

## PLI of BPO can't be compared with PLI of KPO for transfer pricing analysis

**Summary – The High Court of Delhi in a recent case of Rampgreen Solutions (P.) Ltd., (the Assessee) held that while entities rendering Voice Call Center services for customer support and a KPO service provider may be employing IT-based delivery systems, the characteristics of services, the functional aspects, business environment, risks and the quality of human resource employed would be materially different. It plainly follows that benchmarking international transactions on the basis of comparing the PLI of high-end KPO service providers with the PLI of Voice Call Centers would be unreliable and possibly flawed**

- Voice call services are considered to be the lower-end of ITeS. KPO on the other hand are ITeS where the service providers have to employ advanced level of skills and knowledge. Notification No. SO2810(E) dated 18th September 2013 issued by the CBDT notifying Safe Harbour Rules also indicates the above.
- Whilst Voice Call Center represents the lower-end of ITeS, KPO represents services involving a higher level of skills and knowledge.
- The expression "KPO" indicates the involvement of domain knowledge in providing ITeS.
- Typically, KPO includes involvement of advance skills; the services provided may include analytical services, market research, legal research, engineering and design services, intellectual management etc. On the other hand, Voice Call Centers are normally involved in customer support and processing of routine data.
- While entities rendering Voice Call Center services for customer support and a KPO service provider may be employing IT-based delivery systems, the characteristics of services, the functional aspects, business environment, risks and the quality of human resource employed would be materially different.
- It plainly follows that benchmarking international transactions on the basis of comparing the PLI of high-end KPO service providers with the PLI of Voice Call Centers would be unreliable and possibly flawed.
- 'BPO' and 'KPO' are, plainly, understood in the sense that whereas, BPO does not necessarily involve advanced skills and knowledge; KPO, on the other hand, would involve employment of advanced skills and knowledge for providing services.
- Thus, the expression 'KPO' in common parlance is used to indicate an ITeS provider providing a completely different nature of service than any other BPO service provider. A KPO service provider

would also be functionally different from other BPO service providers, inasmuch as the responsibilities undertaken, the activities performed, the quality of resources employed would be materially different.

- In the circumstances, ITeS sector cannot be used for selecting comparables without making a conscious selection as to the quality and nature of the content of services.
- Rule 10B(2)(a) of the Income Tax Rules, 1962 mandates that the comparability of controlled and uncontrolled transactions be judged with reference to service/product characteristics. This factor cannot be undermined by using a broad classification of ITeS which takes within its fold various types of services with completely different content and value.
- Thus, where the tested party is not a KPO service provider, an entity rendering KPO services cannot be considered as a comparable for the purposes of Transfer Pricing analysis.
- The perception that a BPO service provider may have the ability to move up the value chain by offering KPO services cannot be a ground for assessing the transactions relating to services rendered by the BPO service provider by benchmarking it with the transactions of KPO services providers. The object is to ascertain the ALP of the service rendered and not of a service (higher in value chain) that may possibly be rendered subsequently
- It would not be apposite to exclude comparables only for the reason that their profits are high, as the same is not provided for in the statutory framework. The OECD Guidelines suggest that a quartile method be adopted which excludes entities that fall in the extreme quartiles for comparability. However, neither Chapter X of the Act nor the Rules made by CBDT provide for exclusion for such statistical reason.
- supernormal profits may in certain cases indicate a functional dissimilarity or dissimilarity with respect to a feature that has a material bearing on the profitability. In such circumstances, it would be necessary to undertake further analysis to eliminate the possibility of the high profits resulting on account of any material dissimilarity between the tested party and the chosen comparable. A wide deviation in the PLI amongst selected comparables could be indicative that the comparables selected are either materially dissimilar or the data used is not reliable.
- Insofar as identifying comparable transactions/entities is concerned, the same would not differ irrespective of the transfer pricing method adopted. In other words, the comparable transactions/entities must be selected on the basis of similarity with the controlled transaction/entity. Comparability of controlled and uncontrolled transactions has to be judged, *inter alia*, with reference to comparability factors as indicated under rule 10B(2) of the Income Tax Rules, 1962.
- Comparability analysis by TNMM method may be less sensitive to certain dissimilarities between the tested party and the comparables. However, that cannot be the consideration for diluting the standards

of selecting comparable transactions/entities. A higher product and functional similarity would strengthen the efficacy of the method in ascertaining a reliable ALP. Therefore, as far as possible, the comparables must be selected keeping in view the comparability factors as specified. Wide deviations in PLI must trigger further investigations/analysis.

- While using TNMM, the search for comparables may be broadened by including comparables offering services/products which are not entirely similar to the controlled transaction/entity. However, this can be done only if (a) the functions performed by the tested party and the selected comparable entity are similar including the assets used and the risks assumed; and (b) the difference in services/products offered has no material bearing on the profitability.