

आयकर अपीलीय अधिकरण “ K ” (SPECIAL BENCH) न्यायपीठ मुंबई में।
IN THE INCOME TAX APPELLATE TRIBUNAL “ K ” (SPECIAL BENCH),
MUMBAI

श्री डी.मनमोहन, उपाध्यक्ष, श्री बी.आर.मिस्तल, न्यायिक सदस्य ,

एवं श्री पी.एम. जगताप, लेखा सदस्य ।

BEFORE SHRI D. MANMOHAN, V.P., SHRI B.R. MITTAL, JM
AND SHRI P.M. JAGTAP, AM

आयकर अपील सं./I.T.A. No.7466/Mum/2012

(निर्धारण वर्ष / Assessment Year : 2008-2009)

Maersk Global Centres (India) Private Limited, 4 th and 5 th Floor, Prudential Building, Central Avenue Road, Hiranandani Business Park, Powai, Mumbai – 400 076.	बनाम/ Vs.	Asst. Commissioner of Income Tax- Circle 6(3), Aayakar Bhavan, Mumbai.
स्थायी लेखा सं./PAN : AADCM7786M		
(Appellant)	..	Respondent)

Appellant by :	Shri Porus Kaka Shri Sunil M. Lala & Shri Manish Kanth
Department by :	Shri Ajeet Kumar Jain
Interveners M/s Omniglobe Information Technologies India Pvt. Ltd. and M/s CRM Services India Ltd. by	Shri Ajay Vora

सुनवाई की तारीख / **Date of Hearing** : 13-2-14

घोषणा की तारीख / **Date of Pronouncement** : 7-3-14

आदेश / O R D E R

PER P.M. JAGTAP, A.M. :

पी.एम. जगताप, लेखा सदस्य

This Special Bench has been constituted by the Hon'ble President to dispose of the appeal filed by the assessee against the order passed by the Id. ACIT- Circle -6(3), Mumbai (A.O.) u/s 143(3) of the Income Tax

Act, 1961 in pursuance of the directions given by the Dispute Resolution Panel – I (DRP) u/s 144-C-(5) of the Income tax Act, 1961 and specifically to decide the following important questions (as reframed) involved therein:-

“1) Whether for the purpose of determining 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 ?

2) Whether, in the facts of the assessee’s case, companies earning abnormally high profit margin should be included in the list of comparable cases for the purpose of determining the arm’s length price of an international transactions?”

2. The assessee in the present case is a company incorporated in India on 19-11-2003. It is a wholly owned subsidiary of Maersk GSC Holdings A/S, which in turn is a downstream subsidiary of APMM Group (“Maersk Group). It is engaged, inter alia, in the business as shared service centre and renders transaction processing, data entry, reconciliation of statements, audit of shipping documents and other similar support services. It also renders I.T. services such as process support, process optimization and technical support services. The return of income for the year under consideration was filed by it on 30-9-2008 declaring total income of Rs. 34,14,980/- under the normal provisions of the Act and book profit of Rs. 12,29,06,881/- computed u/s 115 JB of the Act. In the said year, it had carried out, inter alia, the international transactions of providing I.T. enabled services to its Associated Enterprises (AEs) for the aggregate value of Rs. 117,56,19,974/-. The nature of such services was stated to be transaction processing, data entry, accounting and other support services. During the course of assessment proceedings, a reference was made by the A.O. to the TPO u/s 92CA(1) of the Act to determine the arm’s length price (ALP) of these international transactions of the assessee with its AEs along with other international transactions.

3. In the TP study report submitted by the assessee, the Arm's Length Price (ALP) of the international transactions representing I.T. enabled services provided to the AEs was determined by applying Transactional Net Margin Method (TNMM) and adopting the operating profit to total cost (OP/TC) as the Profit Level Indicator (PLI). The OP/TC of the assessee company was worked out at 12.82% while the average OP/TC of the thirteen comparables selected by the assessee was arrived at 13.90%. Since the profit margin of the assessee company after claiming working capital adjustment at 4.79% and risk adjustment at 7.46% was higher than the average profit margin of the comparables, it was claimed in the TP study report that the price charged by the assessee company to its AEs for the international transactions involving provision of I.T. enabled services was at arm's length.

4. After a careful study and analysis of the T.P. study report submitted by the assessee, the TPO found the following material defects in the T.P. analysis done therein:-

“1. As per Rule 10B(4), it is mandatory to use the current financial year data i.e. the financial year in which the international transactions took place. (FY 2007-08). But the taxpayer did not consider current year data in 3 of 10 comparable companies.

2. The taxpayer used earlier two years data without justifying how such earlier data had an influence on pricing for the taxpayer or the comparable companies.

3. The taxpayer considered following companies with significant controlled or related party transactions.

Sl No.	Name of the company
1	Fortune Infotech Ltd.
2	ICRA Online Ltd.
3	KPIT Cummins Global Business Solutions Ltd.

4. The taxpayer considered following companies with domestic operations as well when the taxpayer's ITES segment is mainly an export oriented.

Sl No.	Name of the company
1	Informed Technologies India Ltd.
2	Shreeji Info Hubs Ltd.

5. As discussed above, some of the taxpayer's comparables do not stand scrutiny of FAR analysis.

6. Some companies like Eclerx Services Ltd., though is into KPO services and qualify all the filters applied by the tax payer based on the data pertaining to the FY 2007-08, have not been selected."

5. Keeping in view the above material defects pointed out by him, the TPO rejected the TP report submitted by the assessee treating the same as un-reliable and in-correct and proceeded on his own to determine the ALP of the relevant international transactions entered into by it. In this regard, he noted that the assessee company was operating with more than 2000 employees out of the State of Art facility and was providing support services to its AEs such as documentation, finance, operations, logistics, global information systems etc. According to him, these services were in the nature of knowledge based services and thus were liable to be characterised as Knowledge Process Outsourcing (KPO) services. He noted that the assessee was rendering mainly logistic outsourcing services and business analytic services to its AEs which involved the transfer of knowledge intensive business process that required significant domain expertise. He observed that for global corporations looking to move their higher-end research like market research and equity research, analytical based services, engineering design, IPR, legal services, remote education and publishing, India was currently the location of choice.

6. Having held that the services rendered by the assessee company to its AEs were in the nature of Knowledge Process Outsourcing (KPO) services, the TPO rejected twelve of the thirteen comparables selected by the assessee its T.P. study report on the following grounds:-

Sl. No.	Name of the comparable	Remarks
1	Allsec Technologies Ltd.	The annual report of the company is available for the FY 2007-08. As per the information available in the annual report, the company merged its subsidiary B2K Corp. Ltd. was closed down. Due to this peculiar circumstance, the same is not considered as a comparable.
2.	Caliber Point Business Solutions Ltd.	The company is not into KPO services and thus the same is not considered as a comparable.
3.	Cosmic Global Ltd.	The company is not into KPO services and thus the same is not considered as a comparable.
4.	Fortune Infotech Ltd.	The Company has related party transactions (RPTs) to the extent of 100.03% of its revenue for the FY 2007-08 (RPTs) on income and expense side combined). Thus the company fails 25% RPT filter applied by the TPO and is not considered as a comparable.
5	ICRA Online Ltd.	The company is a subsidiary of ICRA Ltd. As per the information submitted by the company, its ITES segment fails 25% RPT filter. In this regard, the annual report of the company (contained in AR for ICRA Ltd.) and reply received from the company are enclosed herewith as a soft copy.
6	ICRA Techno Analytics Ltd.	The annual report does not contain segmental results as the company is into software products, software services and IT enabled services. 133(6) notice was issued to the company. In response, the company submitted segmental results for software and professional services. But, it was also stated that professional services include both

		software development services and IT enabled services. Sub-segmental results are not submitted. Thus the same is not considered as a comparable.
7	Informed Technologies India Ltd.	The company has exports to the extent of 66.52% of its revenues for the FY 2007-08 (RPTs on income and expense side combined). Thus the company fails 75% export filter applied by the TPO and is not considered as a comparable.
8	KPIT Cummins Global Business Solution Ltd.	The company is a subsidiary of KPIT Cummins Infosystems Ltd. As per the information and annual report submitted by the company for the FY 2007-08, the company fails 25% RPT filter.
9	Maple E- solutions Ltd.	The company is not into KPO services and thus the same is not considered as a comparable.
10	R System International (segmental)	The company is not into KPO services and thus the same is not considered as a comparable.
10	Shreejal Info Hubs Ltd.	The company was earlier known as Ask Me Info Hubs Ltd. The company fails 75% export earning filter as it does not have any export for the FY 2007-08. Thus the company is not considered as a comparable.
11	Spanco Telesystems and Solutions Ltd. (Segmental)	Now the company is known as Spanco Ltd. The Annual Report is available for the FY 2007-08. This BPO segment is not into KPO services and thus the same is not considered as a comparable.
12	Triton Corp Ltd.	The company is into KPO services and qualifies all the filters applied by the TPO. Thus the same is considered as a comparable.

7. The TPO also considered the various filters applied by the assessee and found only some of them to be appropriate for the following reasons:-

Sl No.	Particulars	Remark of the TPO
1	Companies for which financial data was available only upto March, 2005 were excluded	It is pertinent here that the TPO used only the data for the FY 2007-08. Thus the TPO excluded those companies whose data was not available for the FY 2007-08.
2	Companies having zero sales or sales less than Rs. 1 crore in the latest year for which the financial data available were rejected.	This is an appropriate filter. But the TPO applied this filter based on the revenues for the FY 2007-08 as only the current year data has been considered. The TPO applied this filter mainly due to the unreliability of the results of these companies with low cost base.
3	Companies having sales more than Rs. 250 crores in the latest year for which the financial data is available in the databases were rejected.	The taxpayer applied a turnover range of Rs. 1 crore to Rs. 250 crores. The taxpayer's turnover in its ITES segment is Rs. 117.56 crores. Thus the taxpayer considered companies varying from twice the size of the taxpayer to almost 117 th of its size, which is not rational. Moreover, size does not play a major role in service industry like IT enabled services. Thus the upper turnover filter applied by the taxpayer is rejected.
4	Companies whose manufacturing sales were equal to or greater than 50% of their total sales in the latest year for which financial data was available were rejected. Companies whose trading sales were equal to or greater than 50% of their total sales in the latest year for which the financial data was available were rejected.	Not an appropriate filter. TPO has applied a more appropriate filter in this regard. The companies whose revenues from IT enabled and related services are more than 75% of their operating revenues for the FY 2006-07 were selected as companies. This is an appropriate filter as this is the stage which will determine the correct comparability.
5	Companies not disclosing segmental financials, whose services appeared different from that of taxpayer	This is considered an appropriate filter since this filter will help to identify companies which are similar in function (IT enables service) to arrive at appropriate comparables. Wherever segmental information is available, the same is considered as a comparable.
6	Companies excluded for other reasons (based on information contained in the product profile, Director's report and other information available in the database)	This is to be seen case by case. TPO tried to obtain maximum information using powers u/s 133(6). If sufficient information is not obtained, the decision is taken based on the information available in the Public domain.

8. In addition to some of the filters found to be appropriate by him as discussed above, the TPO considered some additional filters or criteria which, according to him, would lead towards selecting proper comparables and finally applied the following filters or criteria in searching for comparables:-

- “- Companies whose data is not available for the FY 2007-08 were excluded and the data for the FY 2007-08 has been considered for the period from 01-04-2007 to 31-03-2008.
- Companies with IT enabled service income of less than Rs. 10 Cr and more than 250 crores were excluded
- Companies whose IT enabled service revenue is less than 75% of the total operating revenues were excluded
- Companies who have more than 25% related party transactions (sales as well as expenditure combined) of the operating revenues were excluded
- Companies who have less than 75% of the revenues as export sales were excluded
- Companies who have diminishing revenues/persistent losses for the period under consideration were excluded
- Companies having different financial year ending (i.e. not March 31, 2008) or data of the company does not fall within 12 month period ie. 01-03-2007 to 31-03-2008, were rejected
- Companies that are functionally different from that of taxpayer or working in peculiar economic circumstances, after giving valid reasons, were excluded
- Companies that are not mainly engaged in KPO services were excluded.”

Applying the above filters/criteria, the TPO selected the following seven entities as final comparables:-

Sl No.	Name of the comparable	Functional Lines
1	Acropetal Technologies (Seg.)	The ITES segment of the company is engaged in engineering design services.
2	Coral Hubs Ltd. (Formerly Vishal Information Technologies Ltd)	The company is mainly engaged in data processing services
3	Crossdomain Solutions Ltd.	The company is mainly engaged in data processing, insurance claims processing and payroll processing services
4	Datamatics Financial Services Ltd. (seg)	The company is mainly engaged in financial accounting and internet based research services.
5	eClerx Services Ltd.	The company is mainly engaged in data analytics and data process services. Pricing analytics, bundling optimization, content operations, sales and marketing support, product data management, revenue management and data analytics are some of the offerings to Retail and manufacturing clients. To its Financial Services clients, it offers realtime capital markets, middle and back office support, portfolio risk management services and various critical data management services.
6	Mold-Tek technologies Ltd.	The company is mainly engaged in Engineering design services
7	Triton Corp Ltd.	The company is mainly engaged in knowledge process outsourcing and legal process outsourcing services.

9. The TNMM adopted by the assessee for benchmarking the relevant international transactions with OP/TC as PLI was accepted by the TPO. Accordingly, he considered the profit before interest and tax for computing the operating margins but treated only the income and expenses related to the operations of the relevant financial year for the computation of operating margins of the comparables. Accordingly, certain income and expenses of non-operating nature having nothing to do with the operations of the comparables were excluded by him for the purpose of considering the operating revenue and operating expenses. Similarly, extra-ordinary expenses/income which were non-recurring in

nature such as donations, preliminary expenses etc. were not considered by him as operating expenses or operating income. Accordingly, the arithmetic mean of OP/TC of seven comparables selected by him was worked out by the TPO at 47.74% and after allowing the working capital adjustment at 2%, he worked out the adjusted arm's length mean margin at 45.74%. Applying this arm's length margin at 45.74% to the operating cost of Rs. 104,44,80,271/- submitted by the assessee in its TP report, the arm's length price of the international transactions between the assessee and its AE involving provision of IT enabled services was determined by the TPO at Rs. 152,22,25,547/- and since the price charged by the assessee for the said transactions was Rs. 117,83,81,799/-, the difference of Rs. 34,38,43,748/- was treated by the TPO as the transfer pricing adjustment required to be made in the case of the assessee.

10. In addition to the I.T. enabled services, the assessee company had also provided I.T. services to its AEs for the agreed value of Rs. 13,93,30,950/-. The T.P study report submitted by the assessee in respect of these transactions was also not accepted by the TPO. According to him, the nature of these services was also ITES and adopting the same basis and following the same method as in the case of provision of I.T. enabled services, he selected the following 23 comparables after analysing the database, the annual reports etc. :-

Sl No	Name of the Comparable	Sales	Total Cost	Op. Profit	OP / TC
1	Aarman Software Pvt. Ltd	15629692	15411904	217788	1.41%
2	Accel Transmatic Ltd (Software Services Segment)	103991000	89867000	14124000	15.72%
3	Acropetal Technologies Ltd (IT Segment)	385147981	290777218	94370763	32.45%
4	Aricent Technology (Holdings) Ltd (Earlier known as Flextronics Software Systems Ltd)	9570295187	8896849729	673445458	7.57%
5	Avani Cimcon Technologies Ltd	29342809	24121164	5221645	21.65%
6	Bodhtree Consulting Ltd	104109068	87385058	16724010	19.14%
7	Celestial Biolabs Ltd	202112145	107541778	94570367	87.94%
8	E-Infochips Ltd	240278009	184376391	55901618	30.32%
9	E-Zest Solutions Ltd	76620694	59588823	17031871	28.58%
10	IGate Global Solutions Ltd	7815148000	6908931000	906217000	13.12%
11	Infosys Technologies Ltd	156530000000	112110000000	44420000000	39.62%
12	KALS Information Systems Ltd (Application Software Segment)	20540685	14471510	6069175	41.94%
13	LGS Global Ltd (Formerly Lanco Global Systems Ltd)	1366627613	1080643805	285983808	26.46%
14	Mindtree Ltd (Earlier Mindtree Consulting Ltd)	7415894045	6429612469	986281576	15.34%
15	Persistent Systems Ltd	4069810000	3186990000	882820000	27.70%
16	Quintegra Solutions Ltd	898876034	819057389	79818645	9.75%
17	R Systems International Ltd (Software Development & Customization Segment)	1445601636	1253790215	191811421	15.30%
18	Sasken Communication Technologies Ltd (Software Services Segment)	3358007000	2976115000	381892000	12.83%
19	Softsol India Ltd	189940746	165165066	69906590	42.33%
20	Tata Elxsi Ltd (Software Development & Services Segment)	3420535000	2881806000	538729000	18.69%
21	Thirdware Solutions Ltd (Software Development Services Segment)	509558000	414099000	95459000	23.05%
22	V G L Softech Ltd	42437512	36812017	5625495	15.28%
23	Wipro Ltd (Wipro Technologies Segment)	112762000000	87713000000	25049000000	28.56%

11. The arithmetic mean of the OP/TC of the above comparables selected by him was worked out by the TPO at 24.99% and after applying the same as average profit margin of the comparables, without allowing any working capital adjustment, to the operating cost of Rs.12,05,35,098/- as submitted by the assessee in the TP study report, he determined the ALP of international transactions of the assessee company with its AEs involving provision of I.T. services at Rs. 15,06,56,819/-. Since the price charged by the assessee to its AEs for these international transactions was Rs. 13,96,31,210/-, the difference of Rs. 1,10,25,609/- was treated by the TPO as transfer pricing

adjustment required to be made in the case of the assessee in respect of I.T. services rendered to its AEs.

12. In the draft assessment order, the A.O. proposed to make, inter alia, the T.P. adjustments of Rs. 34.38 crores and 1.10 crores determined by the TPO in respect of the international transactions of the assessee company with its AEs involving provision of I.T. enabled services and I.T. services respectively. On receipt of the said draft assessment order from the A.O., the assessee filed its objections before the DRP. The first objection raised by the assessee before the DRP was that the low-end back office support services rendered by it have been erroneously categorized by the TPO as high-end knowledge process outsourcing services. It was submitted that the TP study of the assessee would show that the functions during the year under consideration remained the same as in the last year and therefore its categorization as KPO instead of BPO was in-correct. It was contended that the rejection by the TPO of atleast five comparables selected by the assessee namely (i) Caliber Point Business Solutions Ltd., (ii) Cosmic Global Ltd., (iii) Maple E Solutions Ltd., (iv) R Systems International (segment) & (v) Spanco Telesystems and Solutions Ltd. on the ground that the same are not KPO was not correct and the same should be included for the purpose of comparability analysis. This objection of the assessee was considered by the DRP in the light of functions performed by it as well as qualification and pay profile of the work force employed by it. On such consideration, the DRP held that the assessee could not be considered only as a low-end service provider. It was also held by the DRP that the activities of the assessee, at the same time, could not be considered as that at the high end of the spectrum to be qualified as KPO. It was noted by the DRP that the assessee had been considered as I.T. enabled service provider generally in earlier years and there being no segmental division between the

different services and their profitability, the DRP considered it proper in the facts of the case to compare the assessee with the mix selection of comparables of I.T. enabled service sector in order to provide reasonable and appropriate comparability. Accordingly, the objection of the assessee regarding the rejection by the TPO of the five comparables selected by it merely on the ground that they are not KPO service provider was held to be sustainable by the DRP.

13. As regards the seven comparables selected by the TPO, the assessee apparently did not raise any material objection in respect of two comparables namely Crossdomani Solutions and Datamatics Financial Services Limited while one comparable namely Triton Corpn. as taken by the TPO was there in the list of comparables selected by the assessee itself. As regards the remaining four comparables selected by the TPO, which were objected by the assessee, the DRP accepted the objection of the assessee in respect of two comparables namely Acropetal Technologies Limited and Coral Hubs Limited and directed exclusion of the same from the comparables for the following reasons :-

“Acropetal Technologies Ltd.— It has been pointed out by the assessee in its submission wherein the Annual Reports of the comparables have been filed, that this comparable fails the export earning filter of 75% in respect of ITES. This has been seen and found correct. Therefore, this comparable fails the TPO’s own filter and cannot be held comparable.

Coral Hubs Limited - It is seen that this comparable has very low employee costs (2.93%) whereas it has very high costs on account of vendor payments and data charges, suggesting outsourcing as its business model. In view of these functional differences, the same is rejected as comparable.”

14. The objection of the assessee regarding other two comparables selected by the TPO namely Eclerx Services Limited and Mold-Tek

Technologies Ltd. however, was not found sustainable by the DRP for the following reasons:-

“Eclerx Services Limited – assessee’s argument is not acceptable in view of above discussion and it is found to be functionally comparable as an ITES provider since it is in the business of custom designing of processes and operations management, like the assessee.

Mold-Tek Technologies Ltd.- The assessee has objected to the fact that the comparable is into structural engineering and design services which are functionally the same as the work of the assessee. Further, it says that since Allsec was rejected, Mold-Tek should be rejected on the same grounds. It also states that it is an outlier in terms of margin and that the margin calculation is wrong:

We find that this comparable’s services fall within the category of ITES as per the CBDT circular and in functionality. Further, Allsec went in for a merger in this year with a loss making subsidiary whose business was wound up. In the case of Allsec it is also seen that its margins have shown a precipitous decline from 27.98% to (13.95%) in the relevant year this is certainly not normal in terms of results. This is very different from the case of Mold-Tek, where a restructuring has taken place and demerger happened of an entirely different business segment, that too in October, 2006 and accounts restructured as on 1-4-2007 ie the beginning of previous year relevant to the assessment year under consideration. This has brought the comparable closer to the same line of ITES business as the assessee. That the company is comparable is clear from its functional profile.

As far as not taking provision for derivative losses as an operating expense is concerned, reliance can be placed upon the decision of ITAT, Pune in the case of Honeywell Automation India Ltd. Vs. DCIT , (2009-TIOL-104-ITAT-PUNE in ITA No. 4/PN/08 dated 10-02-2009) wherein it was held that the provisions made for future losses cannot be considered while computing the operating profit of the relevant year. We also find that TPO/AO has taken this view consistently ie in the case of other comparables and assessee.

From the Annual Report submitted by the assessee it is not clear how the assessee has stated that it has controlled transactions or if it violates the RPT limit. In conclusion, this company is found to be comparable.”

15. The three comparables selected by the TPO namely Mold-Tek Technologies Ltd., M/s Coral Hubs Ltd. and M/s eClerx Services Limited

were also objected by the assessee before the DRP on the basis of their high profitability. This objection of the assessee was not found sustainable by the DRP observing that high and low margins both reflect the industry profitability especially when they are acceptable on functional similarity. It was also observed by the DRP that as the average mean of a fair number of companies is being considered for comparability analysis to arrive at the ALP margin, the super profit of an individual company cannot be objected to if it is otherwise functionally comparable. It was also noted by the DRP that omission only of high profitability comparables as outliers would be addressing only one end of the spectrum which is not correct. It was observed that the Income Tax Act in any case provides for an arithmetic mean and not median range of profitability.

16. The DRP then proceeded to deal with the objections of the assessee in respect of TP adjustment of Rs. 1.10 crores proposed in respect of provision of I.T. services rendered by the assessee company to its AEs. In this regard, DRP found from the functional profile of the segment given in the TP study report that the services rendered by the assessee in respect of process support, process optimization and technical support were essentially support services rendered by the assessee whereby the systems of the business as used by the employees were kept in working order and all glitches were taken care of. The DRP held that these services were similar to I.T. enabled services and not something which could be classified separately. Relying on the CBDT circular No. SO 890 (E) dtd. 26-9-2000 giving a detailed list of products or services that could be claimed as ITES for the purpose of section 10A/10B of the Act, the DRP held that the services claimed to be IT services by the assessee were falling under the broad category of ITES being akin to support center's back office operations and remote maintenance. The DRP, therefore,

considered both the I.T & ITES services claimed to be rendered by the assessee company to its AEs as ITES and accordingly directed the A.O./TPO to bench mark these transactions by taking the following ten entities as final comparables:-

1. Caliber Point Business Solutions Ltd.
2. Cosmie Global Ltd.
3. Maple E Solutions Ltd.
4. R. Systems International (Segmental)
5. Spanco Telesystems and Solutions Ltd.
6. Triton Corp. Ltd.
7. Mold-Tek Technologies Ltd.,
8. Crossdomain Solutions Limited
9. Datamatics Financial Services Limited (segmental)
10. eClerx Services Ltd.”

17. As regards the objection of the assessee that the TPO has not allowed the working capital adjustment to the margins of the comparables selected by him, the DRP directed the TPO to allow such adjustment based on the final comparables selected by following the same method and basis as adopted in assessee’s own case in the earlier years.

18. As regards the objection of the assessee that the TPO has not allowed appropriate risk adjustment to the margins of the comparables selected by him as required u/r 10-B(1)(e)(iii) of the Income Tax Rules, 1962, the DRP discussed the claim of the assessee in respect of various risks as under:-

“Market Risk/Business Risk: The taxpayer’s claim that it does not bear market risk as it renders services exclusively to its group company is not acceptable. In fact, the taxpayer bears a much bigger market risk viz, single customer risk. As the taxpayer is dependent on its AE its entire existence is dependent on it. If the AE runs out of business or if AE’s business gets reduced substantially, the taxpayer’s business will also get adversely affected. The taxpayer being a captive service provider cannot even look for other customers. Thus, in fact the taxpayer runs a greater risk than an average independent entity which can always look for

other customers or other markets. Thus, there is more risk in the case of tax payer who is dependent on a single customer when compared to comparables who may not depend on single customer. At the time of entering into contract with its associated enterprise, the tax payer is not assured of any business and also it is not guaranteed any steady increase in the business. There are two components of a single customer risk which have to be kept in view:

- i. The loss of realization of the debt for the services already rendered from the single customer if the customer goes into liquidation or bankruptcy.
- ii. The loss of future revenues if the single customer either goes into bankruptcy or liquidation or terminates the contract.

This holds true for Contract Risk and Credit Risk in the case of the assessee. What it sees as a risk free business is in fact a very risky model, where it is totally dependent on the AE.’.

Price Risk: It is clear that it bears price risk as the taxpayer is a contract service provider based on a cost plus model for its services. Thus, the taxpayer in a way is agreeing that the price charged for rendering the services is independent of the prevailing market price charged for such services.

Manpower Risk: In this case the assessee also faces manpower risk. That is the most vital risk in the line of business that the assessee is in and has been mentioned earlier also in the context of the manpower costs vis a vis total costs. It has to collect and nurture pool of talented manpower so that it can carry out its functions efficiently. In this day of high attrition rates, all enterprises face this risks especially these like the assessee. Hence, in the event of the assessee being unable to do so, its position will be compromised. In the 21st century, corporations have become increasingly reliant on human capital, at a time when this resource is becoming more difficult to retain. With the globalization of trade, many new opportunities are available to skilled staff, contributing to the already prevalent breakdown of bonds between employers and employees. A soaring employee turnover across many economic sectors has resulted in enormous losses to employers and has in turn enhanced the value of securing and retaining a stable, skilled workforce. Many MNEs are currently investing considerable resources in efforts to retain their employees, although such expenditures do not create ‘assets’ in the traditional sense. Corporations are still coming to terms with the fact that the most valuable information in the organization may be lost when an employee leaves the organization.

The assessee is in a business which requires skilled manpower to run its business. There are judicial pronouncements which confirm that a trained and assembled workforce has a measurable, identifiable value. One example is Ithica Industries Inc. V. CIT 97 TC 253 where the Appellate Tax Court, USA has reached the conclusion that an in-place work force was an intangible asset with an ascertainable value.”

19. After the above discussion, the DRP also referred to the various decisions of the Tribunal wherein a similar claim of the assessee for risk adjustment was considered by the Tribunal and held finally, for the following reasons given in its order, that no risk adjustment could be allowed to the assessee:-

“- As discussed above, the taxpayer has also undertaken several risks. Therefore, it is correct to say that it is a risk mitigated entity.

- The taxpayer is totally dependent on the AE for business. Thus the taxpayer takes the risks associated with heavy dependence on a single customer, In common business parlance it is known as ‘single customer risk’.

- The AE is exposed to the market risk and any fluctuation in the business conditions of the AE affect the contractual terms between the AE and the taxpayer. Thus even if independent comparables undertake some risk, the taxpayer also had to undertake risks

- Different comparables can have different risk profiles and different profit margins. The proviso to Sec. 92C(2) of the Act provides for adopting arithmetical mean of the different prices. This provision neutralizes the effect of difference in the risk profile, if any between the tax payer and the comparables as realized risk may pull down the profitability below the risk free return.

- It is not sufficient to merely spell out risks. It has to be shown risk was actually undertaken by the comparables and to what extent it affected the profitability. The taxpayer has not done so.

- In the various decisions of the ITATs as referred to above no risk adjustments has been allowed in such cases.”

20. As regards the objection of the assessee that the A.O./TPO has resorted to the use of single year data instead of multiple year data of the

companies selected by him u/r 10B(4) of the Income Tax Rules, 1962, the DRP overruled the same by observing that the assessee has not given any details as to how earlier years data have the impact on the profit of the current year of the assessee or of the comparables. The DRP in this regard relied on OECD Transfer Pricing Guidelines as revised on 22nd July, 2010 wherein it was cautioned that use of multiple year data does not necessarily imply the use of multiple year average for the purpose of bench marking.

21. The DRP thus issued directions u/s 144-C(13) of the Act on the objections raised by the assessee vide its order dtd. 7-9-2012 and directed the A.O./TPO to give effect to the said directions. Accordingly, the margins of final set of comparables after giving working capital adjustment were worked out by the A.O./TPO as under:-

Sr. No.	Company Name	Assessee/ Department	FY 2007-08 NCP	Adjustment	FY 2007-08 Revised NCP
1	Caliber Point Solutions Limited	Assessee	9.67	(2.50)	7.17
2	Cosmic Global Limited	Assessee	23.30	(2.43)	20.87
3	Maple Esolutions Limited	Assessee	20.41	(5.27)	15.14
4	R Systems International Limited- Segmental	Assessee	11.87	(9.27)	8.90
5	Spanco Telesystems & Solutions Limited - Segmental	Assessee	7.22	(4.23)	2.99
6	Triton Corp Limited	Common	23.81	(4.46)	19.35
7	Mold-Tek Technologies Limited	Department	96.66	(13.35)	83.31
8	Crossdomain Solutions Limited	Department	26.96	(1.25)	25.71
9	Datamatics Financial Services Limited - Segmental	Department	34.87	(0.97)	33.90
10	eClerx Services Limited	Department	65.88	(2.82)	63.06
	Average		32.07	(4.02)	28.04

22. The adjusted average profit margin of comparables at 28.04% was applied by the A.O./TPO to the combined total operating cost (ITES and IT segment) of the assessee amounting to Rs. 116,50,15,369/- to work out the ALP of the international transactions of the assessee with its AEs at Rs. 149,16,85,678/-. Since the price charged by the assessee to its AEs for such services was Rs. 131,80,13,009/-, the difference of Rs. 17,36,72,669/- was added to the total income of the assessee on account of TP adjustment in the final assessment made by the A.O. vide an order dated 31-10-2012 passed u/s 143(3) r.w.s. 144-C(1) of the Act. Aggrieved by the same, the assessee has preferred this appeal before the Tribunal.

23. In its appeal, the assessee has raised as many as 11 grounds out of which ground No. 1 is general in nature seeking no specific decision. Ground No. 2 challenges the selection of comparables by the TPO as approved by the DRP. In its TP study report, the assessee had selected thirteen comparables out of which only one comparable was accepted by the TPO. After rejecting the TP study of the assessee, the TPO proceeded to do his own exercise of TP analysis and keeping in view the nature of services rendered by the assessee as understood by him and after analyzing the database, annual report etc., he selected seven comparables including the one selected by the assessee namely Triton Corpn. Ltd. The DRP excluded two of these final seven comparables selected by the TPO namely Acropetal Technologies Ltd. (segment) and Coral Hubs Ltd. while it included five of the comparables selected by the assessee but excluded by the TPO. Accordingly, a set of the following ten comparables was selected by the DRP:

1. Caliber Point Business Solutions Ltd.
2. Cosmic Global Ltd.

3. Maple E-Solutions Ltd.
4. R Systems International (Segmental)
5. Spanco Telesystems and Solutions Limited
6. Triton Corpn. Ltd.
7. Mold-Tek Technologies Ltd.
8. Crossdomain Solutions Limited
9. Datamatics Financial Services Limited (segmental)
10. eClerx Services Ltd.

24. As submitted by Sr. Advocate Shri Porus Kaka, the Id. Counsel for the assessee, the assessee is disputing the inclusion of two entities out of ten comparables finally selected by the DRP namely Mold-Tek Technologies Ltd. and eClerx Services Ltd. on the ground that firstly they are KPO service providers who cannot be compared with the assessee company, which is basically a BPO service provider and secondly both these entities earning abnormally high profit margins should not be included in the list of comparables. Both these issues are raised in the questions specifically referred for the consideration of this Special Bench and answers to these questions thus will decide the issue raised in ground No. 2 of the assessee's appeal as agreed by the Id. Representatives of both the sides.

25. While opening his arguments on the issue involved in question No. 1, the Id. Counsel for the assessee Shri Porus Kaka referred to the relevant portion of the TPO's order for the earlier year at page 5 of his paper book wherein the nature of work performed or services rendered by the assessee company was discussed. He then invited our attention to the specific finding recorded by the A.O. in his final order for the year under consideration clearly accepting that there was no material change in the activities undertaken by the assessee company during the year under consideration. He submitted that going by the nature of work performed by the assessee or services rendered, it is basically a back office service provider or low end service provider. He contended that the

assessee thus is basically a BPO service provider and it was wrongly categorized by the TPO as KPO service provider. He took us through the submissions made by the assessee company in this regard before the TPO at page 211 & 212 of his paper book to point out that the brief overview of the assessee's back office support services was given therein as under:-

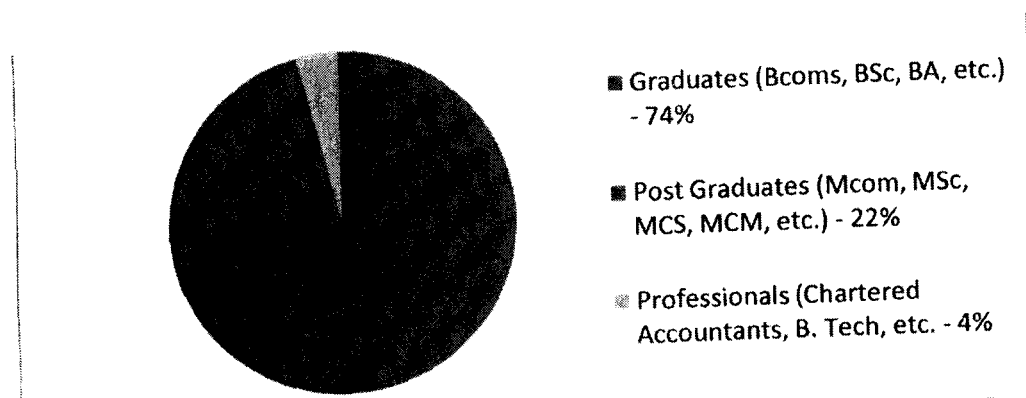
"Brief overview of Assessee's back office support services:

The assessee is a captive service provider primarily engaged in providing back office support services to its AE i.e. APMM.

The activities primarily comprises of low end data entry, transcription, reconciliation, consolidation, co-ordination, preparation, processing and review of shipping documents such as bills of lading, etc. and similar support services.

Assessee acts as a contract service providers carrying out limited low end functions based on instructions, standardized processes, data, specifications, process notes and statement of work all of which are historically provided by its AE. The activities performed by the assessee are thus merely supportive and auxiliary in nature. For ease of understanding attached is the flow chart explaining the work process of documentation activity in brief (Please refer Exhibit 1).

The activities primarily involves the information collation from the shippers/customers/AE and populating the same in various processes and systems provided by the AE. The work requires limited domain expertise and no analytical skills. These activities are performed by low skilled employees who are primarily graduates by qualification. For ease of reference, we have attached herewith the available data of employees during FY 2007-08 and their qualification along with their birth date and in Exhibit 2. Broad classification of employees, based on their qualification is diagrammatically presented as under:-



On perusal of above, your goodself would appreciate that since majority of employees are only graduates, activities of the Assessee cannot be qualified to be high end in nature.

Following are some of the key features of the Assessee's business which are worth noting:

- Assessee's business activities are performed by graduates and freshers with limited experience. Average age of employees is around 26-27 years;
- Activities of the Assessee are based on instructions, standardized processes, data, specifications, process notes and statement of work provided by its AE;
- Team size generally vary from 17-18 employees with one Team Leader;
- Quality or output is generally measured in terms of number of documents / transactions processed, number of punching errors, number of queries, etc.;
- Assessee normally operates in three shifts (8 hours each).

In contrast, KPO services generally would not have the above characteristics and primarily comprise high end research and analytical services such as software development, Research and Development in pharmaceuticals, Engineering Design services and other such high end value adding services. Qualifications of the employees, Team size and Quality yardsticks are substantially different in KPO business."

26. Mr. Porus Kaka pointed out that even the brief overview of the KPO services was also given by the assessee in its submissions filed before the TPO along with objections raised in the light of the same for characterizing it as KPO service provider as under:-

"Brief overview of Knowledge Process Outsourcing services and the Assessee's objections"

It is pertinent to note the following understanding of the KPO services as provided in the captioned notice and relevant annexures available in the CD form:

"KPO involves the transfer of knowledge intensive business processes that require significant domain expertise, to other geographic locations. For global corporations looking to move their higher-end research like market research and equity research, analytical based services, engineering design, IPR, legal services, remote education and publishing, India is currently the location of choice."

KPO- A new breed of high end knowledge based BPO called Knowledge Process Outsourcing (KPO,) emerged. This comprises of vendors providing higher end research and analytic based services in traditional service lines as well as new business areas. Areas for KPO include healthcare — intellectual property rights research, design and development for automotive and aerospace industries and animation and graphics in the entertainment sector.

(please refer IT enabled Services definition as provided in the CD.)
(Please refer Exhibit 3)

We respectfully submit that we object to the characterization of the Assessee as a KPO.

Merely because the services performed by the Assessee pertain to the logistics industry we request your goodself not to conclude that the services performed by the Assessee can be categorized as KPO.

A KPO industry is significantly higher on the value chain and involves processes that demand advanced information analysis as well as some judgment and decision making. Further the main concern of the KPO is the quality of the service provided as the same would involve strategic decision making. Thus a KPO industry is extremely sensitive and absorbs higher risks involving; confidentiality, quality, decision making etc.

As discussed in above paragraphs, the Assessee in turn is a captive entity engaged in the provision of data processing services merely to its AE, which inter alia involves activities such data entry, transcription, reconciliation, consolidation, co-ordination, preparation, processing and review of shipping documents such as bills of lading, etc and similar support services, following pre-defined procedures and adhering to the set standards and criteria as laid down by the AE and routinely sending the same to the AE as required by them.

The Assessee does not have authority to make any decisions (as would be required to be made by an independent KPO) and operates as per the directions and instructions provided by its AE. The activities performed by the Assessee are merely preparatory and auxiliary in nature. Thus the Assessee's role does not involve any judgment or decision making skills and thereby the services provided do not face the risks arising there-from, as in the case of a KPO.

Based on the above, it is evident that the environment within which the services are provided by the Assessee are not as

sensitive, risk oriented as that of the KPO and thus the Assessee should not be compared to the companies engaged in KPO services and cannot be possibly expected to attain margins as demanded by the KPO industry due to the extreme sensitivity and decision making involved therein.”

27. Shri Porus Kaka contended that the proposed action of the TPO in characterizing the assessee as KPO service provider thus was strongly objected to by the assessee by making a detailed submission pointing out the distinction between the low-end services rendered by the assessee as back office support services and the high-end knowledge process outsourcing services. He contended that this elaborate submission made by the assessee to show as to how and why it could not be treated as KPO service provider, however, was completely ignored by the TPO and he treated the assessee as KPO without giving any convincing reasons to justify the same. He submitted that similarly four additional filters were arbitrarily applied by the TPO to remove the comparables which otherwise met FAR analysis just to suit and support the huge TP adjustment suggested by him. He submitted that the nature of functions of the assessee or the FAR analysis made by the assessee was not disputed by the TPO and the findings given by him about the nature of activities of the assessee on page 8 to 9 of his order to treat the assessee as KPO are contrary to the nature of activities of the assessee discussed by the TPO himself on page 2 of his order.

28. Our attention was invited by Shri Porus Kaka to the relevant portion of the submissions made by the assessee before the DRP at page No. 116 & 117 of the paper book to point out that the erroneous categorization of the assessee as KPO was challenged by the assessee by making the following submission:

Erroneous categorization as KPO

- The Assessee's back office support services primarily comprises of low end data entry, transcription, consolidation, co-ordination, preparation, processing and review of shipping documents and such other similar support services
 - The activities primarily involves information collation from shipper/customer/AE and populating the same into various processes and system provided by AE.
- Activities are mechanical application of systems provided by AE and hence Assessee does not have authority to make any decisions
 - Carries limited low end functions based on instruction, standardised processes, data specification, process note and statement of work all of which have always been provided by it's AE
- These activities are performed by **low skilled employees** who are primarily **graduate by qualifications, with minimum / no shipping industry knowledge**

Qualification	Percentage
Graduates (Bcoms, BSc, BA, etc.)	74%
Post Graduates (Mcom, MSc, MCS, MCM, etc.)	22%
Professionals (Chartered Accountants, B. Tech, etc.)	4%
- Minimum training required to perform the activities
- Jobs vacancy advertisement clips by the Assessee appearing in newspaper attached as **Annexure 1** for giving a view on how Assessee portrays itself to the job seekers

Erroneous categorization as KPO (Cont...)

- Assessee providing low end back office support services has been accepted by revenue authorities in earlier years
- There has been no change in Assessee's FAR during year under consideration
 - Employee cost broadly similar in FY 2006-07 and FY 2007-08 (Paper book Page No. 231)
- In contrast, KPO services are significantly higher on the value chain and involves processes that demand advanced information analysis as well as experienced judgement
- KPO involves the transfer of knowledge intensive business processes that requires significant domain expertise
- KPO comprises of vendors providing higher end research and analytic based activities in traditional service lines as well as new business areas
- The high risk taking and professional decision making skills involved in KPO services cannot be compared to the Assessee who enjoys guaranteed risk free return on cost and insulated from competitive environment
- No cogent reasons were provided by the TPO for characterizing the Assessee as a KPO
 - In fact, TPO ignored the Assessee's detailed submission on why it should not be compared with the companies providing KPO services. (Paper book Page No. 328 to 331)

29. Shri Porus Kaka argued that various processes and systems required for providing back office support services were provided by the concerned AE and there was neither any transfer of knowledge by the assessee nor any research and analysis involved in providing the said services. He invited our attention to para 2.1.3 of the DRP's order to show that the case of the assessee of low end service provider still was not fully accepted by the DRP without giving any cogent or convincing reasons. He pointed out that the DRP, however, held that the assessee could not be considered as KPO going by the qualification and profile of its workforce. He contended that the objection of the assessee for inclusion of two comparables on the basis of functional difference, however, was not considered by the DRP specifically.

30. Shri Porus Kaka submitted that none of the services rendered by the assessee is in the nature of logistics outsourcing services and business analytic services and the finding given by TPO to this effect is contrary to the business profile of the assessee company given by the TPO himself on page No. 2 of his order. He contended that even the qualification and profile of the workforce employed by the assessee established the fact that the assessee is providing low end services which cannot be characterized as KPO services.

31. Shri Porus Kaka contended that ITES sector as a whole is taken as functionally similar by the TPO as well as by the DRP for the purpose of comparability analysis, which is not as per the procedure prescribed in the relevant Rules. Relying on the decision of Hon'ble Delhi High Court in the case of Li and Fung (I) Pvt. Ltd. dtd. 16-12-2013, he contended that arbitrary exercise of TP adjustment is not permissible and this exercise has to be done following the Rules prescribed.

32. Shri Porus Kaka then proceeded to explain the nature of functions performed by two entities namely Mold-Tek Technologies Limited and eClerx Services Ltd., with the help of relevant documents. He invited our attention to the relevant portion of the annual report of Mold-Tek Technological Services for financial year 2007-08 at page 139 of the paper book wherein the said entity was described as “pioneers in structural engineering services”. He also invited our attention to page 140 and 144 of his paper book to point out that almost the entire sales of the said entity for the financial year 2007-08 was on account of export of KPO division. He also brought to our notice the relevant portion at page 145 & 146 of his paper book wherein it was clearly stated that Mold-Tek Technologies Ltd. is providing only structural engineering services and it has suitably enlarged its HRD Deptt. to handle the increasing number of manpower in the KPO division. He contended that M/s Mold-Tek Technologies Ltd. thus is clearly a KPO service provider and the functions performed by it of providing only structural engineering services are not comparable with that of the assessee.

33. Referring to the relevant extracts of annual report and web-site of another comparable chosen by the TPO namely eClerx Services Ltd. placed at page 167 to 177 of his paper book, Shri Porus Kaka pointed out that the said entity had claimed itself, at page 167, to be a knowledge process outsourcing (KPO) company providing data analytics and data process solutions to some of the largest brands in the world with expertise in financial services and retail and manufacturing. In the message to the shareholders at page 171, the Chairman of the company had clearly stated that it is a very different company with industry specialized services for meeting complex client needs. It was also stated that the company provides solutions that do not just reduce cost but helps the clients to increase sales and reduce risk by enhancing

efficiencies and by providing valuable insights that empower better decisions. It was also clarified that the company therefore cannot be compared to a BPO or an IT offshoring company. Shri Porus Kaka also took us through the note given by the company on KPO placed at page No. 173 of his paper book and submitted that the contents thereof clearly make out the distinction between BPO and KPO. The said contents are extracted below:-

“Knowledge Process Outsourcing (KPO)

The global business environment is becoming increasingly information and knowledge intensive. In such an environment, business entities have realized the importance of and opportunity in assimilating data, analyzing trends, creating knowledge and harnessing this knowledge for running business operations efficiently thereby contributing to growth and profits.

The evolution and maturity of the Indian BPO sector gave rise to Knowledge Process Outsourcing (KPO). The term KPO has generally come to refer to such activities and process solutions supplied by the service provider that essentially involve information searching, analyzing, interpreting and require significant domain expertise on part of the service provider.

A KPO firm requires substantially more domain expertise than BPO firm. Professionals continue to learn: and undergo continuous training to learn new procedures and newer interpretations. Consequently, a good KPO firm is likely to be judged more by the depth of knowledge and experience of its professionals than just its Size.

India is a preferred destination for KPO because of its large English speaking labour pool, inherent domain expertise due to a large and developed domestic services industry and knowledge and application of internationally accepted quality standards and processes. The country adds more than three million graduates and professional degree and diploma holders annually. It is home to the world's second largest reservoir of engineers and scientists, and the second largest pool of IT manpower.

The knowledge services provided by this industry include Investment Research, Legal Research, Sourcing Management, Information Management, Market Research and Analytic Services. Some of the key sectors it services include Banking and Financial Institutions, Legal, Paralegal and Intellectual Property, Contract Research Organizations and the Bio-Pharma Industry.

According to a research paper released by KPMG, the global KPO industry is expected to reach USD 17 billion by 2010, of which USD 12 billion (almost 70%) would be outsourced to India alone. In addition, the Indian KPO sector is also expected to employ more than 250,000 KPO professionals by 2010.

After achieving great success in BPO, India automatically becomes a natural choice for KPO services. Due to a large knowledge pool and a significant cost arbitrage, countries like India are front runners in providing outsourced services. Overall, India's position in the IT-KPO-BPO field is visibly strong and it may, considering the trends and possibilities, occupy higher grounds in the future."

34. Reliance was placed by Shri Porus Kaka on the Notification No. SO 2810 (E) dtd. 18th September, 2013 issued by the CBDT in exercise of the power conferred by section 92CB r.w.s. 295 of the Act making the Safe harbour Rules and our attention was invited to the definition of "Information Technology Enabled Services" given in Rule 10 TA(e) as the various business process outsourcing services specified therein which are provided mainly with the assistance or use of the information technology. He pointed out that the services so prescribed by the CBDT include back office operations and support centre, which are the services rendered by the assessee company in the present case. He then referred to the definition of "knowledge process outsourcing services" given in clause (g) of Rule 10TA to mean certain specified business process outsourcing services which are provided mainly with the assistance or use of information technology requiring application of knowledge and advanced analytical and technical skill. He contended that the services so specified by the CBDT do not include back office support services as rendered by the assessee company in the present case. He contended that the services rendered by the assessee also do not require application of knowledge and/or advance analytical and technical skill. He contended that these provisions given by the CBDT in safe harbour rules thus clearly show that there is a clear distinction between KPO services and BPO services and the back office support services rendered by the assessee fall within the category of BPO services.

35. Shri Porus Kaka submitted that before the decision of the Mumbai Bench of Tribunal in the case of Willis Processing Services (I) Pvt. Ltd. Vs. DCIT (supra), several Benches of the Tribunal took a view in favour of the assessee, accepting the distinction between BPO and KPO and holding that the BPO service provider cannot be compared with the KPO service provider. He cited two of such decisions one rendered by Hyderabad Bench of ITAT in the case of Capital IQ Information Systems (India)(P.) Ltd. DCIT (I.T.A No. 1961/Hyd.2011 dtd. 23-11-2012 and other rendered by Mumbai Bench of ITAT in the case of Lloyds TSB Global Services Pvt. Ltd Vs. DCIT (ITA No. 5928/Mum/2012 dtd. 21-11-2012). He submitted that even after the decision in the case of Willis Processing Services (I) Pvt. Ltd. rendered on 1-3-2013 taking a view against the assessee, the Tribunal has decided this issue in favour of the assessee in the various decisions rendered thereafter. He filed the copies of such orders of the Tribunal passed in the following cases:-

1. Zavata India Pvt. Ltd. Vs. DCIT – ITA 1781/Hyd/2011 dtd. 2-7-2013
(2013) 35 Taxmann.com.423)
2. PTC Software (I) Pvt. Ltd Vs. ACIT ITA 1605/PN/2011 dtd. 30-4-2013
3. Cognizant Technology Services Pvt. Ltd. Vs. ACIT ITA 2106/1864/Hyd/2011 dtd.
Dated 22-5-2013
4. Symphony Marketing Solutions India Pvt. Ltd. V. ITO ITA 1316/Bang/2012 dt. 14.8.2013
5. Market Tools Research Pvt. Ltd. Vs. DCIT ITA 1811/Hyd/2012 dt. 24.10.2012
6. Avineon (I) P. Ltd. DCIT ITA 1989/Hyd/2011dtd. 31-10-2013

36. As regards the decision of Division Bench of this Tribunal in the case of Willis Processing Services (I) Pvt. Ltd. (supra), Shri Porus Kaka submitted that a different view has been taken therein by not accepting the distinction between BPO service and KPO service and characterising such services as ITES, without taking into consideration the view already taken by the co-ordinate Benches. He took us through the order passed

by the Tribunal in the case of Willis Processing Services (I) Pvt. Ltd. (supra) and submitted that the reliance in support of its view on this issue was placed by the Tribunal on the so called accepted rule of sampling that larger size of sample would be better and adequately represent the lot or population to which the sample belongs. He contended that in so far as transfer pricing exercise is concerned, the comparables have to be better than larger and what matters is the quality of sample/comparables and not the size/quantity. He contended that the comparability for this purpose has to be seen on the basis of FAR analysis and the relevant Rule 10B(3)(ii) allows only reasonably accurate adjustment to be made to eliminate the differences, if any. He contended that in the transfer pricing exercise, analysis has to be qualitative and not quantitative. He also contended that the broad characterisation of BPO and KPO services made by the Tribunal in the case of Willis Processing Services (I) P. Ltd. (supra) as ITES, based on the larger size of sample, is not in accordance with the TP regulations prescribed in the relevant Rule and thus the view taken in the said case has not been followed even by the other co-ordinate Benches of the Tribunal.

37. Reference was made by Shri Porus Kaka to section B.3.1 of the OECD transfer pricing guidelines issued in July, 2010 and our attention was drawn to paragraph Nos. 2.68 to 2.75 contained therein explaining the comparability standard to be applied when TNMM is followed. The said paragraphs read as under:-

“2.68 A comparability analysis must be performed in all cases in order to select and apply the most appropriate transfer pricing method, and the process for selecting and applying a transactional net margin method should not be less reliable than for other methods. As a matter of good practice, the typical process for identifying comparable transactions and using data so obtained which is described at paragraph 3.4 or any equivalent process designed to ensure robustness of the analysis should be followed

when applying a transactional net margin method, just as with any other method. That being said, it is recognised that in practice the level of information available on the factors affecting external comparable transactions is often limited. Determining a reliable estimate of an arm's length outcome requires flexibility and the exercise of good judgment. See paragraph 1.13.

2.69 Prices are likely to be affected by differences in products, and gross margins are likely to be affected by differences in functions, but net profit indicators are less adversely affected by such differences. As with the net margin method resembles, this, however, does not mean that a mere similarity of functions between two enterprises necessarily lead to reliable comparisons. Assuming similar functions can be isolated from among the wide range of functions that enterprises may exercise, in order to apply the method, the net profit indicators related to such functions may still not be automatically comparable where, for instance, the enterprises concerned carry on those functions in different economic sectors or markets with different levels of profitability. 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 associated enterprise and the independent enterprise involved in the transactions in order for the controlled transactions to be comparable; there are various factors other than products and functions that can significantly influence net profit indicators.

2.70 The use of net profit indicators can potentially introduce a greater element of volatility into the determination of transfer prices for two reasons. First, net profit indicators can be influenced by some factors that do not have an effect (or have a less substantial or direct effect) on gross margins and prices, because of the potential for variation of operating expenses across enterprises. Second, net profit indicators can be influenced by some of the same factors, such as competitive position, that can influence price and gross margins, but the effect of these factors may not be as readily eliminated. In the traditional transaction methods, the effect of these factors may be eliminated as a natural consequence of insisting upon greater product and function similarity. Depending on the facts and circumstances of the case and in particular on the effect of the functional differences on the cost structure and on the revenue of the potential comparables, net profit indicators can be less sensitive than gross margins to differences in the extent and complexity of functions and to differences in the level of risks (assuming the contractual allocation of risks is arm's length). On the other hand, depending on the facts and circumstances of the case and in particular on the proportion of fixed and variable costs, the transactional net margin method may be more sensitive than the cost plus or resale price methods to differences in capacity utilisation, because

differences in the levels of absorption of indirect fixed costs (e.g. fixed manufacturing costs or fixed distribution costs) would affect the net profit indicator but may not affect the gross margin or gross mark-up on costs if not reflected in price differences. See Annex I to Chapter II “Sensitivity of gross and net profit indicators”.

2.71 Net profit indicators may be directly affected by such forces operating in the industry as follows: threat of new entrants, competitive position, management efficiency and individual strategies, threat of substitute products, varying cost structures (as reflected, for example, in the age of plant and equipment), differences in the cost of capital (e.g. self financing versus borrowing), and the degree of business experience (e.g. whether the business is in a start-up phase or is mature). Each of these factors in turn can be influenced by numerous other elements. For example, the level of the threat of new entrants will be determined by such elements as product differentiation, capital requirements, and government subsidies and regulations. Some of these elements also may impact the application of the traditional transaction methods.

2.72 Assume, for example, that a taxpayer sells top quality audio players to an associated enterprise, and the only profit information available on comparable business activities is on generic medium quality audio player sales. Assume that the top quality audio player market is growing in its sales, has a high entry barrier, has a small number of competitors, and is with wide possibilities for product differentiation. All of the differences are likely to have material effect on the profitability of the examined activities and compared activities, and in such a case would require adjustment. As with other methods, the reliability of the necessary adjustments will affect the reliability of the analysis. It should be noted that even if two enterprises are in exactly the same industry, the profitability may differ depending on their market shares, competitive positions, etc.

2.73 It might be argued that the Potential inaccuracies resulting from the above types of factors can be reflected in the size of the arm’s length range. The use of a range may to some extent mitigate the level of inaccuracy, but may not account for situations where a taxpayer’s profits are increased or reduced by a factor unique to that taxpayer. In such a case, the range may not include points representing the profits of independent enterprises that are affected in a similar manner by a unique factor. The use of a range, therefore, may not always solve the difficulties discussed above. See discussion of arm’s length ranges at paragraphs 3.55-3.66.

2.74 The transactional net margin method may afford a practical

solution to otherwise insoluble transfer pricing problems if it is used sensibly and with appropriate adjustments to account for differences of the type referred to above. The transactional net margin method should not be used unless the net profit indicators are determined from uncontrolled transactions of the same taxpayer in comparable circumstances or, where the comparable uncontrolled transactions are those of an independent enterprise, the differences between the associated enterprises and the independent enterprises that have a material effect on the net profit indicator being used are adequately taken into account. Many countries are concerned that the safeguards established for the traditional transaction methods may be overlooked in applying the transactional net margin method. Thus where differences in the characteristics of the enterprises being compared have a material effect on the net profit indicators being used, it would not be appropriate to apply the transactional net margin method without making adjustments for such differences. The extent and reliability of those adjustments will affect the relative reliability of the analysis under the transactional net margin method. See discussion of comparability adjustments at paragraphs 3.47-3.54.

2.75 Another important aspect of comparability is measurement consistency. The net profit indicators must be measured consistently between the associated enterprise and the independent enterprise. In addition, there may be differences in the treatment across enterprises of operating expenses and non-operating expenses affecting the net profits such as depreciation and reserves or provisions that would need to be accounted for in order to achieve reliable comparability.”

38. Referring to the relevant portion of the OECD guidelines, Shri Porus Kaka submitted that determining a reliable estimate of arm's length outcome requires flexibility and exercise of good judgment. He contended that a reasonable, sensible and practical approach is expected to be adopted in order to ensure that the TNMM can afford a practical solution to otherwise insoluble transfer pricing problems. Referring to para 2.92 of the OECD guidelines, he also contended that cost based indicators should only be used in those cases where costs are a relevant indicator of the value of the functions performed, assets used and risks assumed by the tested party. In addition, the determination of what cost should be included in the cost base should be derived from a careful review of the facts and circumstances of the case.

39. Shri Porus Kaka also referred to Chapter III of the OECD guidelines and submitted that para 3.2 of the said chapter, dealing with “Performing a Comparability Analysis”, recommends that where it is possible to determine that some uncontrolled transactions have a lesser degree of comparability than others, they should be eliminated. He also referred to the typical process given in para 3.4 of the guidelines that is commonly followed when performing a comparability analysis. He also referred to Section A-5 of OECD guidelines on “selecting and rejecting potential comparables” and pointed out that as per para 3.56 of the guidelines, where it is possible to determine that some uncontrolled transactions have a lesser degree of comparability than others, they should be eliminated. He also referred to para 3.57 of the guidelines wherein it is stated that if the range of comparables includes a sizeable number of observations, statistical tools that take account of central tendency to narrow the range (e.g. the interquartile range or other percentiles) might help to enhance the reliability of the analysis. He also referred to para 3.59 of the OECD guidelines wherein it is suggested that where the application of the most appropriate method produces a range of figures, a substantial deviation among points in that range may indicate that the data used in establishing some of the points may not be as reliable as the data used to establish the other points in the range or that the deviation may result from features of the comparable data that require adjustments. It is suggested that further analysis of those points in such cases may be necessary to evaluate their suitability for inclusion in any arm’s length price.

40. Reference was made by Shri Porus Kaka to section A.7.3 of the OECD guidelines dealing with “extreme results in the context of comparability considerations” to point out that extreme results might

consist of losses or unusually high profits. It is suggested that extreme results can affect the financial indicators that are looked at in the chosen method and where one or more of the potential comparables have extreme results, further examination would be needed to understand the reasons for such extreme results. He submitted that if the relevant data is secured, further analysis is required to find out the reliability of such data as suggested in the OECD guidelines. He contended that this vital aspect was not considered by the Tribunal in the case of Willis Processing Services (I) Pvt. Ltd. (supra) and the decision was rendered without further analysis or investigation to find out any abnormality and to nullify the effect of such abnormality by applying suitable statistical method. He submitted that even the comparison of functions made by the Tribunal in para 30.10 of its order passed in the case of Wills Processing Services (I) Pvt. Ltd. is very generic which is done without making any further analysis of the functions performed in order to ascertain whether it was a case of BPO service provider or KPO service provider.

41. Advocate Shri Ajay Vora, the Id. Counsel appearing for both the interveners M/s Omniglobe Information Technologies India Pvt. Ltd. and M/s CRM Services India Ltd. put forth his propositions on the issues involved in two questions raised before the Special Bench. As regards the issue involved in Question No. 1, he referred to section 92-C (1) of the Act which provides for computation of income arising from the international transaction having regard to the arm's length price. He submitted that the ALP of an international transaction is required to be determined by applying one of the methods provided in section 92-C (3) of the Act, being the most appropriate method and such method must take into consideration certain aspects which are critical. He contended that this position is further amplified in Rule 10-B of the Income Tax Rules, 1962

which envisages adjustment on account of functional and other differences. He contended that adopting of any method ultimately envisages comparison of apple with apple and Rule 10B(2)(a) provides that specific characteristic of services rendered by the two entities should be compared in order to treat the same as comparables for the purpose of transfer pricing analysis. He relied on the decision of Hon'ble Supreme Court in the case of DIT (International Taxation) vs. Morgan Stanley and Co. Inc. [2007] 292 ITR 416 wherein the Hon'ble Apex Court emphasized the significance of functions performed and risks assumed by the enterprise in undertaking the transfer pricing analysis. He contended that comparability should be based on the conclusion drawn from the functional analysis of the enterprise and it should be a backdrop of benchmarking and determining the arm's length price. He argued that the parameters for taking an un-controlled transaction as comparable to international transaction are provided in Rule 10-B(2) and as held by the Bangalore Special Bench of ITAT in the case of Aztec Software and Technology Services Ltd. vs. ACIT 107 ITD 141 (Bang.)[SB], this criteria should form a basis for judging the comparability, whatever be the methodology chosen for the purpose of determination of ALP. He also relied on the decision of Delhi Bench of ITAT in the case of Mentor Graphics (Noida) Pvt. Ltd. Vs. DCIT, 18 SOT 76 (Delhi) wherein it was held that the first step in the determination of ALP is to analyse the specific characteristics of the controlled transaction so as to make meaningful comparison with the comparables possible.

42. Shri Ajay Vora contended that there are basic and fundamental differences in the characteristics of BPO as compared to KPO. In support of this contention, he relied on the report prepared by the National Skill Development Corporation (NSDC) on Human Resource and Skill Requirements in the IT and ITES Industry Sector (2022) placed at page 7

to 45 of his paper book and took us through the relevant portion thereof. He invited our attention to page 12 of the said report to point out that the expression “ITES” and “BPO” are used interchangeably. He invited our attention to page 19 of the report wherein it is stated that customer interaction and finance and accounting services form a significant portion of BPO services. He contended that the BPO thus is involved in rendering mainly voice and data processing services which are in the nature of low end services. He contended that the KPO services on the other hand, as stated in the report, move beyond simple voice and data services and include data analytics, content management, research and information services, animation, biotech and pharmaceutical research, medical and health services. He submitted that the KPO services also include legal services, engineering services and financial and marketing research services. He contended that all these services included in KPO segment are high-end services for which skill set required is entirely different from BPO as stated on page 32 of the report and further explained on page 34 to 38 of the report pointing out skill requirement and skill gap in KPO. He contended that no domain knowledge is required to render BPO services whereas it is very much required to render KPO services. He submitted that the BPO sector as stated on page 27 of the report contributes large volume while the KPO sector is a “value play”.

43. Shri Ajay Vora referred to an article “KPO- An emerging opportunity for the Chartered Accountants” published in July, 2006 issue of Journal “The Chartered Accountants” wherein after explaining the concept of KPO, the difference between KPO and BPO is pointed out by the author as under:-

“2. Difference between KPO & BPO

1. Process: It is not a simple case of the ‘K’ replacing the ‘B’. KPO involves high-end processes like valuation and, investment, research, patent filing, legal and insurance claims processing, amongst others.

2. Focus: Unlike conventional BPO where the focus is on process expertise, in KPO, the focus is on knowledge expertise.

3. Specialisation: The difference lies in domain specialization. BPO employees do not generally require specialized knowledge. Customer care executives at a BPO require good knowledge of the English language, the ability to be articulate and possess basic computer skills. On the other hand, a KPO organisation specializing in equity or financial analysis for example, can employ highly qualified professionals who possess high-end knowledge of accounts and finance. S/he should hold MBA or a CA qualification.

4. Driving Force: While KPO organizations are knowledge-driven, BPOs are process-driven.

5. Activities: KPO involves off shoring of knowledge intensive business processes that demand specialised expertise. This delivers high value to organisations by providing much required business expertise. A few examples of KPO businesses are online teaching, patent filing, legal and insurance claims processing, valuation research, investment research and media content supply. BPO on the other hand, involves a predefined way of handling a business process, which is taught to agents or employees. BPO services normally include transaction processing, setting up a bank account, selling of insurance policies, technical support and voice and email-based support.

6. Contact with clients: Unlike BPOs, KPO employees tend to have greater direct contact both with international clients and with their teams overseas, once again underscoring the need for specialised skills. This could mean establishing direct channels of communication with a team member overseas to seek clarifications in the midst of completing work. If the work involved is complicated, direct communication with the client may also be needed, as seen in several cases of filing tax returns.”

44. Shri Ajay Vora contended that even the CBDT now has recognized the difference between KPO and BPO while framing the safe harbour rules. He contended that the FAR analysis will be different in case of BPO as compared to KPO and pointed out that in the case of CRM Services (I)

Pvt. Ltd. (ITA 4068/Del/2009 and ITA No. 4796/Del/2010 dtd. 30th June, 2011), Delhi Bench of ITAT in para No. 9.3 of its order has made a distinction between voice based and non-voice based BPO services while applying the functional test in comparability analysis.

45. Shri Ajay Vora submitted that Rule 10-B(2)(a) provides that the comparability of an international transaction with uncontrolled transaction is to be judged with reference to the specific characteristics of the property transferred or services provided in either transaction and this India specific Rule is not there in the OECD guidelines. He contended that the TP regulations stipulated in the relevant Rules have a force of law and as held by the Delhi Bench of ITAT in the case of Mentor Graphics (Noida) Pvt. Ltd., (supra) the TPO cannot refuse to consider the specific characteristics of the transactions, notwithstanding the OECD guidelines.

46. As regards the notification No. FO 890(E) dtd. 26-9-2000 issued by the CBDT specifying the various back office support services as ITES, Shri Ajay Vora submitted that the said notification is issued in the context of section 10A, 10B and 80 HHE of the Act to explain and define the term “computer software” for the purpose of Explanation 2(1)(b) of section 10A, Explanation 2(1)(b) of section 10-B and Explanation (b) of section 80HHE of the Act and the same cannot be extended or applied to treat the BPO as KPO. He contended that the said notification is to be read in the context in which it is issued and the same, issued on 26-9-2000 by the CBDT, cannot be applied to decide the issue relating to transfer pricing as the provisions relating to transfer pricing were not even in the statute when the said notification was issued by the CBDT.

47. The Id. CIT (DR) Shri Ajeet Kumar Jain submitted in his reply that the characterisation of the services rendered by the assessee company is required to be done in order to ascertain whether it is a BPO or KPO or something in between. In this regard, he invited our attention to the executive summary given in the TP study report submitted by the assessee at page 62 of the paper book and pointed out that the services provided by the assessee were broadly categorized therein as Information Technology Enabled Services (ITES) and Information Technology Services (ITS). He submitted that the ITES services provided by the assessee were stated to be that of transaction processing, data entries, reconciliation of statements, audit of shipping documents and other similar support services. He submitted that this nature of services rendered by the assessee again was repeated in the relevant portion of the TP study report appearing on page 65 of the paper book. He also invited our attention to the information relating to the functions performed by the assessee in connection with provision of I.T. enabled services to its AE as given in the relevant portion of the TP study report appearing at page 76 and 78 of the paper book and pointed out that the services performed by the assessee included, inter alia, to reconcile the differences between Equipment Management System and the Transport Plan in Global Customers Service Systems, tender handling, contract drafting and data quality. He contended that all these services rendered by the assessee are clearly in the nature of KPO services and not routine BPO functions as it is not possible to render these services without a specialized knowledge. He contended that the assessee thus cannot be considered either as BPO or KPO but it lies somewhere in between as the services rendered by it are in the nature of BPO as well as KPO. He contended that keeping in view these characteristics of the services rendered by the assessee company, both BPO and KPO can broadly be taken as comparables as held by the DRP.

48. Shri Ajeet Kumar Jain, the Id. CIT(DR) invited our attention to the relevant portion of the TPO's order wherein the comparables selected by the assessee and those finally selected by the TPO were discussed. He filed a compilation of relevant portion of the annual reports of some of such comparables and pointed out that M/s ICRA Online Ltd. selected by the assessee company itself as comparable was into KPO services. Similarly, he pointed out from the relevant portion of the annual reports of the other companies that M/s ICRA Techno Analytics Ltd. and KPIT Cummins Global Business Solutions Ltd., selected by the assessee itself as comparables, were into KPO services. He also pointed out that M/s Cosmic Global Ltd., M/s Maple E-Solutions Ltd. and M/s Spanco Telesystems and Solution Ltd. (segmental) selected by the assessee company as comparables, on the other hand, were providing low end BPO services such as call centers. He contended that the assessee company had rightly selected BPO as well as KPO as comparables in its own TP study since the distinction between BPO and KPO would not have much impact for comparability where TNMM is followed particularly when the services rendered by the assessee have attributes of KPO also.

49. Reference was made by Shri Ajeet Kumar Jain, Id. CIT (DR) to the order of the Tribunal passed in assessee's own case for A.Y. 2007-08 placed at page 28 to 40 of his paper book (ITA No. 8558/Mum/2011 dtd. 29-2-2012). It was pointed out from the relevant portion of the said order of the Tribunal at page 33 of the paper book that eClerx Services Pvt. Ltd. having 90.43% OP/TC was taken by the TPO as comparable and the same was not disputed by the assessee. He pointed out that one of the thirty comparables taken by the TPO was M/s Mod-Tek Technologies Ltd. and although the said entity having 113.49% OP/TC was disputed by the assessee, inter alia, on the ground of abnormal profits, the Tribunal

finally restored the matter to the file of the A.O. with a direction to recompute the ALP margin on the basis of profit margin of all the thirty comparables. He contended that both the entities having higher profit margin thus were finally included and taken as comparables for transfer pricing analysis in assessee's own case for A.Y. 2007-08.

50. As regards the dispute raised by the assessee in respect of filters applied by the TPO for the selection of comparables, Shri Ajeet Kumar Jain contended that different filters are required to be applied in order to find a suitable comparable transaction. He submitted that the objective of such search for comparable companies, as stated in the TP study report submitted by the assessee (relevant portion of the paper book page 88), is to identify a group of independent companies with publicly available data that perform broadly similar functions, operate in broadly similar market and bear broadly similar risk to that of tested party. He invited our attention to the reasons given by the TPO on page 3 & 4 of his order for rejecting the filters applied by the assessee and contended that the same are sufficient to show that the filters applied by the assessee were not appropriate. He pointed out that the filters applied by the TPO, on the other hand, were fully justified in the facts of the case as the same were fair and logical as explained by the TPO giving cogent and convincing reasons. He submitted that the assessee, in any case, has finally disputed only two comparables and contended that even though both these entities are KPO service providers, it is to be noted that the assessee company itself has taken some other KPO service providers as comparables and that atleast some of the functions/services rendered by it are in the nature of KPO services.

51. As regards the reliance placed by the Id. Counsel for the assessee Shri Porus Kaka and the Id. Counsel for the intervener Shri Ajay Vora on

the safe harbour rules framed by the CBDT, Shri Ajeet Kumar Jain submitted that these rules are framed by the CBDT as per section 92-CB of the Act whereas the determination of ALP is governed by section 92-C read with Rule 10B of the Income Tax Rules, 1962. He pointed out that the definition given in Rule 10-TA are for the purposes of Rule 10TA to Rule 10TC and not for the purpose of Rule 10B. He submitted that as per Rule 10-TD, safe harbour rules are applicable to the assessee who exercises a valid option for application of safe harbour rules. He contended that the assessee in the present case has not exercised this option and therefore it cannot take a shelter under safe harbour rules by relying on the definition given therein in support of its case that the BPO and KPO services are different and there is no similarity between them. He also contended that the safe harbour rules are framed by the CBDT vide circular dtd. 18-9-2013 and they cannot be applied in the present case involving A.Y. 2008-09. A reference was made by him to the Circular dtd. 20-12-2013 issued by the CBDT wherein it is clarified that if the safe harbour rules are not opted by the assessee, they cannot be relied upon and referred to by him. Relying on the decision of Hon'ble Supreme Court in the case of ITO vs. M.C. Poonnoose and Others - ITO vs. Excel Productions and Others [1970] 75 ITR 174 and in the case of Govinddas and Others vs. ITO [1976] 103 ITR 123, he contended that the safe harbour rules cannot be applied retrospectively to support the case of the assessee that there is a difference between BPO and KPO.

52. Shri Ajeet Kumar Jain invited our attention to para 1.38 of the OECD Transfer Pricing Guidelines issued in July, 2010 wherein it is stated that the information on product characteristics might be more important if the method applied is a comparable uncontrolled price method than if it is TNMM. He also relied on para 1.40 of the said guidelines wherein it is stated that the factor of characteristic of property or services must be given more or less weight depending on the transfer

pricing method. It is explained that under CUP method, any material difference in the characteristics of property or services can have an effect on the price whereas such difference in the characteristics of property/services is less sensitive in the case of TNMM. It is suggested in para 1.41 that in comparability analysis for method based on gross or net profit indicators, it may be acceptable depending on the facts and circumstances of the case to broaden the scope of comparability analysis to include uncontrolled transactions involving products that are different but where similar functions are undertaken. He submitted that the assessee himself took call centers as well as KPO as comparables and the same approach being adopted by the TPO, no fault can be found going by the OECD guidelines suggesting broad functional similarities where TNMM is followed.

53. As regards the reliance placed by Shri Porus Kaka on para 2.64 and 2.65 of the OECD guidelines, Shri Ajeet Kumar Jain submitted that the weaknesses of the TNMM are listed in these paragraphs. He submitted that the strengths of TNMM are discussed in para 2.62 and 2.63 of the OECD guidelines and as suggested in para 2.62, one of the strengths of TNMM is that the net profit indicators are less affected by transactional differences than is the case with price as used in the CUP method. It is also stated that the net profit indicator may be more tolerant to some functional differences between the controlled and uncontrolled transactions than gross profit margins. It is suggested that the differences in the functions performed between enterprises are often reflected in variations in operating expenses which may lead to a wide range of gross profit margins but still broadly similar levels of net operating profit indicators. He also relied on para 3.7 of the OECD guidelines wherein it is suggested that the broad based analysis is an essential part in the comparability analysis.

54. Shri Ajeet Kumar Jain submitted that there are five methods prescribed to determine the ALP in relation to the international transaction and the requirement for comparability analysis are method specific as given in sub rule (1) of Rule 10-B. He referred to the said Rule and submitted that price charged or paid for the property transferred or service rendered in the comparable transaction is relevant in case of CUP and re-sale price method while the cost of production incurred in respect of property transferred or services provided is relevant for cost plus method. He submitted that there is, however, no mention or reference to any property transferred or services provided in case of TNMM which is specifically there in case of other method. He contended that the relevant Rule thus makes it clear that specific characterization of the property transferred or services is not relevant for TNMM and this position is in conformity with the relevant OECD guidelines which suggest that broad comparability of functions to be done for TNMM. He contended that there is thus no need to make any distinction between BPO and KPO for TNMM and the broad category of ITES can be taken for the purpose of comparability analysis. In support of this contention, he relied on the decision of Delhi Bench of ITAT in the case of ACTIS Advisors Pvt. Ltd. (supra) wherein neither the assessee nor the TPO had gone into functional line horizontal test within ITES inasmuch as the comparables were selected from ITES without applying specifically any qualitative filter and the contention of the assessee seeking further dissection of these comparables was not accepted by the Tribunal observing that there will not be any end in that way and it is a very subjective exercise. Shri Ajeet Kumar Jain contended that the assessee in the present case has also not done any horizontal classification since it has taken call centers and KPO as comparables and since the broad comparability at ITES level is quite fair and proper in the facts and circumstances of the case, the

claim of the assessee for further dissection in the form of BPO and KPO should not be accepted.

55. In the rejoinder, Shri Porus Kaka submitted that Rule 10B(2) of the Income Tax Rules, 1962 is applicable in case of all the methods applied for determining the ALP of an international transaction and there is no merit in the contention raised by Shri Ajeet Kumar Jain, the ld. CIT (DR) that the applicability of the said Rule depends on the method followed. Relying on Section B.3.1 of the OECD guidelines and the decision of Hon'ble Delhi High Court in the case of Li and Fung India Pvt. Ltd. (supra), he contended that the standard of comparability is the same to TNMM.

56. We have carefully considered the rival submissions and also perused the relevant material on record to which our attention was drawn during the course of hearing. We have also deliberated upon various aspects of the issues specifically referred to this Special Bench for consideration and decision. Question No. 1 referred to this Special Bench involves the issue relating to selection of comparables in the process of transfer pricing analysis for the purpose of determining the arm's length price in relation to the international transactions of the assessee with its AEs. Before we refer to the provision of section 92-C and Rule 10-B, which are relevant in this context, it would be relevant to trace, in brief, the genesis of T.P. regulations in India. The increasing participation of multinational groups in economic activities in the country gave rise to new and complex issues emerging from transactions entered into between two, or more enterprises belonging to the same multinational group. The profits derived by such enterprises carrying on business in India could be controlled by the multinational group, by manipulating the prices charged and paid in such intra-group

transactions, thereby, leading to erosion of tax revenues. With a view to provide a statutory framework which could lead to computation of reasonable, fair and equitable profits and tax in India, in the case of such multinational enterprises, the Finance Act, 2001 substituted the then existing section 92 of the Income-tax Act by new sections 92 and 92A to 92F. As provided therein, income arising from an international transaction between associated enterprises shall be computed having regard to the arm's length price. The term 'associated enterprise' has been defined in section 92A. Section 92B defines an 'international transaction' between two or more associated enterprises. The provisions contained in section 92C provide for methods to determine the arm's length price in relation to an international transaction, and the most appropriate method to be followed out of the specified methods. While the primary responsibility of determining and applying an arm's length price is on the assessee, sub-section (3) of section 92C empowers the Assessing Officer to determine the arm's length price and compute the total income of the assessee accordingly, subject to the conditions provided therein. The Board has prescribed rules 10A to 10E in the Income-tax Rules, 1962, giving the manner and the circumstances in which different methods would be applied in determining arm's length price and the factors governing the selection of the most appropriate method. These provisions have been enacted with a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profit and tax in India so that the profits chargeable to tax in India do not get diverted elsewhere by altering the prices charged and paid in intra-group transactions leading to erosion of tax revenues.

57. During the course of hearing before us, the ld. Representatives of both the sides have referred to and relied on the OECD Transfer Pricing Guidelines for multinational enterprises and Tax Administrations issued in July, 2010 in support of their respective arguments. These guidelines

focus on the main issues of principle that arise in the transfer pricing area and are intended to address transfer pricing and other related tax issues with respect to multinational enterprises. They provide practical guidance on the application of arm's length principle to evaluate the transfer pricing of Associated Enterprises and analyse the method for evaluating whether the conditions of commercial and financial relations within an multinational enterprises satisfy the arm's length principle.

58. In so far as the relevant T.P. Regulations in India are concurred, it is observed that sub-section (1) of section 92-C of the Act provides that the arm's length price in relation to an international transaction shall be determined by any of the methods specified therein, being most appropriate method, having regard to the nature of transaction or class of transactions or class of associated persons or functions performed by such persons or such relevant factors as the Board may prescribe. Sub-section (2) of section 92-C provides that the most appropriate method referred to in sub section (1) shall be applied for determination of ALP in the manner as may be prescribed. The manner in which the ALP in relation to an international transaction is to be determined by any of the methods, being the most appropriate method, for the purposes of sub section (2) of the section 92-C of the Act has since been prescribed in Rule 10-B of the Income Tax Rules, 1962 which reads as under:-

“Determination of arm's length price under section 92C .

10B . (1) For the purposes of sub-section (2) of section 92C, the arm's length price in relation to an international transaction ^{55a}[*or a specified domestic transaction*] shall be determined by any of the following methods, being the most appropriate method, in the following manner, namely :—

- (a) comparable uncontrolled price method, by which,—
 - (i) the price charged or paid for property transferred or services provided in a comparable uncontrolled transaction, or a number of such transactions, is identified;
 - (ii) such price is adjusted to account for differences, if any, between the

international transaction ^{55a}[or the specified domestic transaction] and the comparable uncontrolled transactions or between the enterprises entering into such transactions, which could materially affect the price in the open market;

- (iii) the adjusted price arrived at under sub-clause (ii) is taken to be an arm's length price in respect of the property transferred or services provided in the international transaction ^{55a}[or the specified domestic transaction] ;

(b) resale price method, by which,—

- (i) the price at which property purchased or services obtained by the enterprise from an associated enterprise is resold or are provided to an unrelated enterprise, is identified;
- (ii) such resale price is reduced by the amount of a normal gross profit margin accruing to the enterprise or to an unrelated enterprise from the purchase and resale of the same or similar property or from obtaining and providing the same or similar services, in a comparable uncontrolled transaction, or a number of such transactions;
- (iii) the price so arrived at is further reduced by the expenses incurred by the enterprise in connection with the purchase of property or obtaining of services;
- (iv) the price so arrived at is adjusted to take into account the functional and other differences, including differences in accounting practices, if any, between the international transaction ^{55a}[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 gross profit margin in the open market;
- (v) the adjusted price arrived at under sub-clause (iv) is taken to be an arm's length price in respect of the purchase of the property or obtaining of the services by the enterprise from the associated enterprise;

(c) cost plus method, by which,—

- (i) the direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an associated enterprise, are determined;
- (ii) the amount of a normal gross profit mark-up to such costs (computed according to the same accounting norms) arising from the transfer or provision of the same or similar property or services by the enterprise, or by an unrelated enterprise, in a comparable uncontrolled transaction, or a number of such transactions, is determined;
- (iii) the normal gross profit mark-up referred to in sub-clause (ii) is adjusted to take into account the functional and other differences, if any, between the international transaction ^{55b}[or the specified domestic transaction] and the comparable uncontrolled

- transactions, or between the enterprises entering into such transactions, which could materially affect such profit mark-up in the open market;
- (iv) the costs referred to in sub-clause (i) are increased by the adjusted profit mark-up arrived at under sub-clause (iii);
 - (v) the sum so arrived at is taken to be an arm's length price in relation to the supply of the property or provision of services by the enterprise;
- (d) profit split method, which may be applicable mainly in international transactions ^{55b}[or specified domestic transactions] involving transfer of unique intangibles or in multiple international transactions ^{55b}[or specified domestic transactions] which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction, by which—
- (i) the combined net profit of the associated enterprises arising from the international transaction ^{55b}[or the specified domestic transaction] in which they are engaged, is determined;
 - (ii) the relative contribution made by each of the associated enterprises to the earning of such combined net profit, is then evaluated on the basis of the functions performed, assets employed or to be employed and risks assumed by each enterprise and on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances;
 - (iii) the combined net profit is then split amongst the enterprises in proportion to their relative contributions, as evaluated under sub-clause (ii);
 - (iv) the profit thus apportioned to the assessee is taken into account to arrive at an arm's length price in relation to the international transaction ^{55b}[or the specified domestic transaction] :

Provided that the combined net profit referred to in sub-clause (i) may, in the first instance, be partially allocated to each enterprise so as to provide it with a basic return appropriate for the type of international transaction ^{55b}[or specified domestic transaction] in which it is engaged, with reference to market returns achieved for similar types of transactions by independent enterprises, and thereafter, the residual net profit remaining after such allocation may be split amongst the enterprises in proportion to their relative contribution in the manner specified under sub-clauses (ii) and (iii), and in such a case the aggregate of the net profit allocated to the enterprise in the first instance together with the residual net profit apportioned to that enterprise on the basis of its relative contribution shall be taken to be the net profit arising to that enterprise from the international transaction ^{55c}[or the specified domestic transaction] ;

- (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 realized by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;
- (iii) the net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international 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 ^{55c}[*or the specified domestic transaction*];

⁵⁶ [(f) *any other method as provided in rule 10AB.*]

(2) For the purposes of sub-rule (1), the comparability of an international transaction ^{55c}[*or a specified domestic 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.

(3) An uncontrolled transaction shall be comparable to an international transaction ^{56a}[*or a specified domestic transaction*] if—

- (i) none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such

transactions in the open market; or

- (ii) reasonably accurate adjustments can be made to eliminate the material effects of such differences.

(4) The data to be used in analysing the comparability of an uncontrolled transaction with an international transaction ^{56a}[or a specified domestic transaction] shall be the data relating to the financial year in which the international transaction ^{56a}[or the specified domestic transaction] has been entered into :

Provided that data relating to a period not being more than two years prior to such financial year may also be considered if such data reveals facts which could have an influence on the determination of transfer prices in relation to the transactions being compared.”

59. The manner in which the ALP in relation to an international transaction is to be determined is prescribed in Rule 10B and it is relevant in this context to take into account the specific method followed for determining the ALP in relation to an international transaction. In the present case, the method followed for determining the ALP of an international transaction by the assessee as well as by the A.O./TPO is Transactional Net Margin Method (TNMM) and the comparability of an international transaction with an uncontrolled transaction has to be judged with reference to the functions performed, taking into account the assets employed or to be employed and the risks assumed by the respective parties to the transaction as per Rule 10B(2)(b). The specific characteristics of the property transferred or services provided as envisaged in Rule 10-B(2)(a) in either transactions may not be that relevant to judge the comparability of an international transaction in TNMM as the price charged or paid for property transferred or services provided and the direct and indirect cost of production incurred by the enterprise in respect of property transferred or services provided are taken into account for comparability analysis in the transaction methods such as CUP, resale price and cost-plus whereas the profit based method such as TNMM takes into account, the net margin realized. In TNMM, the comparability of an international transaction with an uncontrolled transaction is required to be judged with reference to functions

performed as provided in sub Rule (2)(b) of Rule 10-B read with sub Rule (1)(e) of that Rule after taking into account assets employed or to be employed and the risks assumed by the respective parties to the transaction.

60. The OECD transfer pricing guidelines, issued in July, 2010, also express a similar view when it states in para 1.38 that information on product characteristics might be more important if the method applied is CUP than if it is TNMM. It further explains in para 1.40 that the requirement for comparability of property or services is the strictest for the CUP method whereas differences in characteristics of property or services are less sensitive in case of transactional profit methods than in case of traditional transaction methods. It further clarifies, in para 1.41, that the comparability analysis for method based on gross or net profit indicator often puts more emphasis on functional similarity than on product similarity and, depending on the facts and circumstances of the case, it may be acceptable to broaden the scope of comparability analysis to include un-controlled transactions involving products that are different, but where similar functions are undertaken.

61. Chapter II of the OECD transfer pricing guidelines (July, 2010) deals with selection of the transfer pricing method and Part III thereof deals with transactional profit methods. Section B-2 of this part discusses about strengths and weaknesses of Transactional Net Margin Method (TNMM) and one of the strengths of TNMM, as explained therein, is that the net profit indicators (e.g. operating income) are less affected by transactional differences than is the case with price as used in the CUP method. It is further explained that the net profit indicators may also be more tolerant to some functional differences between the controlled and uncontrolled transactions than gross profit margins as the differences in functions performed between enterprises are often

reflected in variations in operating expenses leading to wide range of gross profit margin but broadly similar levels of net operating profit indicators.

62. At the time of hearing before us, Shri Porus Kaka has relied on the guidelines given by the OECD in section B-3.1 (para 2.68 to 2.75) in respect of the comparability standard to be applied to the Transactional Net Margin Method. However, as rightly pointed out by the Id. D.R., these guidelines are issued by the OECD as a caution to overcome the number of weaknesses of the TNMM, as clearly mentioned in para 2.64. In any case, we will deal with these guidelines, given by the OECD, subsequently at an appropriate stage. Suffice it to say at this stage that the net profit indicators such as operating profit to operating cost or total cost or total sales are less affected by transactional differences and the same being more tolerant to some functional differences between controlled and uncontrolled transactions, broad functionality can be taken into consideration for selecting the potential comparables in case of TNMM. If such broad functionality is taken into consideration in the present context, we are of the view that the potential comparables at ITES sector level can be selected at first stage in the comparability analysis as the functions performed by IT enabled service providers are broadly similar and there is a common thread running through them as rendering of these services involve extensive use of information technology.

63. At this stage, it may be relevant to deal with the contention raised by Shri Porus kaka that the standard of comparability is the same even to TNMM. We may clarify here that it is not at all our intention to dilute the standard of comparability just because the method followed is TNMM. We are fully aware of the decision of the Hon'ble Delhi High Court in the case of Li and Fung India Pvt. Ltd. (supra) wherein it was observed

in para 34 that the standard of comparability for application of TNMM is no less than that for the application of any other transfer pricing method. We are also aware of the guidance provided in OECD Transfer Pricing Guidelines in section B.3.1. of Chapter II wherein it is stated that a comparability analysis performed for selecting and applying a transactional net margin method should not be less reliable than for other methods. At the same time, we have to take note of the fact that the relevant financial data is not available in the public domain in respect of many ITES service providers as they are private limited companies. Moreover, many of the ITES providers, which are listed public limited companies and whose financial data is available in public domain, are captive service providers and they, therefore, cannot be considered as comparables having substantial related party transaction. Keeping in view these problems as well as other problems discussed in the remaining portion of this order, which are peculiar to the ITES industry, our endeavor is to find out a practical solution which can help to perform a comparability analysis in the cases belonging to ITES sector. In our opinion, this problem can be solved by splitting the exercise of comparability analysis in two steps in order to attain relatively equal degree of comparability, the first being to select the potential comparables at ITES sector level by applying the broad functionality test.

64. Having held that all the entities providing IT enabled services can be taken as potential comparables by applying a broad functionality test, the next issue that arises is whether further dissection or bifurcation of ITES is possible for rejecting or selecting the potential comparables.

65. A useful reference in this regard can be made to the OECD transfer pricing guidelines. Section A-1 of Chapter III of these guidelines narrates the typical process that is considered as an accepted good practice which

can be followed while performing the comparability analysis. One of the steps involved in this process stated as step 2 is “broad-based analysis of the tax payer’s circumstances”. It is explained in section A-2 (para 3.7) that the “broad-based analysis” is an essential step in the comparability analysis which can be defined as an analysis of the industry, competition, economic and regulatory facts and other elements that affect the tax payer and its environment, but not yet within the context of looking at the specific transactions in question. Section A-5 of Chapter III of the OECD guidelines deals with “selecting or rejecting potential comparables” and suggests that there are basically two ways in which the identification of potentially comparable third party transactions can be conducted. As stated in para 3.41, the first one, which can be qualified as the “additive” approach consists of the person making the search drawing up a list of third parties that are believed to carry out potentially comparable transactions. It is stated that this approach gives a wide set of companies that operate in the same sector of activity, perform similar broad functions and do not present economic characteristics that are obviously different.

66. Section A.7 of Chapter III of the OECD guidelines deals with “arm’s length range” and states that as the transfer pricing is not an exact science, there will also be many occasions when the application of the most appropriate method or methods produces a range of figures all of which are relatively equally reliable. It is stated in para 3.56 that in some cases, all comparable transactions examined will not have a relatively equal degree of comparability. It is suggested that where it is possible to determine that some uncontrolled transactions have a lesser degree of comparability than others, they should be eliminated.

67. As already observed, the comparability of an international transaction with uncontrolled transaction for the purpose of determining the ALP of an international transaction by following TNMM is required to be judged with reference to the functions performed as per sub Rule (2)(b) of Rule 10B read with Rule (1)(e) thereof and there is no bar in the TP regulations in India to exclude certain entities selected as potential comparables on broad functionality test by applying the functional test at narrow or micro level to attain the relatively equal degree of comparability. On the other hand, Rule 10-B(3) provides that the uncontrolled transaction selected/judged as per Rule 10-B(2) shall be comparable to an international transaction only if none of the differences, if any, between the transactions being compared, or between enterprises entering into such transactions are likely to materially affect the price or cost charged or paid or the profit arising from such transaction in the open market or reasonably accurate adjustment can be made to eliminate the effects of such difference. In our opinion, sub Rule (3) of Rule 10B thus clearly provides for further exclusion of the comparables selected by applying the test/criteria given in sub Rule (2) of Rule 10-B if there is any difference found between the enterprises entering into the transactions which materially affects the cost charged or the profit arising from such transaction in the open market.

68. Keeping in view the relevant portion of the OECD T.P. Guidelines discussed above and having regard to the relevant TP regulations as contained in Rule 10-B(3) of Income Tax Rules, 1962, we are of the view that further dissection or classification of ITES services can be done depending on the facts and circumstances of each case so as to select the entities having a relatively equal degree of comparability.

69. Having held that further dissection, bifurcation or classification of IT enabled services may be required to be done to bring into relatively equal degree of comparability, the next question that arises is whether such classification can be done into BPO & KPO services so as to say that the BPO & KPO services have a lesser degree of comparability and cannot be compared with each other. During the course of hearing before us, Shri Ajay Vora has filed a copy of report prepared by National Skill Development Corporation (NSDC) on Human Resource and Skill Requirements in the IT and ITES Sector (2022). This report is mainly focused on mapping of human resource skill in India till 2022 especially with reference to the requirements of IT and ITES sector. As per this study report, even within the ITES industry, the skill sets required for BPO services are very different from KPO services and this aspect has been examined by NSDC in great detail in its report. It is mentioned in para 1.4.2. of the report that the growing area in this segment is what is called as Knowledge Process Outsourcing (KPO) which is moving beyond simple voice and data services and includes data analytics, content management, research and information services, animation, biotech and pharmaceutical research, medical and health services. It is also stated that the growth in this segment is expected to be in the areas of legal process outsourcing, engineering services outsourcing and financial and market research. In para 1.4.3 of the report, one of the key success factors for Indian BPO industry is stated to be its ability to move up the value chain through KPO service offerings. In para 4.3 of the report, it is stated that the ITES industry is likely to see an increasing share of penetration from KPOs. It is also stated that while the BPO sector would contribute large volumes, the KPO sector would be a “value play”. It is further stated that a lot more areas are likely to witness KPO activity spanning patent advisory, high end research and analytics, online market research and legal advisory.

70. Shri Ajay Vora has also placed on record a copy of Article “KPO – An Emerging Opportunity for Chartered Accountants” published in 2006 in the Journal “The Chartered Accountants” to highlight the distinction between BPOs and KPOs. As stated in the said Article, KPO, simply put, is the upward shift of the BPO industry in the value chain. It is explained that the KPO is a new industry with high growth rate in India and older BPO companies that provided basic back-end or customer care support service are moving up this value chain. It is stated that unlike conventional BPO, where the focus is on process expertise, the focus in KPO is on knowledge expertise. It is explained that KPO involves business process requiring domain expertise and high end qualifications such as MBA, engineering, medical, law, accountant degree or other highly skilled professional qualifications. It is further explained that KPO requires moving away from the simple execution of standardized processes to the implementation of processes that demand advanced analytical and technical skills together with some decision making. The difference between KPO and BPO is also highlighted with particular reference to process, focus, specialization, driving force, activities etc.

71. Shri Porus Kaka and Shri Ajay Vora have 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;”

72. 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;”

73. On a careful study of the material placed before us to highlight the distinction between BPO services and KPO services, we are of the view that even though there appears to be a difference between the BPO and KPO services, the line of difference is very thin. 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 the analysis 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.

79. In so far as the present case is concerned, we now proceed to do an exercise of comparability analysis keeping in view the observations made in para 76 to 78 in order to attain relatively equal degree of comparables by taking into consideration the functional profile of the assessee company and comparing the same with that of the entities selected as comparables by TPO/DRP on broad functional analysis taken at ITES level. There are ten entities which are finally selected as comparables in the present case by the AO/TPO as per the direction of the DRP and the assessee has mainly disputed the inclusion of only two comparables namely Mold-Tek Technologies Ltd. and eClerx Services Pvt. Ltd. on the ground that they are functionally different from the assessee company. In order to appreciate the stand of the assessee on this issue, it is necessary to identify the principle functions performed by the assessee and compare the same with the principle functions performed by the entities selected by the AO/TPO. The claim of the assessee right from the beginning was that there are two types of services mainly provided by it to its AEs and they were classified under two heads “provision of IT enabled services” and “provision of IT services”. Although this claim of the assessee has not been accepted by the DRP which treated both these services under one broad head of “IT enabled

services”, the functions performed by it in relation to both these types of services were separately given by the assessee company in its TP study report as under:-

“4.1.1 – Provision of I.T. enabled services.

MGSCIPL is engaged in providing back office support services to AE. Activities undertaken by MGSCIPL are essentially IT enabled services such as data entry, transcription, reconciliation, consolidation, co-ordination, preparation, processing and review of shipping documents such of hills of lading. etc.

Broad activities carried on by MGSCIPL as directed by AL from time to time are as follows:

Export/Import documentation

- Log, review and process shipping instructions to produce draft transport documents;
- Receive, log and process amendments to shipping instructions:
- Publish Transport Documents to the Web;
- Perform data quality checks and updates;

Reconcile differences between Equipment Management System (RKEM — Rederiets Kontainer Equipment Management) and the Transport Plan in Global Customer Service System (GCSS): -

Identify and correct manifest errors including coding errors in GCSS;

- Other services such as daily exchange rate update in Maersk Line Invoicing System (MLIS), manual entry of surcharges not covered by Maersk Automated Rating System (MARS), reports required by local authorities and customs, submit vessel port omission notifications, issue arrival notices, manual entry of surcharges not covered by MARS, confirm and collect invoice details, etc.

Agency Operation:

- Prepare vessel load and discharge lists;
- Clearance of Electronic Data Interchange (EDI) errors in the tracking system;
- Update of various operations systems including Global Schedule Information System (GSIS):
- Prepare Hazardous and special cargo manifests and lists;
- Maintenance and update of the transport plan in GCSS;
- Verify and index dangerous good declarations in Global Hazardous Declaration Electronic Replacement (GHDER) system:

- Approve hazardous cargo on Maersk Line vessels, etc.

Logistics Export/Import handling

- Update Shipment details in Maersk logistics Operations and Documents)MODS) system;
- Check MODS updates to ensure alignment with APMM SOP

:

- Prepare airfreight shipment file, payment of carrier bill of lading, etc.; and
- Other services such as daily overview report to Areas; packing list update; report on late shipping instruction submission b vendors to Areas: update of KPI Measurement data. etc.

Finance and Accounting

- Accounting to Reporting: Reconciliations, Period End Close and Rolling Budget;
- Exception handling of scanned invoices for matching against open purchase order;
- Travel expense management;
- First time creation and maintenance of Master Data; and
- Other services such as payment applications, write-offs, invoicing, exchange rate update; bank reconciliations; demurrage and detention waivers and audits: accounts payable audit; invoice verification: owner's expenses; monthly disbursements; RKDS pay-at; purchase order creation: Maersk Logistics Import Processing System (MIPS) web; Hyperion Financial Management (HFM) controlling tasks.

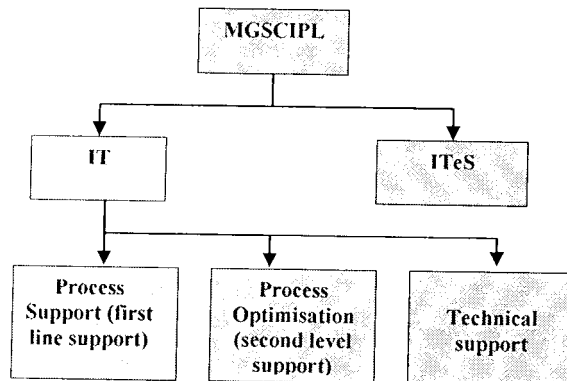
Other services

- Tender Handling: Prepare tenders by updating Maersk Product Catalogue (MEPC) details;
- Contract Drafting: Draft all lanes in MARS awarded to Maersk Line; and
- Data Quality: Various audit functions based on different business units' strategy (Global invoice audit, (Container billing count, DSL Audit. GBR dispute team).

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4.1.2 Provision of IT services

MGSCIPL provides IT services such as process support. process optimization and technical support to its A Is. MGSCIPL provides technical support services to users of corporate systems. Functions performed by MGSCIPL under IT services segment could be categorised under following headings: DL



Process support

MGSCIPL, provides first line process support services or preliminary support services to users of corporate systems. Users are the employees of Maersk group entities worldwide. IT professionals of MGSCIPL analyze the problem faced by users and offer preliminary solutions on use of systems and provide support to system implementation. If the problem is not resolved, then the same is escalated to second level support.

Process Optimisation

Second level support is provided by technical personnel who are expert in specific modules within the corporate systems and provide solutions through remote access control. Employees who are involved in rendering these services require in depth understanding of the system for analyzing system utilization and user behavior. MGSCIPL provides consultancy to Global IS portfolios and Area business teams in areas of deployment support and post implementation audits. MGSCIPL also carries out surveys, identifies the gaps in the process and bridges the same.

Technical support

MGSCIPL provides following technical support services:

- Service desk support which includes desktop and telephony systems, mobility solutions and server support (including setting up of server and optimizing its utilisation):

- Resolution to incidents raised by users, including technical set up of devices (PC, laptop, PDA, etc):
- Interface monitoring, security systems Support (firewall, antivirus/antispam solutions etc.) configuration, testing and implementation of solutions:
- Remote infrastructure support to its corporate system users: and
- Assistance in implementation and monitoring of the Global security policy followed by the group.”

80. A perusal of the functional profile of the assessee company shows that although the services claimed to be provided by it to the AEs as IT services such as process support, process optimization and technical support are not in the nature of low end services such as voice or data processing as they require some degree of special knowledge and domain expertise in the concerned field, the revenue generated from these services was only about 10% of the total revenue generated during the year under consideration. There were also some other services rendered by the assessee company to its AEs as IT enabled services such as reconciling the difference between equipment management system and transfer plan in global custom services study, contract drafting, various audit functions based on different business strategy, tender handling etc. which, as rightly submitted by the Id. D.R., cannot be strictly considered as low-end services as they involved some degree of special knowledge and expertise in the relevant field. However, these services again were only incidental to the main services rendered by the assessee involving information collation from shipper/customer/AE and populating the same into various processes and systems provided by the AE. These main services rendered by the assessee to its AEs thus involved primarily data entry, transcription, consolidation, co-ordination, preparation, processing and review of shipping documents and such other similar support services which were mainly comprising of back office support services rendered by the assessee to its AEs in the nature of low-end services. The profile of work-force employed by the assessee during the

year under consideration comprised of 96% of graduates and post-graduates whereas only 4% work-force was professional such as CA, B.Tech etc. which again goes to show that the functions performed by the assessee company to its AEs were mainly in the nature of providing back office support services of low-end nature. Going by the functions performed by the assessee to its AEs during the year under consideration, we are of the view the assessee was a captive contract service provider mainly rendering back office support services and such services rendered by it to its AEs involving some degree of special knowledge and expertise formed only small portion of the services rendered by it which essentially were in the nature of incidental services.

81. In so far as the case of Mold-Tek Technologies Ltd. is concerned, it is observed from the annual report of the said company for the financial year 2007-08 placed at page 139 to 151 of the paper book that the said company was pioneer in structural engineering KPO services and its entire business comprised of providing only structural engineering services to various clients. Further information of Mold-Tek Technologies Ltd. available on their Website is furnished in the form of printout at page 158 to 165 of the paper book and a perusal of the same shows that it is a leading provider of engineering and design services with specialization in civil, structural and mechanical engineering services. It is stated to have a strong team of skilled resources with world class resources and skill sets. It is also stated to have consistently helped the clients to cut down design and development costs of civil, structural, mechanical and plant design by 30-40% and delivered technologically superior outputs to match and exceed expectations. It is claimed to have in-house software development team, quality control training and trouble shooting facilities. M/s Mold-Tek is also rendering web design and development services with experience in turning them into an effective

graphic design representation and creating dynamic and graphic rich web applications from IT specs, design prints etc. Keeping in view this information available in the annual report of Mold-Tek as well on its website, we are of the view that the said company is mainly involved in providing high-end services to its clients involving higher special knowledge and domain expertise in the field and the same cannot be taken as comparable to the assessee company which is mainly involved in providing low-end services. It may be pertinent to note here that the financial year 2007-08 was a unique year for Mold-Tek Technologies Ltd. as the scheme of arrangement involving amalgamation between Tekmen Tool Pvt. Ltd. and Mold-Tek Technologies Ltd. and de-merger between Mold-Tek Technologies Ltd. simultaneously was sanctioned by the Hon'ble AP High Court by 15th July, 2008 with the appointed date for amalgamation and de-merger being 1st October, 2007 and 1st April, 2007 respectively. It is also pertinent to note that while working out the operating margin of the said company, provision for derivative loss of Rs. 6.43 crores made by Mold-Tek technologies Ltd. was excluded by the A.O. treating the same as non-operating expenses whereas in the case of Rushabh Diamonds (supra), it was held by the Division Bench of this Tribunal that the gain or loss arising from the forward contract entered into for the purpose of foreign currency exposure on the export and import has to be taken into consideration while computing the operating profit.

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.

84. As submitted by the ld. Counsel for the assessee, if these two entities are excluded from the comparables and the ALP of international transactions of the assessee company with its AEs is recomputed by taking into consideration the arithmetic mean of the margins of the remaining eight comparables, the difference between such ALP and the price charged by the assessee would be within the safe harbour limit of 5% requiring no TP adjustment. We accordingly direct the A.O.to recompute the ALP of the transactions of the assessee company with its AEs applying the average profit margin of the remaining eight comparables. If the difference between the ALP so recomputed and the price actually charged by the assessee is within the safe harbour limit of (+) or (-) 5%, the A.O. is directed not to make any TP adjustment as per the second proviso to section 92C(2) of the Act.

85. Keeping in view our decision rendered above, the other issues involved in ground No. 2 to 8 of the assessee's appeal including the issue involved in Q No. 2 referred to this Special Bench have become infructuous/academic requiring no adjudication on merit. The same are accordingly dismissed. However, keeping in view that the issue involved in Q No. 2 has been specifically referred for the adjudication by this Special Bench, we now proceed to consider and decide the same for the sake of completeness.

86. As regards the issue involved in question No. 2 as to whether in the facts and circumstances of the case, the company earning abnormal high profit margin should be included in the list of comparable cases for

the purpose of determining ALP of an international transaction, Shri Porus Kaka referred to the provisions of section 92-C of the Act to point out that the word used therein is “Arithmetic mean” and not “mean” or “average”. He contended that the arithmetic mean envisages existence of arithmetic progression meaning thereby that it expects the comparable figures in a specific range. He contended that anything beyond that range therefore should not be taken into consideration. In support of this contention, he relied on the meaning of the expression “arithmetic mean” given in the Concise Oxford Dictionary which says that it is a mean number of arithmetic progression. He relied on the Board Circular No. 14 of 2001 (252 ITR (St.) 103) explaining the object of provision of section 92-A to 92-F of the Act to contend that the object of these provisions is to provide a detailed statutory frame work which can lead to computation of reasonable, fair and equitable profits and tax in India in the case of such multinational enterprises. He also referred to para 55.10 of the said circular wherein the purpose of arithmetic mean is explained. He submitted that the application of most appropriate method to different sets of comparable data can possibly result in computation of more than one ALP and as explained by the CBDT, with a view to avoid unnecessary disputes in such a situation, the proviso to section 92-C(2) of the Act provides that the arithmetic mean of the prices shall be adopted as ALP. He submitted that if the different sets of comparable data are equally reliable, there may not be any significant diversion between the various ALPs determined in the normal course as mentioned by CBDT in para 55.10 of the Notification. He contended that this clearly indicates the expectation of the legislature that there would not be any significant diversion between various ALPs if the different sets of comparable data are equally reliable.

87. Shri Porus Kaka submitted that there are several cases decided by the different Benches of the Tribunal wherein it is held that the

comparables earning super normal or abnormal profits should be excluded. He placed on record the copies of orders passed by the Tribunal in the following such cases:-

Sr. No.	Decision	Citation
1.	CES Pvt. Ltd. v. DCIT	ITA No. 1445/Hyd/2010
2.	DCIT v. Hellosoft India (P.) Ltd.	[2013] 32 taxmann.com 101 (Hyd)
3.	BA Continuum India Pvt. Ltd. v. ACIT	ITA no. 1154/Hyd/2011
4.	Avineon India Pvt. Ltd. v. DCIT	ITA No. 1989/Hyd/2011
5.	Market Tools Research Pvt. Ltd. v. DCIT	ITA No. 1811/Hyd/2012
6.	Google India (P.) Ltd. v. DCIT	[2013] 29 taxmann.com 412 (Bang)
7.	Capital IQ Information Systems (India) Pvt. Ltd. v. DCIT	[2013] 32 taxmann.com 21 (Hyd)
8.	Sap Labs India Pvt. Ltd. v. ACIT	[2011] 44 SOT 156 (Bang)
9.	DCIT v. Quark Systems Pvt Ltd	[2010] 132 TTJ 1 (Chd) (SB)
10.	Agnity India Technologies Pvt. Ltd. v. ITO	ITA No. 3856(Del)/2010 <i>page</i>
11.	Philips Software Center (P) Ltd. v. ACIT	[2008] 119 TTJ 721 (Bang)
12.	Adobe Systems India (P) Ltd. v. ACIT	[2011] 138 TTJ 122 (Del)
13.	Teva India (P.) Ltd. v. DCIT	[2011] 44 SOT 105 (Mum) (URO)
14.	ACIT v. Sonata Software Ltd.	[2013] 29 taxmann.com 144 (Mum)
15.	Meritor LVS India (P) Ltd. v. ACIT	ITA No. 405/Bang/2011
16.	DCIT v. Mitsui O.S.K Lines Maritime (India) Pvt. Ltd.	[2011] 48 SOT 155 (Mum)
17.	ITO v. Saunay Jewels Pvt. Ltd.	[2010] 42 SOT 4 (Mum)
18.	Lintas India Pvt. Ltd. v. ACIT	[2012] 27 taxmann.com 300 (Mum)
19.	ACIT v. D.A. Jhaveri	[2012] 54 SOT 219 (Mum)
20.	Symantec Software Solutions Private Limited v. ACIT	[2012] 25 taxmann.com 163 (Mum)
21.	Adaptec (India) Pvt. Ltd. v. DCIT	ITA No. 1801/Hyd/09
22.	Market Tools Research Pvt. Ltd. v. ACIT	[2013] 32 taxmann.com 358 (Hyd)
23.	Brigade Global Services Pvt. Ltd. v. ITO	[2013] 33 taxmann.com 618 (Hyd)
24.	Zavata India Pvt. Ltd. v. DCIT	[2013] 35 taxmann.com 423 (Hyd)
25.	Cummins Turbo Technologies Limited v. DDIT	[2013] 35 taxmann.com 350 (Pun)
26.	Cognizant Technology Services Pvt. Ltd. v. ACIT	ITA No. 2106 & 1864/Hyd/2011
27.	Sapient Corporation (P) Ltd. v. DCIT	(2011) 11 taxmann.com 69 (Del)
28.	Addl CIT v. UBS Securities India Pvt. Ltd.	ITA No. 6451/Mum/2011

88. Shri Porus Kaka took us through the relevant portion of some of the above orders of the Tribunal to support and substantiate his contention that the entity earning super normal or abnormal profits ought to be excluded from the list of final comparables. He pointed out that in the case of Agnity India Technologies Pvt. Ltd. (supra), the Delhi Bench of ITAT applied the turnover filter to exclude Infosys Technologies Ltd. from the final list of comparables and this reasonable and fair view taken by the Tribunal has been upheld by the Hon'ble High Court. He

submitted that the Bangalore Bench of ITAT in the case of Sap Labs India Pvt. Ltd. (supra) has held that if the difference in the margin earned by the entity selected as comparable is wide, the onus is on the A.O./TPO to show the common thread running through these entities so as to include them in the list of final comparables. Our attention was drawn to the decision of Chandigarh Special Bench of ITAT in the case of Quark Systems Pvt. Ltd. wherein the issue of super normal profit was considered by the Tribunal and it was held that when the profit margin is abnormally high, the matter may be investigated further. Mr. Porus Kaka also relied on the decision of Mumbai Bench of ITAT in the case of Symantec Software Solutions Private Limited (supra) and pointed out that the entities earning super normal profits were excluded by the Tribunal in this case on the ground that there was failure on the part of the A.O./TPO to prove that the higher profits shown by these entities were normal. He contended that super normal profits thus certainly is a trigger which atleast should invoke further investigation or enquiries to ascertain and decide whether the entities earning such super normal profits should be included in the list of final comparables or not.

89. Shri Ajay Vora, the Id. Counsel for the intervener also put forth his argument on the issue relating to the exclusion of entity earning super normal or abnormal profits from the list of final comparables. He contended that if the high margin earned by the concerned entities is due to their efficiency, these entities cannot be excluded merely on the ground of high margin. He contended that if such high margin, however, is due to any exterior factor, the concerned entities should be excluded from the list of comparables. He submitted that such exterior factor could be different such as lower depreciation, earnings due to fluctuation in foreign currency rates etc. He contended that the consistency of high margin is also required to be seen to find out as to whether the high

margin is a normal situation or abnormal. He submitted that in the case of Symantec Software Solutions Pvt. Ltd. (supra), three out of thirteen comparables selected by the TPO were showing high magnitude of margin as compared to the remaining 10 entities and the Tribunal held that these three entities should not be taken as comparables on account of their super normal profit since the TPO did not establish on evidence that these super normal profits earned by them was in accordance with normal activities of their business. He contended that whether the high profit is normal or abnormal profit is required to be seen from the relevant facts of each case. He also relied on the decision of the Chandigarh Bench of ITAT in the case of Quark Systems (India) Pvt. Ltd. (supra) wherein it was held by the Tribunal in para 13 that if one entity was not treated as comparable by the tax authority on the ground of heavy losses suffered by it, they also have to consider that another entity taken by them as comparable had earned extra ordinary profit. He also cited the decision of Bangalore Bench of ITAT in the case of SAP LABs India (P.) Ltd.(supra) wherein it was held in para 54 of the order that in the absence of any common thread explained by the A.O./TPO running through the four entities earning super profit to bring out the functional similarity, the same could not be considered as comparable.

90. In his reply on this issue, Shri Ajeet Kumar Jain at the outset invited our attention to page 22 of the decision of the Tribunal in the case of Willis Processing Services India Pvt. Ltd. (supra) to point out that the extreme cases of loss and profit were considered by the Tribunal in the said case to work out the average profit margin of the comparables by taking the arithmetic mean. He submitted that as per the principles of statistical analysis, the size of sample is important inasmuch as higher the sample size, better or closure is the estimate. He referred to Chapter 5 “Measures of Central Tenancy” given in the book “Statistics for Economics” prescribed as text book for class XI and submitted that

arithmetic mean as explained therein is the most commonly used measure of central tendency. It is defined as a sum of the values of all observations divided by number of observations. He pointed out from the example given therein that in case of extreme figures also, the arithmetic mean is used as a measure of central tendency. He contended that by adopting the arithmetic mean to work out the average profit margin of the comparables, Indian law has recognized the extreme values also for comparability. He submitted that the quartile method of central tendency removes the extreme results but by adopting the arithmetic mean and not quartile, the law makers want even the extreme results to be considered.

91. As regards the CBDT Circular No. 14 of 2011, para 55.10 referred by Shri Porus Kaka, Shri Ajeet Kumar Jain submitted that section 92-C of the Act was originally introduced w.e.f. 1-4-2002 in the statute providing for calculating the average profit margin by using arithmetic mean without any scope for further adjustment. He submitted that an amendment, however, was made subsequently to allow such $\pm 5\%$ adjustment right from inception providing more flexibility. In this regard, he relied on para 50.4 of the CBDT Circular No. 8/2002 issuing clarification regarding provision for transfer pricing wherein it is clarified that under the existing provisions contained in the proviso to the sub-section (2) of section 92-C of the Act, if the application of the most appropriate method leads to determination of more than one price, the arithmetic mean of such prices shall be taken to be the ALP in relation to the international transaction and with a view to allow a degree of flexibility in adopting the ALP, the Finance Act 2002 has amended the said proviso to provide that where the most appropriate method results into more than one price, the price which differs from the arithmetic mean by an amount not exceeding 5% of such mean can be taken to be ALP, at the option of the assessee.

92. As regards the orders of the Tribunal cited by Shri Porus Kaka in support of the assessee's case that the entities earning super normal or abnormal profits should be excluded from the comparables, Shri Ajeet Kumar Jain furnished a chart giving findings recorded by the Tribunal in those cases along with the remark of the Revenue thereon. Referring to the said chart, Shri Ajeet Kumar Jain contended that the Tribunal in the case of Adobe Systems India (P) Ltd. took a view on this issue without much discussion or without giving any reason and it has been followed by the Tribunal in the case of Teva India (P.) Ltd. He pointed out that the decision in the case of Teva India (P.) Ltd. has been followed by the Tribunal in most of the other cases cited by Shri Porus Kaka. He contended that none of these decisions of the Tribunal contains any meaningful discussion on this issue and this Special Bench, in any case, now has to decide this issue afresh in the light of the submissions made by both the sides. Shri Ajeet Kumar Jain submitted that there are several decisions of the Tribunal rendered by different Benches holding that the comparables cannot be excluded merely on the basis of abnormal and super normal profits. Some of such decisions cited by him are as under:-

Sl No.	Name of the case	Date of decision	Bench
1	Exxon Mobil Company India Pvt. Ltd.	10.06.11	Mumbai
2	BP India Services Pvt. Limited	23.09.11	Mumbai
3	Actis advisors Pvt. Limited	12.10.13	Mumbai
4	Nextlink India Pvt. limited	...10.12	Bangalore
5	24/7 Customer.Com. Pvt. Limited	09.11.12	Bangalore
6	Trilogy E-Business software India Pvt. Limited	23-11-12	Bangalore
7	Exxon Mobil Company India Pvt. Limited	19.12.12	Mumbai
8	Stream international Services Pvt. limited	11.01.13	Mumbai
9	Willis Processing Services (I) P. Limited	01.03.13	Mumbai
10	Vodafone India Services P. Limited	26.04.13	Mumbai
11	Rushabh Diamonds	26.04.13	Mumbai
12	Syscom Corporations	12.07.13	Mumbai
13	ChrysCapital Investment Advisors India Private limited	20.12.13	New Delhi

93. Shri Ajeet Kumar Jain pointed out that there were atleast eight decisions rendered by the Tribunal prior to the case of Willis Processing Services (I) P. Ltd. (supra) taking a view in favour of the assessee on this issue and it therefore cannot be said that the Tribunal in the case of Willis Processing Services (I) Pvt. Ltd. deviated from the consistent view taken earlier by the Tribunal on this issue in favour of the assessee. He submitted that in para 34.1 of its order passed in the case of Willis Processing Services (I) Pvt. Ltd., the Tribunal in fact has taken note of at least five decisions rendered by the co-ordinate Benches taking a view in favour of the Revenue on this issue. He submitted that in most of these thirteen cases decided by the Tribunal, all the material aspects including the relevant Rules and even the OECD guidelines have been taken into consideration by the Tribunal while passing the orders. He submitted that in the case of BP India Services Private Limited (supra), for instance, the fact of comparables earning extreme profits than the profits earned by other comparables was taken note of by the Tribunal and it was held that the very rationale of having average in case of more than one comparables is to iron out the effect of extreme cases and find out the profit margin as a representative of the whole lot. He submitted that even the relevant provisions of Rule 10B(2) and 10B(3) of the Income Tax Rules were taken into consideration by the Tribunal and it was held that nowhere in the said Rules, the higher or lower profit rate has been prescribed as the determinative factor to make a case incomparable. It was also held that the profit rate in any case cannot be such determinative factor in itself as it is a consequence of the effect of the various factors.

94. Reliance was placed by Shri Ajeet Kumar Jain on the decision of the Tribunal the case of 24/7 Customer.Com Pvt. Ltd. (supra), wherein it

was held by the Bangalore Bench that the exclusion of companies with abnormal profits from the comparables may be in line with the principles enumerated in the OECD guidelines but the same cannot be said to be in tune with the Indian TP regulations. It was noted by the Tribunal in this context that the Indian TP Rules specifically deviate from OECD guidelines in this aspect and specify the arithmetic mean for determining the ALP as against the quartile method suggested in the OECD guidelines which excludes the companies that fall in the extreme quartiles for comparability. He submitted that in the case of Trilogy E-Business Software India Ltd. (supra) a similar view was reiterated by the Tribunal holding that there is no bar in the relevant Rule 10B(2) to consider the companies earning abnormal profits as comparable to tested party as long as they are functionally comparable. It was held that this question may not arise at all in the context of OECD guidelines and US TP regulations as they advocate a quartile method for determining ALP whereby the extreme results get automatically excluded. It was also held that the Indian regulations, however, deviate from OECD guidelines and provide arithmetic mean method for determining ALP whereby all companies that are in the sample are considered without exception and the average of all the companies is considered as ALP. It was held that the entity showing extreme results, however, can be excluded for comparability if it is found there are specific or special reason for such extreme results. In the case of Stream International Services Pvt. Ltd., (supra) it was held by the Mumbai Bench of ITAT that comparability is judged primarily by seeing the functional similarity and then the capital employed and risks undertaken. Higher or lower profit rate is not and can never be a relevant criteria to judge the comparability. Shri Ajeet Kumar Jain contended that the filters are the means to achieve the end results of comparables in order to determine the ALP on the basis of margin. He contended that the margin therefore

cannot be considered as filter as sought to be contended by Shri Porus Kaka or otherwise it would amount to taking end result as mean. He contended that the factors affecting end result only can be taken as filters.

95. As regards the reliance placed by Shri Porus Kaka on para 3.63 to 3.66 of the OECD guidelines dealing with extreme results, Shri Ajeet Kumar Jain pointed out that these paras are part of section A-7 of the OECD commentary dealing with arm's length range and it is suggested that if such range includes a sizeable number of observations, statistical tools that take account of central tendency to narrow the range (e.g. the inter-quartile range or other percentile) might help to enhance reliability of the analysis. He contended that there is no such arm's length range recognized by Transfer Pricing Regulations in India and the statistical tool to take account of central tendency to narrow the range in order to enhance reliability of the analysis in TP regulations in India is arithmetic mean and not inter quartile range or other percentile as suggested in the OECD guidelines. He contended that para 3.63 to 3.66 of the OECD guidelines dealing with extreme results in the context of the arm's length range thus are not relevant in the Indian context and the reliance of Shri Porus Kaka thereon is clearly misplaced.

96. We have considered the rival submissions on the issue involved in Question No. 2 referred to this Special Bench relating to exclusion of high margin comparables and also perused the relevant material available on record. As per the first proviso to section 92C(2) of the Act, where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices. The meaning of the term "arithmetic mean" is given in the Concise Oxford Dictionary, as a mean number of arithmetic

progression and relying on the same, Shri Porus Kaka has argued that by using the expression “arithmetic mean” in the statute, the legislature has expected the comparable figures to be within a specific range. He has contended that anything beyond that range should not be taken into consideration and any significant diversion such as abnormal high profit margin should not be included in the list of comparable cases for the purpose of determining the ALP of an international transaction. We find it difficult to accept this contention of Shri Porus Kaka. The arithmetic mean may be a mean number in the context of any arithmetic progression as given in the Concise Oxford Dictionary. However, in the context of measuring central tendency or averages like that of more than one price as contemplated in the first proviso to section 92C(2) of the Act, it is to be taken as the sum of the values of all observations divided by number of observations as rightly submitted by the Shri Ajeet Kumar Jain, the ld. CIT (DR) relying on the Text Book “Statistics for Economics”. It, therefore, cannot be said that by using the term “arithmetic mean” in the said proviso, the legislature has envisaged existence of the comparable figures in a specific range as sought to be contended by Shri Porus Kaka. On the other hand, the arithmetic mean is a commonly used measure of central tendency after taking into consideration the sum of the values of all observations and then divided by the number of observations. At the time of hearing before us, Shri Ajeet Kumar Jain has furnished hypothetical working of arithmetic mean of profit margins of fifteen comparables to show that even the extreme values do not affect the arithmetic mean materially or substantially. We also find from the final working of arithmetic mean of profit margins of ten comparables made by the A.O./TPO in assessee’s own case that out of these ten cases, three cases were of low profit with 2.99%, 7.70% and 8.90% of profit margin and two were of high profit margin of 83.31% & 63.06% while the remaining five were in the range of 15 to 35% and their average profit

margin by calculating the arithmetic mean was 28.04%. This working made in assessee's own case thus clearly shows that the extreme values in both the end of spectrum do not materially affect the arithmetic mean and such extreme values are taken care of when the arithmetic mean is used as the measure of central tendency.

97. At the time of hearing before us, both the sides have cited several decisions of the Tribunal in support of their corresponding stand taken on this issue. After going through all these decisions of the Division Benches of this Tribunal, we find that the issue relating to exclusion of high profit margin entities from comparables has been decided in favour of the assessee in the cases cited by Shri Porus Kaka without taking into consideration some vital aspects including the relevant TP Regulations in India. It is observed that the decision initially taken in one case without much meaningful discussion has been invariably followed by the Tribunal in other cases decided thereafter. On the other hand, it is observed that the Tribunal, in some of the cases cited by Shri Ajeet Kumar Jain, the Id. CIT DR, has passed well discussed and well reasoned orders after taking into consideration not only the relevant TP regulations in India but even the relevant OECD guidelines. For instance, in the case of BP India Services Private Limited (supra), it was held by the Mumbai Bench that the very rationale of having average in case of more than one comparables is to iron out the effect of extreme cases and find the profit margin as a representative of the whole lot. It was also held by the Tribunal that the higher or lower profit rate has not been prescribed as the determinative factor in the relevant Rules i.e. Rule 10B(2) and 10B(3) to make a case incomparable. The Tribunal observed that the profit rate in any case cannot be such determinative factor in itself as it is a consequence of the effect of the various factors. In the case of 24/7 Customer.Com Pvt. Ltd. (supra), the Bangalore Bench of this

Tribunal considered the relevant OECD guidelines in this respect and held that the exclusion of companies with abnormal profits from the comparables may be in line with the principles enumerated in the OECD guidelines, but the same cannot be said to be in tune with the Indian TP Regulations. The Tribunal noted that there was a deviation in the TP Rules specifically from OECD guidelines by specifying the arithmetic mean for determining the ALP as against the quartile method suggested in the OECD guidelines which excludes the companies that fall in the extreme quartiles for comparability. To the similar effect is another decision of Bangalore Bench in the case of Trilogy E-Business Software India Ltd. (supra) wherein it was held that the TP Regulations provide arithmetic mean method for determining the ALP wherein all companies that are in the sample are considered without exception and the average of all the companies is considered as ALP. In the case of Stream International Services Pvt. Ltd.(supra), the Mumbai Bench of ITAT held that comparability is judged primarily by seeing the functional similarity and then the capital employed and risks undertaken but the higher or lower profit rate is not and can never be a relevant criteria to judge the comparability.

98. As noted by the Division Benches of the Tribunal in the cases discussed above, the OECD guidelines suggest quartile method which excludes the companies that fall in the extreme quartiles for comparability and there is deviation in this respect in T.P. Regulations in India which specify the Arithmetic Mean for determining the ALP. Nevertheless, the OECD TP Guidelines have considered and dealt with the situation of extreme results in the context of comparability consideration in section A.7.3 of chapter III and it is

++++++ suggested in para 2.63 that where one or more of potential comparables have extreme results consisting loss or unusual high profits, further examination would be needed to understand the reasons for extreme results. After taking into consideration this guidance provided in OECD Transfer Pricing Guidelines and on analyzing the decisions rendered by the Division benches of this Tribunal on this issue after taking into consideration inter alia the T.P. Regulations in India as discussed above, we are of the view that the potential comparables cannot be excluded merely on the ground that their profit is abnormally high. In our opinion, the matter in such case would require further investigation to ascertain the reasons for unusual high profit and in order to establish whether the entities with such high profit can be taken as comparables or not.

99. The question No. 2 referred to this Special Bench is as to whether, in the facts and circumstances of the case, companies earning abnormally high profit margin should be included in the list of comparable cases for the purpose of determining arm's length price of an international transaction. As already observed, the issue involved in this question has become infructuous in so far as the case of the assessee before the Special Bench is concerned and the same therefore no more survives for consideration in the present case. In generality, we are of the view that the answer to this question will depend on the facts and circumstances of each case inasmuch as potential comparable earning abnormally high profit margin should trigger further investigation in order to establish whether it can be taken as comparable or not. Such investigation should be to ascertain as to whether earning of high profit

reflects a normal business condition or whether it is the result of some abnormal conditions prevailing in the relevant year. The profit margin earned by such entity in the immediately preceding year/s may also be taken into consideration to find out whether the high profit margin represents the normal business trend. The FAR analysis in such case may be reviewed to ensure that the potential comparable earning high profit satisfies the comparability conditions. If it is found on such investigation that the high margin profit making company does not satisfy the comparability analysis and or the high profit margin earned by it does not reflect the normal business condition, we are of the view that the high profit margin making entity should not be included in the list of comparable for the purpose of determining the arm's length price of an international transaction. Otherwise, the entity satisfying the comparability analysis with its high profit margin reflecting normal business condition should not be rejected solely on the basis of such abnormal high profit margin. Question No. 2 referred to this special bench is answered accordingly

100. As regards the issue raised in ground No. 9 relating to the assessee's claim for credit of Rs. 6,12,400/- on account of TDS credit, Shri Porus Kaka has sought only a direction to the A.O. to verify the claim of the assessee on this issue and allow the credit for TDS on such verification. Since Shri Ajeet Kumar Jain, the Id. CIT(DR) has also not raised any objection in this regard, we restore this issue to the file of the A.O. with a direction to allow the claim of the assessee for TDS credit after necessary verification.

101. The issue raised in ground No. 10 relating to initiation of penalty proceedings u/s 271(1)(c) of the Act is pre-matured requiring no decision from us at this stage. Ground No. 10 is accordingly dismissed.

102. The issue raised in ground No. 11 relating to interest charged u/s 234B is consequential in nature and the A.O. is accordingly directed to allow consequential relief to the assessee on this issue.

103. Before parting, we may clarify that the various decisions of the Tribunal referred to by the Id. Representatives of both the sides during the course of their arguments have been considered and deliberated upon by us while arriving at our conclusions. All of them, however, are not specifically mentioned or discussed in the order for the reason that this Special Bench has been constituted to resolve the controversy arising from the different/contrary views expressed therein on the issues which have been referred to this Special Bench. We take this opportunity to place on record our appreciation for the assistance provided by the Id. Representatives of both the sides by making elaborate submissions which helped us to analyse the legal position emanating from the interpretation of the relevant provisions of the domestic law as well as the relevant OECD Transfer Pricing Guidelines and apply the same to decide the issues referred to this Special Bench.

104. In the result, appeal of the assessee is partly allowed.

Order pronounced in the open court on 07.03.2014.

आदेश की घोषणा खुले न्यायालय में दिनांक: 07.03.2014 को की गई।

Sd/-

Sd/-

Sd/-

(D. MANMOHAN)

(B.R. MITAL)

(P.M. JAGTAP)

VICE PRESIDENT

JUDICIAL MEMBER

ACCOUNTANT MEMBER

मुंबई Mumbai; दिनांक Dated

व.नि.स./ RK , Sr. PS

आदेश की प्रतिलिपि अद्योषित/Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. आयकर आयुक्त(अपील) / The CIT(A)—Concerned, Mumbai.
4. आयकर आयुक्त / CIT – Concerned,, Mumbai
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / DR, ITAT, Mumbai K Bench
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

सत्यापित प्रति //True Copy//

उप/सहायक पंजीकार (Dy./Asstt. Registrar)
आयकर अपीलीय अधिकरण, मुंबई / ITAT, Mumbai

	Draft dictated on	3/2/14, 4/2/14 5/2/14 6/2/14 7/2/14 10/2/14 11/2/14 12/2/14 14/2/14 3-3-14 4-3-14 5-3-14	Sr PS
2	Draft placed before Author on	19-2-14 4-3-14 5-3-14 5-3-14	Sr PS
3	Draft proposed & Place before the 2 nd member		JM/AM
4	Draft discussed/approved by 2 nd Member		JM/AM
5	Approved draft comes to the Sr PS		Sr.PS
6	Kept for pronouncement on		Sr PS
7	File sent to the Bench Clerk		Sr PS
8	Date on which file goes to the Head Clerk		
9	Date on which file goes to the AR		
10	Date of dispatch		Sr PS