

**IN THE INCOME TAX APPELLATE TRIBUNAL
“B” BENCH : BANGALORE**

**BEFORE SHRI N. V. VASUDEVAN, VICE PRESIDENT AND
SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER**

IT(TP)A No.308/Bang/2017
Assessment Year : 2012-13

M/s. Fidelity Business Services India Pvt. Ltd., Pinehurst, Embassy Golf Links Business Park, Off Intermediate Ring Road, Bangalore – 560 071. PAN : AAACF 6175 E	Vs.	The Assistant Commissioner of Income Tax, Circle – 3(1)(1), Bangalore.
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Assessee by	:	Shri. G. C. Srivastava, Advocate
Revenue by	:	Shri. B. K. Panda, CIT(DR)(ITAT), Bangalore

Date of hearing	:	15.12.2020
Date of Pronouncement	:	17.12.2020

ORDER

Per N. V. Vasudevan, Vice President

This appeal by the assessee is directed against the order dated 08.12.2016 of ACIT, Circle – 3(1)(1), Bangalore (hereinafter referred to as the Assessing Officer, “AO” in short) passed u/s.143(3) read with Section 144C(13) of the Income Tax Act, 1961 (Act) in relation to AY 2012-13.

2. The Assessee is engaged in the business of provision of Information Technology enabled Services (ITeS), to its wholly owned holding company. In terms of the provisions of Sec.92-A of the Act, the Assessee and its wholly owned holding company were Associated Enterprises ("AEs"). In terms of Sec.92B(1) of the Act, the transaction of providing ITeS was “international transaction” i.e., a transaction between two or more associated enterprises, either or both of whom are non-

residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises. In terms of Sec.92(1) of the Act, any income arising from an international transaction shall be computed having regard to the arm's length price. In this appeal by the Assessee, the dispute is with regard to determination of Arms' Length Price (ALP) in respect of the aforesaid two international transaction of rendering ITeS to the AE.

3. As far as the provision of ITeS are concerned, the Assessee filed a Transfer Pricing Study (TP Study) to justify the price paid in the international Transaction as at ALP by adopting the Transaction Net Margin Method (TNMM) as the Most Appropriate Method (MAM) of determining ALP. The Assessee selected Operating Profit/Operating Cost (OP/OC) as the Profit Level Indicator (PLI) for the purpose of comparison. The OP/OC of the Assessee was arrived at 15% by the Assessee in its TP study. The operating income was Rs.279,48,41,942/-and the Operating Cost was Rs.243,03,36,267/-. The Operating profit (Operating income – Operating cost was Rs.36,45,05,674/-. Thus the OP/TC was arrived at 15%. The Assessee chose companies who are engaged in providing similar services such as the Assessee. The Assessee identified companies whose average arithmetic mean of profit margin was comparable with the Operating margin of the Assessee. The Assessee therefore claimed that the price it charged in the international transaction should be considered as at Arm's Length.

4. The Transfer Pricing Officer (TPO) to whom the determination of ALP was referred to by the AO, accepted TNMM as the MAM and also used the same PLI for

comparison i.e., OP/TC. He also selected comparable companies from database. The TPO on his own identified companies as comparable with the Assessee company and worked out the average arithmetic mean of their profit margins as follows:

Sl. No.	Name of the Case	Operating Income	Operating Cost	OP/OC
1.	Accentia Technologies Ltd.	126,38,02,000	112,89,16,000	11.75
2.	Universal Print Systems Ltd.(Seg)(BPO)	6,17,67,000	3,87,49,000	52.46
3.	Informed Technologies India Ltd.,	1,96,36,431	1,82,45,770	6.08
4.	Infosys B P O Ltd.	1316,75,11,974	962,91,06,964	36.30
5.	Jindal Intellicom Ltd.	30,27,51,875	30,29,02,990	0.05
6.	Microgerietic Systems Ltd.	1,29,93,217	1,08,63,390	19.61
7.	T C S E-Serve Ltd.	15,78,44,000	9,64,28,000	63.69
8.	B N R Udyog Ltd.(Seg)(Medical Transcription)	1,47,04,000	97,87,000	50.61
9.	Excel Infoways Ltd.(Seg)(IT/BVPO)	790,96,95,000	559,06,04,000	29.79
10.	e4e Healthcare Services Pvt Limited	89,50,04,209	74,59,23,078	19.85
	Average PLI			28.11%

5. The TPO computed the Addition to total income on account of adjustment to ALP as follows:

“12.4 Computation of Arm's Length Price:

The arithmetic mean of the Profit Level indicators is taken as the arm's length margin. Please see Annexure B for details of computation of PLI of the comparables. Based on this, the arm's length price of the services rendered by the taxpayer to its AE(s) is computed as under:

<i>Arm's Length Mean Margin on cost</i>	28.11%
<i>Less: Working Capital Adjustment</i>	-0.01%
<i>(As per Annex. C)</i>	
<i>Adjusted margin</i>	28.12%
<i>Operating Cost</i>	2,38,85,43,050
<i>Arms Length Price(ALP)</i>	3,06,02,01,356
<i>128.12% (of Operating Cost)</i>	
<i>Price Received</i>	2,79,48,41,942
<i>Shortfall being adjustment u/s 92CA:</i>	26,53,59,414
<i>5% of price received</i>	13,97,42,097
<i>Since the shortfall is exceeding 5% of the International Transaction, adjustment is made</i>	

Thus, a sum of Rs.13,97,42,097/- was added to the total income of the Assessee on account of determination of ALP for provision of SWD services by the Assessee to its AE.

6. The Assessee filed objections before the Disputes Resolution Panel (DRP) against the draft assessment order passed by the AO wherein the addition suggested by the TPO as adjustment to ALP was added to the total income of the Assessee by the AO. The Assessee filed objections before the DRP and the DRP gave certain directions. Based on the directions of the DRP, the AO passed the final order of assessment. To the extent the Assessee did not get relief from the DRP, the Assessee has preferred appeal before the Tribunal.

7. The learned Counsel for the assessee submitted before us that the assessee wishes to press for adjudication only ground Nos.9 and 10 with regard to comparability of Infosys BPO Ltd., and TCS e-Serve Ltd., and grounds 12 and 15 with regard to errors in the computation of working capital adjustment and the action of the Revenue authorities in not considering the foreign exchange fluctuation gain as part of the operative and profits of the company while computing assessee's profit margin respectively.

8. Ground Nos.9 and 10, 12 and 15 raised by the assessee read as follows:

9. *The learned AO/ learned TPO and the learned DRP have erred in law and on facts in including Infosys BPO Ltd. as a comparable to the Appellant on the ground that it is functionally comparable, whereas this company should have been excluded on the grounds that it fails the RPT Filter applied by the learned TPO and is functionally dissimilar to the Appellant.*

10. *The learned AO/ learned TPO and the learned DRP have erred in law and on facts in including T C S E Serve Ltd. as a comparable to the Appellant on the ground that it is functionally comparable, whereas this company should have been excluded on the grounds that it-is functionally dissimilar to the Appellant.*

12. *The learned AO/ learned TPO and the learned DRP erred in the computation of working capital levels / positions (including the average working capital of the comparables and the Appellant) and consequently erred in the computation of working capital adjustment as provided in the TP order.*

15. *That the learned AO/ learned TPO and the learned DRP erred in not considering the foreign exchange fluctuation gain earned by the Company as part of operations for the purpose of computing the Assessee's operating mark-up on total cost to arrive at the arm's length price.*

9. As far as ground Nos.9 and 10 of the revised grounds of appeal is concerned, the learned Counsel for the assessee brought to our notice the decision of the Hon'ble ITAT, Bangalore Bench in IT(TP)A No.2297/Bang/2016 for Assessment Year 2012-13 in the case of M/s. Societe Generale Global Solution Global Centre Pvt. Ltd., order dated 22.02.2019. In the aforesaid case, the assessee was a company engaged in the business of providing ITeS to its AE and the comparables chosen in the case of the assessee in this appeal were also chosen as comparable in the case of the aforesaid assessee. On the comparability of Infosys BPO Ltd., and TCS e-Serve Ltd., the Hon'ble Tribunal held as follows:

"13. On the segmentation of exclusion of Infosys BPO Ltd., the learned AR submitted that the turnover of said company is Rs.1316.75 crores and functionally not comparable to the assessee-company and has brand profits and owns significant intangibles to the extent of 7.55% and erroneous margin computation. The learned AR supported his argument of exclusion on the brand profit segment that the company is functionally not comparable as it owns brand intangibles and incurred huge advertisement expenditure of Rs.5.54

crores and marketing expenses of Rs.1.54 crores for brand building and referred to pages 930 and 931 of the paper-book. Similarly, peculiar economic circumstances being acquisition of 100% stake in Portland Group during the year and the forex is treated as non-operating and referred to page 932 of the paper-book and the turnover higher Rs.1316.75 crores which is outside 10 times range. Learned AR emphasized that Infosys BPO was excluded by the Tribunal considering the brand value and extraordinary event during the year and referred to paras.45 & 46 of the order of Tribunal in the case of CGI Information Systems & Management Consultants (P) Ltd. (*supra*) which reads as under:

45. We have considered the rival submissions. In the case of Baxter (I) (P.) Ltd., (*supra*) the Delhi ITAT Bench considered comparability of the aforesaid three companies with a company engaged in providing ITBS such as the Assessee. The functional profile of the Assessee and the Assessee in the case of Baxter (I) (P.) Ltd. (*supra*) are identical inasmuch as 7 out of the 10 companies chosen by the TPO in the case of the Assessee were chosen as comparable in the case of Baxter (I) (P.) Ltd. (*supra*). The Tribunal held on the comparability of the three companies Infosys BPO Ltd., TCS E-service Ltd. and Excel Infoway Ltd., as follows:

(i) In paragraph 23 of its order the Tribunal held that Infosys BPO Ltd., is not comparable with a company providing ITES because of brand value and extraordinary events in the previous year relevant to AY 2012-13 viz., acquisition of an Australia based company which had effect on its profits.

(ii) In paragraphs 24 & 25 of its order the Tribunal held Excel Infoway Ltd., as not comparable because of consistent diminishing revenue. The figures of diminution revenue are given in paragraph 24 of its order.

(iii) In paragraphs 21 & 22 of its order the Tribunal held that Excel Infoway Ltd., was liable to be excluded because it was also engaged in the business of software testing, Verification and validation of software at the time of implementation and data centre management activities.

46. Respectfully, following the decision of the Tribunal we hold that the aforesaid 3 companies be excluded from the final list of comparable companies for the purpose of arriving at the arithmetic mean of comparable companies for the purpose of comparison with the profit margins."

14. The learned AR supported his argument with the decision of the Delhi Tribunal in the case of [Baxter India Pvt Ltd. vs. ACIT](#) (85 taxmann.com 285) para.16 which reads as under:

"16. Coming to Infosys BPO Ltd. he submitted that this company also should be rejected from the list of comparables. He submitted that the TPO rejected the contention of the assessee stating that the company is engaged in ITES and hence functionally comparable. The TPO further mentioned that the Annual Report does not mention anything in regard to brand deriving its profitability. According to the TPO, the brand in service industry may derive revenue but does not affect the profitability. Ld. counsel for the assessee submitted that Infosys BPO Ltd. is functionally not comparable since the services are in the niche areas. He submitted that this company fails the TPO's own filter of rejecting companies with peculiar circumstances, since this company has acquired the Australian based company M/s. Portland Group Pty Ltd. during the financial year 2011-12. Further, the turnover of this company is more than 111 times than that of the assessee company and it has a presence of brand. Referring to the decision of the Bangalore Bench of the Tribunal in the case of Swiss Re Global Business Solutions India Pvt. Ltd. (supra) for assessment year 2012-13, he submitted that this company was examined by the Tribunal and the Tribunal directed the Assessing Officer/TPO to exclude Infosys BPO Ltd. on account of high turnover. Referring to the decision of Delhi Bench of the Tribunal in the case of Actis Global Services Pvt. Ltd. (supra), he submitted that Infosys BPO Ltd. was directed to be excluded from the list of comparables on the ground of huge turnover. Further, it was also held that Infosys BPO Ltd. cannot be considered as comparable to a captive service provider. Similar view has also been taken by the Mumbai Bench of the Tribunal in the case of Maersk Global Service Centers (India) (P.) Ltd. v. ITO [IT Appeal No. 1082 (Mum.) of 2015, dated 29- 7-2016] for assessment year 2010-11. This company was directed to be excluded on the ground that this belongs to Infosys Group thereby carries the goodwill and brand value of the group and it has got high turnover, apart from being functionally different from that company. He accordingly requested that Infosys BPO Ltd. should be rejected."

We found the submissions of the assessee are supported with the judicial decisions and are applicable to the assessee- company for excluding Infosys BPO Ltd., from the list of comparables selected. Accordingly, we direct the TPO/AO to exclude company Infosys BPO Ltd., for determination of ALP.

15. The third comparable being TCS e Service Ltd., learned AR submitted that the turnover being Rs.1578.44 crores and functionally not comparable as brand profits and also diversified activities of BPO and KPO and no segmentation information available. Further, TCS e Serve Ltd., is functionally not comparable as it enjoys more brand value and referred to pages 933 to 936 of

the paper book and also engaged in KPO activities including delivery of core business processing IT(TP)A No.2297/Bang/2016 services, analytics and insights. The turnover being Rs.1578.44 crores which is outside the range being 10 times and ld. AR supported his submission with the decision of CGI Information Systems & Management Consultants (P) Ltd. (supra) and referred to paras.45 & 46 of the order and para.14 of the Delhi Tribunal decision in the case of Baxter India Pvt Ltd. (supra) which reads as under:

"14. So far as the TCS e-Serve Ltd. is concerned, he submitted that the TPO rejected the contention of the assessee stating that the company is engaged in ITES and high turnover does not have any correlation with the profitability. He submitted that this company was rejected as a comparable in assessee's own case for assessment year 2011-12 on the ground of absence of segmental information and considerable brand value. He submitted that the TCS e-Serve Ltd. is functionally different. The company is engaged in ITES and software development services. Further, the segmental information between ITES and software development services are not available. The company has presence of brand and the services are provided pre-dominantly to Citi Group company. So far as the employee base is concerned, TCS e-Serve Ltd. has more than 296 times of that of the assessee's employee base. The turnover is greater than 133 times of the assessee. Incomparable size of operations, abnormal profitability trend and super normal profits are the other grounds for rejection of TCS e-Serve Ltd. as a comparable. He submitted that this company was examined by the Delhi Bench of the Tribunal in assessee's own case in ITA No. 345/Del/2016 and company was excluded from the list of comparables while computing the average margin of comparables.

14.1 Referring to the decision of the Bangalore Bench of the Tribunal in the case of Swiss Re Global Business Solutions India (P.) Ltd. v. Dy. CIT [IT (TP) Appeal No. 2315 (Bang.) of 2016, dated 13-4-2017] for the assessment year 2012-13, he submitted that the Tribunal had directed the Assessing Officer/TPO to exclude TCS e-Serve Ltd. from the list of comparables on account of high turnover."

10. The learned DR however submitted that the functionality of the assessee as only a BPO is not clear from the order of TPO and the DRP and therefore as to whether the assessee performs BPO functions which are of the routine nature not requiring any analytical knowledge has not be spelt out.

11. We have considered the rival submissions and are of the view that exclusion of Infosys BPO was on the basis that the said company has huge brand value and had extraordinary events of acquisition during the previous year relevant to Assessment Year 2013-14 which had an effect on this profits. Therefore, the exclusion of this company has nothing to do with the company rendering high end services. As far as the comparability of the company being TCS e-Serve is concerned, this company was also excluded on the basis that it was engaged in software testing, verification and validation of software and also on the basis that it had huge turnover and was engaged in providing KPO services. We are, therefore, of the view that based on the precedents cited, these two companies are to be excluded from the list of comparable companies. We hold and direct accordingly.

12. As far as ground No.12 raised by the assessee with regard to wrong computation of working capital adjustment, the learned Counsel submitted that there are computational errors in the order of the TPO. It was brought to our notice that before the DRP, the assessee raised a specific objection with regard to computation of working capital adjustment which is as follows:

“Further, the learned TPO, while computing the working capital adjustment, erred in considering the simple average of the effective State Bank of India benchmark prime lending rate (i.e. 13.85%) instead of considering the weighted average of the interest rate (i.e. 14.40%). The computation of the weighted average State Bank of India benchmark prime lending rate for financial year 2011-12 has been provide in the table below:

<i>Effective Date</i>	<i>Effective till</i>	<i>Days (A)</i>	<i>Interest Rate (%) (B)</i>	<i>Weighted Interest Rate% (B*A)</i>
<i>01-Apr-11</i>	<i>24-Apr-11</i>	<i>24</i>	<i>13.00%</i>	<i>312.00%</i>
<i>25 Apr-11</i>	<i>11-May-11</i>	<i>17</i>	<i>13.25%</i>	<i>225.25%</i>
<i>12-May-11</i>	<i>10-Jul-11</i>	<i>60</i>	<i>14.00%</i>	<i>840.00%</i>
<i>11-Jul-11</i>	<i>12-Aug-11</i>	<i>33</i>	<i>14.25%</i>	<i>470.25%</i>
<i>13-Aug-11</i>	<i>31-Mar-12</i>	<i>232</i>	<i>14.75%</i>	<i>3422.00%</i>
<i>Sum of Weights</i>		<i>366</i>		<i>5269.50%</i>
<i>Weighted Average</i>				<i>14.40%</i>

The correct computation of working capital adjustment is provided in Exhibit B.”

13. The DRP, however, decided the issue by observing as follows:

“Having considered the submissions, it is noticed by us from the web site of State Bank of India, that during the financial year 2011-12, the PLR interest rate were prevailing at 14.75%, 14.25%, 14%, 13.25% and 13%, the average of which works out to 13.85%. Therefore, we do not find any infirmity in the computation of the average PLR of SBI for working capital adjustment. The objection is accordingly rejected.”

14. It is clear from the perusal of the submissions made by the assessee and the order of the DRP that the argument with regard to adopting weighted average of the interest rate was not considered by DRP. We are, therefore, of the view that it would be just and appropriate to remand the issue to the TPO/AO for fresh consideration with regard to computation of working capital level and the consequent adjustment on account of working capital.

15. As far as ground No.15 raised by the assessee is concerned, it is a consistent view of the Bangalore Benches of ITAT that foreign exchange gain has to be taken as part of the operating profits to the extent that it has nexus with the international transaction in respect of which the ALP is being determined. As far as the issue with regard to treatment of foreign exchange gain as part of operating profit is concerned,, this issue is no longer res integra and has been settled by the decision of the Bangalore Bench of ITAT in the case of e4e Business Solutions P. Ltd. v. DCIT [2016] 67 taxmann.com 68 [Bang. Trib.]. It has been held therein that the gains arising from fluctuation of foreign exchange having nexus with international transaction should be treated as operating income and taken into consideration while computing the operating profit of the assessee. Following the aforesaid decision, we direct the computation of PLI by treating the gains arising from fluctuation of foreign exchange having nexus with international transaction as part of operating income.

16. The TPO directed to compute the ALP of the international transaction in question in accordance with the directions contained in this order, after affording the assessee opportunity of being heard.

17. The assessee has also raised an issue with regard to computation of deduction under section 10AA of the Act. The relevant grounds raised in this regard reads as follows:

“Other than Transfer Pricing Related

1. *That the learned AR erred in not allowing deduction under section 10AA of the Act on the entire profits of the undertaking amounting to INR 17,69,52,122.*
2. *That the learned AO has erred in reduction of telecommunication charges attributable to the delivery of computer software outside India of Rs.1,13,57,110/- from the Export Turnover ('ET') without corresponding reduction in Total turnover (TT) while computing deduction under section 10AA of the Act.”*

18. As far as the aforesaid grounds are concerned, ground No.2 alone requires adjudication. As far as Grd.No.2 raised by the Assessee is concerned, the same is with regard to exclusion of telecommunication expenses loss both from the export turnover and total turnover for the purpose of computation of deduction u/s. 10AA of the Act. It is not in dispute before us that the Hon'ble High Court of Karnataka in the case of CIT v. Tata Elxsi Ltd [2012] 349 ITR 98 (Karn) has held that charges/expenses relating to telecommunication, insurance charges and foreign exchange loss should be excluded both from export turnover and total turnover while computing deduction u/s.10A of the Act i.e., whatever is removed from the numerator should also be excluded from the denominator while working total turnover and export turnover for allowing deduction u/s.10A of the Act. The aforesaid decision of the jurisdictional High Court has been upheld by the Hon'ble Supreme Court in the case of CIT v. HCL Technologies Ltd. in Civil Appeal No.8489-98490 of 2013 & Ors. dated 24.04.2018. In view of the above, we are of the view that the telecommunication charges should be excluded both from the export

turnover as well as total turnover while computing deduction u/s.10AA of the Act. We hold and direct accordingly.

19. In the result, appeal by the assessee is partly allowed.

Order pronounced in the open court on this day of December, 2020.

Sd/-

(CHANDRA POOJARI)
Accountant Member

Sd/-

(N. V. VASUDEVAN)
Vice President

Bangalore.

Dated: 17.12.2020.

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| 1. Appellants | 2. Respondent |
| 3. CIT | 4. CIT(A) |
| 5. DR | 6. Guard file |

By order

Assistant Registrar,
ITAT, Bangalore.