

INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH "I-2": NEW DELHI
BEFORE SHRI BHAVNESH SAINI, JUDICIAL MEMBER
AND
SHRI PRASHANT MAHARISHI, ACCOUNTANT MEMBER

ITA No. 6579/Del/2015

(Assessment Year: 2011-12)

Bertelsmann Marketing Services India Pvt. Ltd, 215, Second Floor, Suneja Tower-II, District Centre, Janakpuri, New Delhi PAN: AABCB8378GQ (Appellant)	Vs.	DCIT, Circle-4(2), New Delhi (Respondent)
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Assessee by :	Shri Vishal Kalra, Adv Ms. Reema Malik, Adv
Revenue by:	Shri Nidhi Sharma, Sr. DR
Date of Hearing	21/8/2020
Date of pronouncement	19/11/2020

O R D E R

PER PRASHANT MAHARISHI, A. M.

1. This is an appeal filed by Bertelsmann Marketing Services India Private Limited (The Assessee/ Appellant) against the order of the Id Deputy Commissioner Of Income Tax, Circle 4 (2), New Delhi (the learned AO) dated 9/10/2015 passed u/s 143 (3) read with Section 144C of The Income Tax Act, 1961 (The Act) dated 09/10/2015 for the Assessment Year 2010-11 determining the total income of the assessee at Rs Nil against the returned income at a loss of ₹ 7,323,902/- as per return of income filed on 29/11/2011. The returned income has one adjustment of Rs 195,70,892/- on account of the order of the learned Asst Commissioner Of Income Tax, Transfer Pricing Officer -I (1) (1), New Delhi [The Ld TPO] passed u/s 92CA of the act on 7/1/2015 where the total adjustment was proposed at ₹ 21,113,342/- comprising of arm's-length price of the ITeS services of ₹ 21,053,389 and another adjustment on account of outstanding receivable of ₹ 59,953/- which was subject to the direction of the Dispute Resolution

Panel – 1, New Delhi (the learned DRP) dated 9/9/2015 after which the ALP of provision of ITeS services of ₹ 141,969, 072/- was determined at ₹ 135,208,614/- which resulted into an adjustment of Rs 1 95,10,939/- and interest on outstanding receivable was retained at ₹ 59,953/-. Thereby, assessee is aggrieved and has preferred this appeal.

2. The assessee has raised the following ground of appeal:-

- “1. That on facts and in the circumstances of the case and in law, the Learned Assessing Officer (AO) / Learned Transfer Pricing Officer (TPO) / Hon’ble Dispute Resolution Panel (DRP) erred in making an addition to the returned income of the appellant by Rs. 1,95,70,892 by recomputing the arm’s length price (ALP) of the international transactions under section 92 of the Income-tax Act, 1961 (the Act).*
- 2. That on facts and in the circumstances of the case and in law, the reference made by the AO to the TPO suffers from jurisdictional error as the AO has not recorded any reasons in the assessment order based on which he reached the conclusion that it was ‘necessary or expedient’ to refer the matter to the TPO for computation of ALP, as is required under section 92CA(1) of the Act.*
- 3. That on facts and in the circumstances of the case and in law, the DRP/AO/TPO erred in not appreciating that none of the conditions set out in section 92C(3) of the Act are satisfied in the present case.*
- 4. The DRP/AO/TPO erred on facts and in the circumstances of the case and in law by rejecting the Assessee’s claim of being an low end IT enabled service provider (“ITES”) and recharacterizing it as a Knowledge process outsourcing (“KPO”)*
- 5. That on facts and in the circumstances of the case and in law, the DRP/AO/TPO erred in rejecting the Internal Transactional Net Margin Method (“TNMM”) applied by the Appellant on the ground that:*
 - 5.1. Services rendered by the Appellant to associated enterprises (AEs) and non-AEs are not similar;*
 - 5.2. Basis of allocation of costs in respect of AE and non-AE segments have not been furnished by the Appellant.*
- 6. That on facts and in the circumstances of the case and in law, the DRP/AO/TPO erred in modifying the economic analysis conducted by the Appellant as a corroborative analysis i.e. External TNMM by:*
 - 6.1. Inappropriately applying the quantitative filters to arrive at a cherry-picked result;*
 - 6.2. Accepting companies which are functionally not comparable to the Appellant in terms of Functions, Assets and Risk profile; and*
 - 6.3. The DRP/AO/TPO erred in facts and circumstances of the case and in law by disregarding the multiple year data selected by the*

Appellant in the TP Documentation and in selecting the current year (i.e. financial year 2010-11) data for comparability. —

7. *That on facts and in the circumstances of the case and in law, the DRP/AO/TPO erred in v7l treating the overdue receivables from AEs as an international transaction. Without prejudice, the DRP/AO/TPO erred on facts and in law by selecting incorrect methodology to compute the ALP of international transaction of receivables as on March 31, 2011.*
8. *That on the facts and circumstances of the case and in law the AO/TPO erred in initiating the penalty proceedings u/s 271 (1) (c) of the Act mechanically and without recording any adequate satisfaction for such initiation.”*
3. Briefly stated the facts shows that assessee is a company engaged in the business of provision of IT enabled services which is resident, registered as an hundred percent export oriented unit Under the software technology Park scheme of the Ministry of information and technology, government of India. Assessee is also operating and managing the activities of BPO delivery centres, call centres and consumer services. It is a wholly-owned subsidiary of a German company and engaged in rendering back-office support services and back end information technology enabled support services. It renders services to both its associated enterprise and Non associated enterprise.
4. Assessee filed its return of income on 29/11/2011 declaring loss of ₹ 7,323,902/-. It has entered into 6 different type of international transactions with its associated enterprise in the form of
 - a. provision of back-office support services of ₹ 132,304,149/-,
 - b. procurement of IT support services of ₹ 6,156,378/-,
 - c. training expenses paid of ₹ 628,119/-,
 - d. fees for management services of ₹ 291,375 /-,
 - e. interest on corporate guarantee charges of ₹ 3,322,441/- and
 - f. interest on external commercial borrowing of ₹ 1,579,463/-.

It benchmarked these international transactions adopting the Transactional Net Margin Method [TNMM] as the Most Appropriate Method [MAM] adopting the Profit Level Indicator [PLI] of operating profit/total cost[OP/OC] . Assessee arrived at set of 11 comparable companies whose average mean margin was 5.63 percentage by using multiple year data and assessee's own margin was worked out at 13.96%. Based on this the assessee concluded in its transfer pricing study report that its international

transactions are at arm's-length. The functional profile of the assessee was accepted by the TPO however he challenged the search process adopted by the assessee and use of multiple year data. Therefore he issued a show cause notice on 11/12/2014. In show cause notice he tested the 11 comparable selected by the assessee and retained only two comparables. He further introduced six new comparable companies which were rejected by the assessee stating in its acceptance/reject metrics that the functions are not comparable. However according to the learned TPO those comparable passes all filters also and are functionally comparable. Accordingly in the show cause notice he computed the average margin of these comparable adopting profit level indicator of Operating profit/operating cost at 29.57% and applied same to the operational cost of the assessee at ₹ 118,649,984/-, against the price received of ₹ 135,208,640/- and computed the proposed adjustment of Rs 1 86,44,794/-. He further stated that payment on account of sales to associated enterprise is realized after a significant time, which according to him varies from advance payment to a gap of 364 days. Therefore he applied base rate of state bank of India at 7.84 percentage and added thereto 300 basis point for risk including Lack of security, processing fees, credit rating and loan tenure and proposed the interest on overdue at 10.84 percentage. The assessee submitted its reply on 24/12/2014 challenging the various filters as well as the comparable companies selected by the learned transfer pricing officer. The learned transfer pricing officer after considering the objection of the assessee retained eight comparable companies (2 selected by the assessee and further 6 introduced by TPO) computed that average margin of OP/OC at 31.70% and accordingly proposed an adjustment of ₹ 21,053,389 with respect to the ITeS services provided to the associated enterprise. With respect to the outstanding receivable by the assessee he computed such interest receivable of ₹ 59,953/-. Thereby total adjustment was proposed of ₹ 21,113,342/-.

5. The assessee submitted its objections before the learned DRP which passed on its direction on 9/9/2015 and based on that the learned TPO passed an order on 5/10/2015 giving effect to the directions and computed the working capital adjusted margin of the comparable companies selecting following seven comparables at 30.40 percentage.

Serial number	name of the company	unadjusted margin	working capital adjusted margins
1	Accentia technologies Ltd	29.89%	27.29%
2	E4e healthcare business services private limited	9.14%	9.39%
3	Eclrex services Ltd	56.86%	56.35%
4	ICRA Techno analytics Ltd	24.83%	23.71%
5	Infosys BPO Ltd	17.73%	16.96%
6	Jindal intellicom Ltd	9.30%	10%
7	TCS E Serve limited	69.02%	69.12%
	Total	30.82%	30.40%

Based on above working the operational cost of assessee of ₹ 118,649,984 was used and applied margin of 30.40% against the price received of ₹ 135,208,640 and proposed an adjustment u/s 90 2CA of rupees one crore 95,10,939/- the interest on receivable was retained at ₹ 59,953/- and total adjustment was proposed at Rs 1 95,70,892. Consequently the final assessment order was passed by the AO on 9/10/2015. Assessee is aggrieved with the same.

6. A detailed chart was submitted by the assessee contesting inclusion of (1) Accentia technologies limited, (2) ICRA Techno analytics Ltd, (3) Eclrex services Ltd , (4) TCS e serve Ltd, and (5) Infosys BPO Ltd. Assessee also contested that R systems international Ltd should be included in the comparability analysis.
7. With respect to **Accentia technologies Ltd** it is submitted that it has entered into an extraordinary event as it has invested in acquiring 16% of static tension Corporation a software development company having expertise and development of software relates to electronic medical records and software as services[SaaS] . It is submitted that in organic growth followed by that company resulted in increasing the revenue significantly.

Even otherwise it was stated that the comparable company is a knowledge process outsourcing company that renders diverse nature of services and products in the healthcare sector. It offers an integrated model which function as a one-stop shop for a clinical provider that will manage all their healthcare needs, receivables management needs, performance tracking and reporting. He refers to the diverse nature of activities in which the comparable company is engaged. It was further stated that no segmental information is available and the comparable company has significant amount of brands, IPR and goodwill. The learned authorised representative further referred to several judicial precedents wherein this comparable company was rejected being functionally different, in absence of segmental information as well as on account of ownership of goodwill and extraordinary events that took place in the comparable company in case of assessment and appeals of other assesses.

8. The learned departmental representative referred to paragraph number 16.2 of the direction of the learned dispute resolution panel wherein it is stated that the above company is functionally similar. He referred that the transfer pricing officer has held that the assessee itself is a KPO.
9. We have carefully considered the contentions of the parties with respect to the above comparable. In the paper book at page number 25 – 103 assessee has submitted the audited financial statement of the above comparable company for the year ended on 31st of March 2011. The fact shows that the learned transfer pricing officer has looked at the standalone balance sheet of the comparable company. Therefore, we also look at only the standalone balance sheet of the above company which is placed at page number 36 – 53 of the annual Reports (corresponding page number of the paper book at 60 – 79) only. First contention is that there is an extraordinary event in the company wherein it has acquired 16% in a software development company. The assessee is referring to Note Schedule 10 (B) (1) of the financial statement where the company has invested in Company which is a software development having expertise in development of software related to EMR and SaaS. The above investment has been shown in schedule 5 of Investments – At Cost. It is merely an investment of the comparable company and it does not have any impact on the profitability or its margin

therefore this argument does not help the case of the assessee. The second issue that assessee has stated is that the comparable is a knowledge process outsourcing company and references made at page number 28 of the compilation of the annual report which is merely a Vision And Mission of the comparable company on its consolidated basis therefore it does not have any impact on the margin of the comparable on standalone basis. Further looking at the scheduled which is Income of the comparable company comprising of sales and services in medical transcription, billing and collection and coding. Therefore the comparable company on standalone basis does not provide any knowledge process outsourcing services. Further reference to page number 54 where the core services offered by the Accentia are referred to however, it refers to the consolidated revenue of that company which is not at all compared by the learned transfer pricing officer with the margins of the assessee. In view of this we do not find that the comparable company on standalone basis is engaged in any knowledge process outsourcing activities or any diverse activities. Therefore according to us , it is functionally comparable. The fourth argument of the assessee is that it does not have any segmental information available. Looking at schedule 10 (B) (7) the company Annual Report it is stated that it has only one segment of activity namely healthcare receivable management, therefore segment reporting as defined as per Accounting Standard – 17 does not apply. As assessee is only engaged in one activity there is no requirement of having any segmental accounting according to the above stated accounting standard. With respect to the claim of the assessee that the comparable company is having significant amount of brand/intellectual property rights and goodwill. For this we perused the schedule 4 of the fixed assets. The first heading of the fixed assets shows that there are goodwill/brands on/intellectual property rights. Goodwill is one of the assets which has been accounted for at the time of acquisition of the other companies by the comparable company. Further we do not find that such goodwill has made any impact on the profit earning capacity of comparable company. Further from the annual accounts produced before us it is not shown that comparable company owns any intellectual property rights or other brands other than goodwill. In view of this, we

reject this argument of the assessee. No other arguments with respect to exclusion of the above company were raised before us.

10. With respect to the several judgments relied upon wherein this comparable is rejected on functionally being different and absence of any segmental data as well as occurring of any extraordinary events as discussed above did not happen in the case of this comparable for this year. In view of this, the decisions relied upon by the assessee does not help the case for exclusion of the above comparable. In view of this we confirm the order of the learned TPO/DRP in including the above comparable company for the comparability analysis of the profit margin of the assessee.
11. With respect to **ICRA Techno analytics Ltd** the learned AR has submitted that it is engaged in the provision of software development and consultancy, engineering services, Web development and hosting, web analytics and business process outsourcing. It is further contested that no segmental information is available.
12. The learned DR referred to paragraph number 16.6 of direction of the learned dispute resolution panel wherein the functions performed by this company was found to be comparable with the functions performed by the assessee.
13. In case of the above company the annual accounts of produced before us at page number 104 – 198 of the paper book. Looking at the standalone annual accounts of this company we find that the company deals in purchase and resale of branded computer software, this fact is mentioned that page number 110 wherein the auditor's report states so. This information is further corroborated at page number 152 of the paper book wherein revenue from sale of goods is accounted for. Further at page number 130, it is mentioned that this company is engaged in software development and consultancy as well as engineering services, Web development hosting and subsequently diversified into the domain of business analytics and business process outsourcing. Further though it is mentioned that company is engaged in consultancy business as also in software development, therefore this company cannot be compared with the assessee appellant which does not carry on such activity. Naturally the activity of software development and consultancy are altogether different

from the functional profile of the assessee. Therefore we direct the learned transfer pricing officer to exclude the above comparable.

14. With respect to **Eclrex services Ltd** it was stated that it is functionally different as it has two different business units (1) financial services and (2) sales and marketing services. It was further stated that there is no segmental information available and there are unreliable data as he submitted certain discrepancies. It was further submitted that it serves the high-end clients and various awards and accolades one by that company makes its functionally dissimilar. It was stated that that company works with over 30 global Fortune 500 clients including many of the words leading high tax industrial manufacturing companies and distributors, online retailers. The comparable has won many awards and accolades being ranked as number one financial services KPO.
15. The DR referred paragraph number 16.3 of the direction and stated that when the assessee is held to be a KPO therefore functional dissimilarity is not correct it is further stated that the company operates in a single segment. Therefore, it is a valid comparable.
16. The assessee has submitted the copy of the annual report of the above comparable company which is placed at page number 199 – 3 27 of the paper book, standalone financial statement of the above company is available at page number 56 onwards of the annual report which is at page number 254 – 281 of the paper book. We have carefully perused the same. We have perused note number III Notes to Accounts (19) wherein the reference to quantitative details is mentioned (page number 79 of the annual report and 280 of the paper book) which says that the company is in the business of providing knowledge process outsourcing services. Though the learned transfer pricing officer has also tried to justify the inclusion of the above comparable stating that assessee is also a KPO , however, as per his order [TP Order] at serial number 3.1 at page number 2 wherein he himself stated that the TP report has described the functions of the assessee and its associated enterprises and the functions of the assessee as submitted in the TP report are found to be in order. The assessee has not described it as a knowledge process outsourcing unit. Therefore, before establishing that assessee is also a KPO, TPO cannot

adopt another comparable KPO for comparability analysis. Such is the mandate of the honourable Delhi High Court in case of Rampgreen Solutions Private Limited Versus Commissioner Of Income Tax 377 ITR 533 (Delhi)/60 taxmann.com 355 (2015). In view of this fact that assessee is not a KPO, the above comparable is required to be excluded. Ld TPO is directed accordingly to exclude this comparable.

17. With respect to **TCS E serve Ltd** it was submitted that it is functionally dissimilar, no segmental information available, significantly high turnover stating that the turnover of the comparable company is ₹ 1442 crores whereas the appellant has a turnover of ₹ 41.6 crores which is more than 34 times of the assessee's turnover. It was further stated that it has presence of high intangibles.
18. The learned DR referred to paragraph number 16.4 of the direction and also supported the order of the learned TPO and stated that above company is a perfect comparable.
19. We have carefully considered the argument of the learned parties. The assessee has also placed on record the annual account of the above comparable company at page number 328 – 448 of the paper book. The last reason stated by the learned authorised representative is that the revenue as per the profit and loss account of the comparable company is Rs. 1442 crores whereas the revenue of the assessee is merely Rs 41 crores. Naturally this makes the comparable company 34 times larger in revenue. As such there cannot be any criteria laid down that how much big comparable can be used for the comparability analysis of the assessee. But, as per the past judicial precedents of the honourable High Court, we can have some clue. In (381 ITR 216) CIT versus Pentair water Ltd Honourable Bombay High Court held that a comparable company having a turnover of Rs 260 crores (HCL commet Ltd] cannot be compared with the assessee having only ₹ 11 crores turnover. Thus, the honourable Bombay High Court upheld the exclusion of the comparable which is having turnover 23 times of the assessee. Here we are pitched to compare a comparable which is having turnover 34 times larger than the assessee. Therefore on this ground, we accept the argument of the assessee that such a large comparable cannot be used to determine ALP of an international

transaction of the assessee. Therefore respectfully following the criteria laid down by the honourable Bombay High Court, we direct the learned transfer pricing officer to exclude TCS **E Serve Limited**.

20. With respect to **INFOSYS BPO LTD** Assessee submitted that it is engaged in diverse and nicht area of business of providing business process management services, it has presence of high brand value and goodwill, it subsidiary of Infosys technology hence has an element of brand associated with it. Further the turnover of that comparable company is more than 27 times of the appellant's turnover as the turnover of comparable company is ₹ 1129 crores against the turnover of the assessee of 41.6 crores which is more than 27 times that of turnover of the appellant.
21. The learned DR referred to paragraph number 16.5 of the direction and also supported the order of the learned TPO at page number 29 and stated that all these arguments of the assessee have been considered and therefore it is a valid comparable.
22. We have carefully considered this argument of the learned parties and find that **Infosys BPO Ltd**, which is having the turnover more than 27 times, than the revenue of the assessee. Therefore, for the reasons given by us for exclusion of TCS E Serve Limited we also direct the learned transfer-pricing officer to exclude Infosys BPO Ltd from the comparability analysis.
23. With the respect to inclusion of R systems international Ltd it is stated that the learned dispute resolution panel has not specifically adjudicate on the comparability of this company. It is stated that the audited quarterly financial results of our systems are available in public domain and the same can be used for extrapolating segmental accounts of that company. Therefore for the reason that it has a different accounting period compared to the assessee, when it is functionally similar cannot be merely excluded for that reason.
24. The learned DR submitted that if the assessee can produce the relevant details then this comparable can be included provided the details are credible, reliable and accurate.
25. The assessee has also raised an issue that **R system international** limited included by the assessee, has been excluded by the learned transfer pricing officer for the reason that this comparable has different financial year as its

accounting period. In fact, this comparable follows the calendar year as the accounting period whereas; the assessee follows the financial year as its accounting year. There is no dispute that it is functionally comparable. However, the assessee to be a listed entity, which follows the SEBI guidelines for disclosure of its financial results on quarter-to-quarter basis, states the comparable company. Therefore, though R Systems International Ltd follows calendar year as its accounting year, its financial for the financial year can be recast by considering its quarterly financial results. Several coordinate benches have taken this view therefore, we also direct the assessee to reconstruct the financial results of this comparable by producing credible information with respect to eliminating and includible quarter before the learned transfer-pricing officer. Ld TPO is directed to examine the same and if found in order, include this comparable in the comparability analysis.

26. There is no dispute with respect to any other comparables. Accordingly ground number 6 of the appeal is partly allowed.
27. Ground number 1-5 were either general grounds or are with respect to the transfer pricing issues other than comparables which are not pressed by the assessee. Therefore those are dismissed.
28. Ground number 7 is with respect to treating the overdue receivable from associated enterprise as an international transactions however looking to the order of the learned transfer pricing officer after the direction of the learned Dispute Resolution Panel that working capital adjusted margin were considered with respect to all the comparables, therefore, we do not find any reason to further sustain any adjustment on account of interest on outstanding receivables from its associated enterprise. As the outstanding of associated enterprise is shown as debtors and is covered in the working capital adjustment itself, it amounts to double addition. Had the working capital adjusted margin were not taken in case of comparable company, this addition/adjustment would have been worth considering. In view of this, we direct the learned transfer pricing officer to delete the addition of ₹ 59,953 on account of interest on overdue receivable from associated enterprise. Accordingly ground number 7 of the appeal is allowed.

29. Ground number 8 is with respect to the initiation of the penalty proceedings which is premature at this stage and therefore is dismissed.

30. Accordingly appeal of the assessee is partly allowed.

Order pronounced in the open court on 19/11/2020

-Sd/-
(BHAVNESH SAINI)
JUDICIAL MEMBER

-Sd/-
(PRASHANT MAHARISHI)
ACCOUNTANT MEMBER

Dated: 19/11/2020
A K Keot

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1. Applicant
2. Respondent
3. CIT
4. CIT (A)
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ASSISTANT REGISTRAR
ITAT, New Delhi