

TPO should assign reasons explaining differences in FAR analysis of comparable to reject them in relevant year

Summary – The Delhi ITAT in a recent case of Nortel Networks India (P.) Ltd., (the Assessee) held that If there is a change in functions carried out, assets employed and risk taken (FAR analysis) of comparables in year under consideration vis-a-vis earlier years, comparables selected in earlier year might be rejected in year under consideration, but TPO should assign reasons as to what are differences in FAR analysis of comparables as compared to earlier years, which led to rejection of those in current year

Facts

- The assessee-company was engaged in providing 'marketing and after sales support services to 'Nortel' group companies and in providing technical services to independent customers in India in the nature of installation maintenance, testing and commissioning services in relation to telecom equipment and other products.
- In the case of transaction of business support services (marketing and after sales support services), the assessee applied Transactional Net Margin Method (TNMM) and Operating Profit to Total Cost (OP/TC) ratio as the profit level indicator. The PLI of the assessee company was arrived at 12.98 per cent on cost. The assessee had chosen 12 comparables and average PLI of those comparables was arrived at 8.97 per cent. The average PLI of the comparables being less than the assessee company, no adjustment was made to the price of the international transaction of marketing and sales support services.
- The TPO bifurcated the transactions relating to provision for marketing and after sales support services in two parts *i.e.* technical support services and business support services on the ground that marketing support services provided by the assessee were not general in nature and required specialization and technical expertise. From list of employees the TPO concluded that 15 per cent of the employees were providing technical support services and rest were providing business support services. The TPO, accordingly, allocated the revenue and cost for both the technical support services and business support services for the year under consideration. The TPO Selected new comparable for market/business support services and average PLI of those comparables was worked out at 22.41 per cent. Applying the average PLI of 27.36 per cent of the comparables chosen over the cost of technical support service which was bifurcated by TPO and the adjustment was worked out. The TPO applied the above average PLI of 22.41 per cent over the cost of business support services, which was bifurcated by the TPO and the adjustment was worked out accordingly.
- DRP confirmed said order.
- On appeal, the assessee submitted that TPO/DRP had incorrectly bifurcated a single transaction of marketing and after sales support services into two parts in arbitrary and ad-hoc manner using employee headcount. He submitted that the functions performed by the assessee in year under consideration in respect of market support and after sales support services were same, as were the functions performed by the assessee for those services in preceding assessment year 2008-09.

Held

- In earlier years, the marketing and sales support services segment had been considered as single transaction as against two separate transactions of marketing support services and technical support services considered Assessing Officer/TPO. The assessee has asserted that marketing and after sales support services provided in the year under consideration as well as in earlier assessment year were pursuant to the same service agreement dated 01-07-2000 and thus there was no question of change in the functions performed by the assessee in the assessment year under consideration *viz-a-viz* earlier assessment year in respect of the services. The department could not address on this issue in absence of records of earlier years.
- If there is a change in functions carried out, assets employed and risk taken (FAR analysis) of the comparables in the year under consideration *viz-a-viz* earlier years, the comparables selected in earlier year might be rejected in the year under consideration, but the TPO should assign reasons as what are the differences in the FAR analysis of the comparables as compared to the earlier years, which led to rejection of those in the current year. The departmental authorities (*i.e.* TPO/DRP) are required to bring on record the salient feature of the year under consideration as compared to the facts of the earlier years, in absence of which, the departmental authorities cannot take opposite view. This issue was taken up by the assessee before the DRP while challenging the approach of bifurcating single transaction of marketing and after sales support service into the separate transaction of marketing support service and technical support service, however, the issue of consistency was not addressed by the DRP.
- Similarly, on the issue of following the rule of consistency in respect of rejection of the comparables in both the segments, the assessee has submitted that FAR analysis of the assessee as well as comparables was similar in earlier years and, therefore, there was no reason for rejection of the comparables chosen by the assessee. On the other end, the department contended that the Assessing Officer/TPO has given reasons for rejection of the comparables chosen by the assessee. Issue is if the comparables chosen by the assessee in earlier years were having FAR analysis similar to FAR analysis in year under consideration, how the same were accepted by the TPO in earlier years but rejected in the current year. If there is no change in the FAR analysis of the comparables and the assessee in earlier years *viz a viz* current year, then the rule of consistency demands that comparables chosen by the assessee should be accepted. In absence of records of earlier years, the department could not address on the issue, and therefore in such circumstances, it would be appropriate to restore following issues to the file of the Assessing Officer for deciding afresh in the light of rule of consistency.