pvt. Ltd. vs. DCIT (ITA No.1054/Bang/2011, AY 2007-08)*** the Bangalore ITAT considered the decisions of the Tribunal relied on by the assessee, while discussing in detail whether abnormal margin/super-profit comparables should be excluded and held in principle against the assessee while holding as follows:

"""32. We have considered the rival submissions. First we will consider the submission of the Assessee that companies with abnormal margins should not be regarded as comparable. In the case of Quark Systems Pvt. Ltd. (supra), the Special Bench had to deal with cases where the results were abnormal. The special Bench observed as follows:

"Even if the taxpayer or its counsel had taken Datamatics as comparable in its T.P. audit, the taxpayer is entitled to point out to the Tribunal that above enterprise has wrongly been taken as comparable. In fact there are vast differences between tested party and the Datamatics. The case of Datamatics is like that of "Imercius Technologies" representing extreme positions. If Imercius Technologies has suffered heavy losses and, therefore, it is not treated as comparable by the tax authorities, they also have to consider that the Datamatics has earned extraordinary profit and has a huge turnover, besides differences in assets and other characteristics referred to by Shri Aggarwal."

The above observations of the special Bench is a pointer to the fact that where there are extraordinary profits and those companies are considered by the TPO for comparability but loss making companies are not considered as comparable, that would improper. The Tribunal found that such contradiction in approach should not be permitted. Similarly in the case of ***M/S. Sap Labs India Pvt. Ltd. 2010-TII-44-ITAT Bang-TP*** *had observed as follows:*

"86. At the cost of repetition, we have to say that extreme cases should not be included in samples and extreme comparables mean not only the positive higher side but also the lower side. In the list of 22 comparables, many of them are having very low margin rate, not only less than 10 or 5, even below that. We have already considered that the agreement entered into by the assessee with its German associate concern has contemplated a compensation of cost plus 6 per cent, or 1.5 times of the total wages bill, whichever is higher. This point we have to consider in the light of the fact that the assessee is working in a risk mitigated environment. That is why we have agreed with the argument of the assessee-company that there may not be extreme profits in the case of the assessee. When extremes are excluded from the samples, all

sorts of extremes should be avoided. Otherwise, samples selected for comparative study may not be representative."

33. Even in the aforesaid decision the point that has been emphasized is that when the margins of comparable companies are either extremely low or high, the approach should be to eliminate both and not consider only the high or low margin comparables as it suits either the TPO or the Assessee.

34. As far as the provisions of the Act are concerned, they lay down that the comparable companies should be functionally comparable to the tested party. There are no specific standards of comparability on the basis of abnormal profits or loss. Rule 10B(2) provides that the comparability of an international transaction with an uncontrolled transaction shall be judged with reference to the following, namely:—

(a) the specific characteristics of the property transferred or services provided in either transaction;

(b) the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;

(c) the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;

(d) conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

35. There is therefore no bar to considering companies with either abnormal profits or abnormal losses as comparable to the tested party, as long as they are functionally comparable. The OECD guidelines and in US TP regulations, this question may not arise at all because those regulations advocate the quartile method for determining ALP. Indian regulations specifically deviate from OECD guidelines and provide Arithmetic Mean method for determining ALP. In the quartile method, companies that fall in the extreme quartiles get excluded and only those that fall in the middle quartiles are reckoned for comparability. Hence, cases of either abnormal profits or losses (which are referred to as outliners) get automatically excluded. In the arithmetic mean method, all companies that are in the sample are considered, without exception and the average of all the companies are considered as the ALP. Hence, a general rule that companies with abnormal profits should be excluded may be in tune with the principles enunciated in OECD guidelines but cannot be said to be in tune with Indian TP regulations. However, if there are specific reasons for abnormal profits or losses or other general reasons as to why they should not be regarded as comparables, then they can be excluded for comparability. It is for the Assessee to demonstrate existence of abnormal factors.

36. In the present case factors for abnormal profits have not been highlighted by the Assessee. ***In such circumstances it is not possible to accept the submission of the Assessee to exclude this company for the purpose of comparison"*** (emphasis supplied)."""

21. The above rationale squarely applies in the assessee's case as during the proceedings the assessee was asked to produce reasons for the abnormal profits earned by the comparable "Cosmic Global" during the relevant financial year and it could not give any substantiation of the same.

22. In the above context, given the facts and circumstances of the case, I hold Cosmic Global as a valid comparable and arrive at the following final set of comparables for the assessee:

S.No.	Name of the company	OP/TC %
1	Aditya Birla Minacs Worldwide	1.85
2	Microgenetics Systems Ltd	9.56
3	Cosmic Global Ltd	48.10
	Average	**19.84**

23. Computation of ALP

Arms' Length Mean Margin on cost	19.84%
Operating cost	88,31,37,582
Arms Length Price (ALP)	105,83,52,078
Price received	97,81,63,186
Shortfall being adjustment u/s 92CA	8,01,88,892

The above shortfall of Rs. 8,01,88,892/- is treated as transfer pricing adjustment u/s 92CA in respect of the taxpayer's international transactions.

(Sd/-)

Deputy Commissioner of Income Tax

Transfer Pricing, Chennai

Copy to

The Assessing Officer

Assessee (VulcanTech BPO Pvt. Ltd.)

File