

## **ITAT calls for exclusion of comparables in which high operating margin occurred due to extraordinary events**

**Summary – The Hyderabad ITAT in a recent case of NTT Data India Enterprise Application Services (P.) Ltd., (the Assessee) held that where assessee had entered into international transactions with its associated enterprise and Commissioner (Appeals) selected certain companies as comparable to assessee for determination of ALP, since there was an extraordinary event which resulted in high operating profit margin of said companies, Assessing Officer was directed to exclude above comparable and re-work out arm's length margin**

### **Facts**

- The assessee-company was engaged in the business of software development and related services. During the year, it had entered into international transactions with its associated enterprise.
- Since the value of such transactions exceeded Rs. 5 crores, the Assessing Officer had made a reference to the TPO for determining the ALP of such transactions. The TPO while accepting the TNM method as the most appropriate method determined the ALP of such transactions at Rs. 93.63 crores as against Rs. 86.51 crores shown by the assessee. Thereupon the Assessing Officer in conformity with such order of the TPO made addition of Rs. 7.12 crores to the income of assessee towards adjustment under section 92CA.
- On appeal, the Commissioner (Appeals) more or less confirmed the order of the Assessing Officer.
- On second appeal, the assessee contended that (i) the TPO had selected various comparables and ultimately the Commissioner (Appeals) excluded some and confirmed 16 companies as comparable companies to it for arriving at arm's length margin, and (ii) the Commissioner (Appeals) had erred in selecting the following seven companies as comparable to it for determination of ALP under TNM method:
  - i. Exensys Software Solutions Ltd.,
  - ii. Thirdware Solutions Ltd.,
  - iii. Infosys Technologies Ltd.,
  - iv. Sankhya Infotech Ltd.,
  - v. Foursoft Ltd.,
  - vi. Tata Elxsi Ltd., and
  - vii. Bodhtree Consulting Ltd.

### **Held**

- As regards the Exensys Software Solutions Ltd., there was amalgamation of Holool India Ltd. with the said company. In the director's report, there is a clear mention that the company's income of Rs. 737.79 lakhs is possible with the amalgamation of Holool India Ltd. It was further mentioned that the company has got benefit by advanced latest technical expertise on various technology domains of the transferor company. Further that company has charged deferred expenditure and the amount

claimed in the current year is Rs. 1.22 crores as against Rs. 30.21 lakhs in earlier year. This was clearly stated in Notes that claim was with reference to the AS-14 and also due to amalgamation of two companies. From the paper book, it was seen that out of gross assets of Rs. 7.95 crores, brands alone consist of Rs. 5 crores. Therefore, intangible assets comprising of substantial part of this company's assets. Not only in the correspondence with the TPO that the assessee expressed its inability to furnish separate accounts for two amalgamated companies but also further it has clearly mentioned to the TPO that there is a gap in the expenditure expected to incur and actual expenditure incurred which made the company record high operating margin on cost. These factors indeed support the assessee's contention that this exceptional profit with the fact of amalgamation effected operating profit of the company and this cannot be taken as comparable.

- In view of the above, it is clear that there is an extraordinary event which resulted in high operating profit margin of Exensys Software Solutions Ltd. Therefore, on the basis of facts placed on record, the aforesaid company Exensys Software Solutions Ltd. cannot be taken as comparable. Similarly the other companies by names Thirdware Solutions Ltd., Infosys, Sankhya Infotech Ltd., etc. are also to be excluded.
- Therefore, the Assessing Officer was to be directed to exclude the above seven comparable companies and re-work out the arm's length margin.