Tenet Tax & Legal
Private Limited

Tenet Tax Daily
September 30, 2014

Entities engaged in KPO engineering services couldn't be comparables for a Company providing back office operations

Summary – The Mumbai ITAT in a recent case of Lionbridge Technologies (P.) Ltd., (the Assessee) held that where assessee was providing back office operations, companies providing KPO services in engineering or in data analysis/processing etc. could not be comparable.

Facts

- The assessee was a 100 per cent Export Oriented Unit (EOU) engaged in providing low end back office support services. As both the units of the assessee were situated at Software Technology Park, deduction under section 10A was claimed in the return of income. During the year under consideration, the assessee had also entered into transaction in connection with IT and ITES activity undertaken by it with its associated enterprises. For this purpose, the assessee had benchmarked the low end back office support services rendered by it to its AE on an aggregated basis. The affair of the assessee company demonstrates that assessee company was a 'low end back office support services' provider.
- The assessee had applied Transactional Net Margin Method (TNMM) as the most appropriate method to test the international transactions and operating profit to total cost as profit level indicator (PLI). The assessee had selected 27 comparables, the PLI of the assessee is 18.18 per cent, which was higher than all comparable companies. Accordingly, it was argued that the international transaction of the assessee was at arm's length price.
- However, the TPO proposed 22 different comparable companies engaged in the IT enable services. After considering the assessee's objection five companies were accepted to be non-comparables and deleted from the set of 22 companies. The remaining set of 17 comparable companies were having an arithmetic mean of 32.33 per cent. After considering overall PLI of assessee at 17.38 per cent an upward adjustment of Rs. 16,83,86,191 was made by TPO to the transfer price.
- The assessee approached to the DRP. The DRP deleted two companies from the set up comparables identified by the TPO. As a consequence the revised margin was computed at 30.10 per cent. By applying the arithmetic mean of 30.10 per cent an adjustment of Rs. 10,39,54,664 was sustained by DRP.
- Out of the comparables taken by the DRP, the assessee contended against three companies namely, Mold-Tek Technologies Limited, Eclerx Services Ltd. & Acropetal Technologies Ltd. which were alleged to be functionally different from the assessee company being a low end back office support service provider.
- On appeal:

Held

Comparable- Mold-Tek Technologies Limited.

- Mold-Tek provides KPO services in the field of engineering. Mold-Tek has demerged its subsidiary Mold-Tek Plastics which is an extraordinary event. Furthermore, since the Mold-Tek is into providing KPO engineering services, hence, cannot be functionally compared with the assessee company which is engaged in the provision of back office operations.
- There was justification in the order of DRP for not excluding Mold-Tek as comparable which is a knowledge Processing Company. Thus the DRP was not justified in the comparing the same with the assessee which is functionally different insofar as assessee is engaged in providing low end back office support services.

Comparable-Eclerx Services Limited

- This company is a knowledge process outsourcing (KPO) engaged in providing data analysis and data process solutions, online operation support, customer relationship management support, data de-duplication services etc. Since functionally, it is different from assessee company, DRP was not justified in not excluding the same from the list of comparables.

Comparable-Acropetal Technologies Ltd.

- The Assessing Officer has called for information with respect to this company under section 133(6), wherein it was found that company is engaged in providing services under IT segment and it is functionally comparable to the assessee. The audited account of the Acropetal for the year under consideration, shows segment-wise revenue in case of engineering division at Rs. 20.8 crore, and in case of Information Technology Services division, at Rs. 38.5 crore. However, the computation of margin (PLI)-ITES the segment operating revenue has been shown at Rs. 20.8 crore and segmental OP/TC(PLI) at 35.30 per cent. If the correct segmental revenue of information technology service as per audited accounts is taken at Rs. 38.5 crore in place of Rs. 20.8 crore, PLI will be much more than 35.30 per cent. There appears to be some contradiction/error which requires examination on the part of the lower authorities. Accordingly, the Assessing Officer /TPO is directed to verify and compare the revenue of IT segment of Acropetal Technologies Ltd. with that of assessee company in place of revenue of its engineering design and services. Accordingly, the matter is restored back to the file of the Assessing Officer only with respect to comparable Acropetal.