

## Co. outsourcing major portion of its business to third party couldn't be taken as comparable for ITES provider

**Summary – The Hyderabad ITAT in a recent case of Flagstone Underwriting Support Services India (P.) Ltd., (the Assessee) held that while computing ALP, functionally different companies having extraordinary circumstances like merger/de-merger, super normal profits and substantially high turnover could not be taken as comparables**

### Facts

- The assessee is a wholly owned subsidiary of 'F' Group (AE). The assessee was established to provide back office support services in the field of investment and insurance management primarily to its associated enterprises.
- Matter was referred to the TPO on account of the international transactions with AE.
- The TPO suggested an adjustment of Rs. 1.84 crores under section 92CA.
- The Assessing Officer *vide* his order added the amount determined by the TPO as ALP to the total income of assessee. The Assessing Officer also made a disallowance of Rs.20.38 lakhs on account of communication expenses as per *Explanation 2* to section 10A and recalculated the exemption under section 10A.
- On appeal, the Commissioner(Appeals) noted that TPO had selected 20 comparables by giving reasons out of which assessee had no objection for inclusion of 11 comparables but with reference to 9 comparables they had objected in terms of functionality.
- After noting that assessee had objected to 9 comparables, the Commissioner (Appeals) further noted that assessee mainly contested against inclusion of two comparables, he accordingly, directed to exclude two comparables out of 9 objected and issued directions accordingly.
- In addition to the adjustments on T.P., the Assessing Officer also excluded communication charges from export turnover while working out the deductions under section 10A.The Commissioner (Appeals) directed the Assessing Officer to exclude the communication charges from total turnover as well.
- On cross appeals:

### **Revenue's contentions:**

- Revenue was aggrieved on the exclusion of two comparables and direction of Commissioner(Appeals) on exclusion of communication charges from both export turnover as well as total turnover for the purpose of computing deduction under section 10A.

### **Assessee's contentions:**

- It was submitted by the assessee that Commissioner (Appeals) had wrongly considered exclusion of only two comparables when assessee had objected to 9 comparables.

### Held

**Exclusion of comparables 'C' and 'M'**

- As far as comparable 'C' is concerned, the commissioner (Appeals) discussed the same and followed the decision of DRP in the case of *Zavata India (P.) Ltd. v. Dy. CIT* [2013] 35 taxmann.com 423 (Hyd. - Trib.), for assessment year 2008-09 and decision of Tribunal 'A' Bench, Hyderabad in the case of *Capital IQ Information Systems India (P.) Ltd. v. Dy. CIT* [2013] 57 SOT 14/32 taxmann.com 21 (URO), it was held that 'C' works as an agent by outsourcing its work to third party vendors and cannot be taken as a comparable to the ITES functions being involved by assessee. Since the decision of the Commissioner (Appeals) is in tune with the decisions already available of this comparable both by DRP and Tribunal in various cases and since the Commissioner (Appeals) has given finding that the company is not comparable functionally to the assessee, there is no reason to interfere with the order of the Commissioner (Appeals). Likewise, in the case of 'M' the Commissioner (Appeals) followed the decision in the case of *Capital IQ Information Systems India (P.) Ltd. (supra)*, of Tribunal and gave a finding that because of exceptional financial results due to merger/demerger, 'M' cannot be taken as comparable. The Commissioner (Appeals) also followed the Co-ordinate Bench decision of Mumbai in the case of *Stream International Services (P.) Ltd. v. Asstt. DIT (International Taxation)* [2013] 141 ITD 492/31 taxmann.com 227 on the unreliability of the data. Since the Commissioner (Appeals) order is in tune with the various decisions of the Co-ordinate Benches, there is no reason to interfere with the order of the Commissioner (Appeals) on the exclusion of two comparables.

**Exclusion of communication charges both from export turnover as well as total turnover**

- The Assessing Officer excluded the communication charges from export turnover holding that they are not to be included in the Export turnover. The Assessee contested the same stating that data link charges cannot be considered as attributable to export service, however, a alternate plea was made that if the same was excluded from the export turnover, the same was also to be excluded from the total turnover while computing deduction under section 10A. Following the decision of the Tribunal in the case of *CIT v. Mentor Graphics (I) (P.) Ltd* [IT Appeal No.696 (Hyd.) of 2009, dated 18-8-2009] and Special Bench decision in the case of *ITO v. Sak Soft Ltd.* [2009] 30 SOT 55 (Chennai), the Commissioner (Appeals) gave direction to exclude communication charges from the total turnover as well. Since, this direction is in tune with the decision of Coordinate Bench including Chennai Special Bench decision of Tribunal in the case of *Sak Soft Ltd.(supra)* and also as approved by Hon'ble Bombay High Court in the case of *CIT v. Gem Plus Jewellery Ltd.* [2011] 330 ITR 175/[2010] 194 Taxman 192 there is no need to interfere with the direction of the Commissioner(Appeals) and accordingly, revenue appeal is dismissed.

**Exclusion of seven comparables selected by TPO but objected to by assessee**

- As far as 7 comparables selected by TPO but objected to by assessee, these are already decided by Co-ordinate Bench in various orders. For the sake of record the orders in the case of *Symphony Marketing Solutions India (P.) Ltd. v. ITO* [2013] 38 taxmann.com 55 (Bang. - Trib.) on the above 7 comparables are extracted.

***Accentia Technologies Ltd. (seq.)***

- It is apparent from records that during the previous year there were extra ordinary events that took place in this company which warrants exclusion of this company as a comparable. Therefore, this company cannot be considered as a comparable.

***Acropetal Technologies Ltd. (Seq.)***

- On a perusal of notes to accounts which gives segmental revenue of this company, it is clear that the major source of income for this company is from providing Engineering Design Service and Information Technology Services. The functions performed by the Engineering Design Services segment of the company cannot be considered as comparable to the ITES/BPO functions performed by the assessee.
- The performance of Engineering Design Services is regarded as providing high end services among the BPO which requires high skill whereas the services performed by the assessee are routine low end ITES functions.
- Therefore, this company could not have been selected as a comparable, especially when it performs engineering design services which only a Knowledge Process Outsourcing [KPO] would do and not a Business Process Outsourcing [BPO]

***Cosmic Global Ltd.***

- The assessee's objections before the DRP regarding this company that it fails employee cost filter have not been addressed by the DRP. It is for the TPO to determine whether this company falls within the filters as adopted by the TPO himself. If the assessee fails the employee cost filter, then the same cannot be accepted as a comparable company. In order to examine this aspect, selection of this comparable is to be restored to the file of the TPO for fresh examination, after giving due opportunity of hearing to the assessee. The issue is restored to the file of the TPO.

***Eclerix Services Ltd.***

- The Tribunal in the case of *Capital IQ Information Systems India (P.) Ltd. (supra)* had an occasion to deal with comparability of this company in the case of an ITES company such as the assessee and the Tribunal had held that this company cannot be taken as a comparable both for the reasons that it was having supernormal profit and it is engaged in providing KPO services, which is distinct from the nature of services provided by the assessee.
- *In the light of the decision of the Hyderabad Bench referred to above, this company cannot be regarded as a comparable for the reason that it was functionally different as it was having extraordinary event and super normal profits.*

***Genesys International Corporation Ltd.***

- As far as this company is concerned, the stand of the assessee has been that this company is functionally not comparable and that it has a different employee skill set and that this company performs R&D services and also owns intangibles.
- From the notes to accounts of this company, it is seen that this company is engaged in providing geographical information services comprising of photogrammetry, remote sensing cartography, data conversion related computed based services and other related services.
- Further the business of this company requires skilled manpower and scientists, civil engineers, etc. The assessee is a routine ITES provider who does not require such highly skilled employees. Besides the above, this company also carries out R&D services and own intangibles. The aforesaid facts will take this company out of the list of comparables.

***HCL Comnet Systems & Services Ltd. & Wipro Ltd.***

- The assessee has objected for these two companies being taken as comparables mainly on the ground that these companies are industrial giants considering their turnover compared to that of the assessee, whose turnover is only Rs. 15 crores. The TPO has excluded the companies whose turnover is less than Rs. 1 crore, on the ground that they may not be representing the industry trend. That very logic also applies to the companies having high turnover of over Rs. 200 crores as against the assessee's turnover of only Rs. 15 crores, and, therefore, it would be fair enough to exclude those companies also. The aforesaid companies cannot be treated as comparable, considering their substantially high turnover as compared to that of the assessee.
- Since the seven comparables are held not comparable in various decisions of co-ordinate benches, Assessing Officer/TPO was directed to exclude the above comparables and reworkout the ALP. Assessee should be given an opportunity to make submissions on the risk adjustments/working capital adjustment if so required before finalising the order. With these observations, assessee's appeal is considered as allowed for statistical purposes.