Co. incurring abnormal losses due to winding-up of relation with key clients are excludible from comparable lists

Summary – The Pune ITAT in a recent case of Bindview India (P.) Ltd., (the Assessee) held that A company having incurred super losses due to extraordinary events, like winding up of relationship with clients, filing of bankruptcy by some clients, etc., is to be excluded from comparables list; simultaneously company earning super profit should also have to be excluded from list of comparables.

Facts

- The assessee was engaged in the export of network security and administrative software solutions which were developed exclusively for its parent company (BDC).
- For purpose of determining the Arm's Length Price, the assessee selected 11 comparables and determined the Average Arithmetic Mean at 10.30%.Since the mean operating profit/Total cost of comparable companies was less than the OP/TC of 12.90% of the assessee, it was claimed that its international transaction relating to software development services was at Arm's Length Price.
- The TPO did not accept the comparables given by the assessee and selected 14 new companies. Accordingly, the TPO determined the mean of margins earned by the final set of comparables at 26.07% as against the margins of 12.40% and computed ALP. Thus, he made T.P. adjustment to the total income of the assessee.
- DRP directed the TPO to consider 11 companies as comparables which included 4 companies originally selected by the assessee.
- On appeal: the assessee submitted that the Assessing Officer had cherry picked new comparables with high profits, and the same was not transparent and, therefore, these could not be considered as comparables and that some of the companies taken as comparables had been rejected by the Tribunal in assessee's own case in the subsequent years.

Held

Comparable : ICSA (India) Ltd.

- The assessee submitted that turnover of the said company exceeds Rs. 50 crores and further that the Research and Development expenses of this company is in excess of 3% of sales. The Tribunal in assessee's own case for A.Y. 2006-07 has rejected the same as a comparable because of crossing the R&D/sales threshold of 3%. During A.Y. 2005-06 such ratio come to 7%.
- Since in the impugned assessment year R&D/sales threshold comes to 7%, in view of the order of the Tribunal in assessee's own case in the subsequent year, it cannot be considered as a comparable.

Comparable : SIP Technologies Ltd.

- No relevant data for A.Y. 2004-05 is available since the company had closed its books of account for the year ending 30-9-2004 and subsequently closed its books of account only for the year ending 31-3-2006 which is for a period of 18 months. Therefore there was merit in the submission of the assessee that SIP should not be considered as a comparable and has to be rejected although the same was considered by the assessee itself while preparing the T.P. report. When the TPO rejected certain companies as not comparable, there was no reason why SIP should not be excluded from the list of comparables when the results of the entire year are not available.

Comparable : VNF Soft Tech. Ltd.

- It is the argument of the assessee that if super loss making concerns are excluded then in that case super profit making concerns are also to be excluded. There is merit in the above submission of the assessee. The Assessing Officer excluded Cressanda as a comparable on the ground that the company has incurred losses in the relevant year due to extraordinary reasons like winding up of relationship with clients, filing of bankruptcy by some clients, higher depreciation and finance charges due to infrastructure expansion. If this logic according to Assessing Officer is accepted, then there is no reason as to why the super profit making company (VMF) should not be excluded from the list of comparables. Since both these companies were taken by the assessee as comparables, similar view should be taken for both the comparables.

Comparable : ABN Knowledgeware Ltd.

- Now coming to the exclusion of ABM. It was taken by the assessee and rejected by the TPO/DRP as a comparable. The same was rejected by the Revenue authorities on the ground that the company is basically into e-governance section and as well as the product company. Further, the company holds intellectual property rights for several products and solutions and therefore the functions of ABM are not comparable with that of assessee. From the various details furnished by the assessee, the assessee had very clearly brought out that the company is in software services. Annual report shows that the company has discontinued its sale of IT products division which clearly demonstrates that the company is into IT services and not sale of IT products. Further, when VMF which is also into e-governance was retained by the TPO as a comparable, then one cannot understand as to why by following the same logic ABM was excluded from the list of comparables. In this view of the matter, ABM should be retained as a comparable.

Comparable : Ontrack Systems Ltd.

- There is merit in the submission of the assessee that when the same was acceptable as a comparable in the A.Y. 2004-05 and when there is no change in the business activity during the A.Y.

2005-06, and, therefore, the same should not be excluded. Accordingly, the AO was directed to consider Ontrack as a comparable.

- In the A.Y. 2006-07 the Tribunal in assessee's own case has considered +/-5% safe harbour provided under 92C(2) of the I.T. Act. Further, the submission of the the assessee that during A.Y. 2006-07 the AO himself has allowed working capital adjustment to the assessee could not be controverted by the Department. Considering the above and considering the fact that the Arithmetic Mean of the assessee shown at 12.40% is near to the Arithmetic Mean determined at 14.69% no adjustment is required to the international transaction of the assessee as the assessee would be at arm's length from the Indian Transfer Pricing perspective.