
(2016) 08 GUJ CK 0005
In the Gujarat High Court
Case No : Tax Appeal No. 258 of 2016

Pr. Commissioner of Income Tax-Vadodara-1	APPELLANT
Vs	
Allscripts (India) private Ltd	RESPONDENT

Date of Decision : 02-08-2016

Acts Referred:

Income Tax Act, 1961 — Section 92C

Citation : (2016) 288 CurTR 675

Hon'ble Judges : Mr. Akil Kureshi and Mr. A.J. Shastri, JJ.

Bench : Division Bench

Advocate : Mr. K.M. Parikh, Advocate, for the Appellant No. 1; Mr. S.N. Soparkar with Mr. B.S. Soparkar, Advocates, for the Opponent No. 1

Final Decision : Disposed Off

Judgement

Mr. Akil Kureshi, J. (Oral)—The Revenue has challenged the judgment of the Income-Tax Appellate Tribunal raising following question :

"Whether Tribunal was justified on facts and in the circumstances of the case and in law in not appreciating on the issue of transfer pricing and erred in by resorting the issue back to the file of AO/TPO and directed AO to rework addition after excluding the aforesaid 2 companies without going to merits and facts of the case ?"

2. On 5.7.2016, after recording the submissions of the counsel for the revenue that the Tribunal, while remanding the issue of transfer pricing to the Assessing Officer, directed that the Assessing Officer should exclude two of the companies while working out comparability analysis, we had issued notice indicating that we may dispose of the Tax Appeal finally at the admission stage itself. In response to such notice, learned Senior Counsel, Mr. S.N. Soparkar appeared for the respondent ? assessee.

3. We have perused the orders on record with the assistance of learned counsel for the parties. From the impugned order of the Tribunal, we notice that against

the total of 12 companies, who were taken into account by DRP for carrying out the exercise of ascertaining arm's length price through Transactional Net Margin Method (for short "TNMM"), the Tribunal provided that the results of two companies, viz., Bodhtree Consulting Ltd. And E-Infochip Bangalore Ltd. would be kept out of consideration. The Tribunal thereupon directed the Assessing Officer to re-work the additions in case of the assessee on the basis of transfer pricing mechanism after excluding the aforesaid two companies.

4. Section 92C of the Act as is well known pertains to computation of arm's length price in relation to international transaction or specified domestic transaction. Various methods mentioned in sub-section (1) of Section 92C of the Act include TNMM. Rule 10B of the Income-Tax Rules pertains to determination of arm's length price under Section 92C of the Act. Clause (e) of sub-Rule (1) of Rule 10B of the Rules elaborates TNMM method as under :

"Cl.(e) transactional net margin method, by which,-

(i) the net profit margin realised by the enterprise from an international transaction (or a specified domestic transaction) entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;

(ii) the net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;

(iii) the net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction (or the specified domestic transaction) and the comparable uncontrolled transactions, or between the enterprise entering into such transactions, which could materially affect the amount of net profit margin in the open market;

(iv) the net profit margin realised by the enterprise and referred to in sub-clause (I) is established to be the same as the net profit margin referred to in sub-clause (iii);

(v) the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction (or the specified domestic transaction);"

5. In the context of agreed application of TNMM method, the Revenue adopted the results of various companies including above two companies, despite strong opposition from the assessee. The final working out by the Assessing Officer was done in tune with the report of the TPO. The Tribunal with respect to Bodhtree Consulting Ltd. referred to orders passed by other Tribunals in similar background and noted that the financial results of this company were highly fluctuating from year to year. On such basis, the Tribunal provided for exclusion

of such company for transfer pricing on the basis of TNMM. With respect to E-Infochip Bangalore Ltd., the Tribunal noted that the company was engaged in software development and IT enabled services. The assessee was involved only in software development. The Tribunal accepted assessee's contention that since the financial information with respect to these two segments was not separately available, the profit margin of this company also must be kept out of consideration.

6. With respect to Bodhtree Consulting Ltd., we notice that the Tribunal in case of another assessee had noted the company's financial results for financial year 2005-06 to financial year 2012-13 as under :

Particulars

FY 05-06

FY 06-07

FY 07-08

FY 08-09

FY 09-10

FY 10-11

FY 11-12

FY 12-13

OP/TC

13.87%

80.15%

19.89%

62.27%

33/42%

-4.46%

3.29%

-11.53%

7. Term "OP" stands for operation profit and "TC" stands for total cost. It can thus be seen that this ratio has fluctuated widely from -11.53% to 80.15% in a span of about 7 years. From year to year also, this ratio has fluctuated between 13.87% to 80.15%, back to 19.89% up again to 62.27% and so on. Therefore, on account of such widely fluctuating and erratic results of the company, the Tribunal found that it would be unsafe to assess arm's length price based on

TNMM taking into account the results of this company. We do not find the decision of the Tribunal gives rise to any substantial question of law. The Revenue's objection in this regard therefore, must be turned down.

8. With respect to exclusion of E-Infochip Bangalore Ltd., however, the issue requires a closer scrutiny. As noted, the grievance of the assessee was that this company was engaged in software development as well as IT enabled services. Since the assessee was engaged only in software development, the financial results of the company in connection with such business alone could be compared. According to the assessee, the TPO committed an error in taking the overall results of the company which was engaged in two different businesses. It was in this background the Tribunal held that since the segmental information was not available, such company also must be kept out of consideration. However, we notice that before the TPO also, the assessee had raised similar contention. The TPO rejected the contention on the ground that the said company was engaged only in software development. TPO had observed as under :

"B.11.2. As far as the contention regarding entity being engaged in software development and IT enabled services is concerned, the observation of the assessee is itself negated by the details submitted by the company, which was incidentally reproduced by the assessee in the reply to show cause notice also. The same is being reproduced again for convenience:

e-infochips Bangalore Limited is engaged in the business of providing software development services, as mentioned below :

I. Chip Designing and system verification by using complex systems languages like Specmen, Vera, Verilog. The major customers here comprise of IT/Semiconductor companies located abroad.

II. Embedded technologies which involve system integrations and system porting using the correct language for scripting. The major customers in this segment are designing new products and are in system development phase.

III. Application software development for various projects using the languages like C, C++, Java, Net and Android. The major customers in this segment are spread across all sorts of industries who need software for their support functions or integrations of their various systems.

From perusal of the above, there can be no doubt that the comparable is engaged in providing software development services only. The only difference can be in respect of the verticals in which such development services are being provided. Since neither the assessee nor the TPO has carried out research on the basis of different verticals, raising such a contention in respect of the comparable is inappropriate. The fact that this comparable is engaged only in providing software development activities is again fortified by the reply submitted u/s 133(6), which was not reproduced by the assessee, but is being reproduced for

more clarify:

e-Infochips Bangalore Limited

I.T.A.Y. 2009-10 and 2010-11

ANNEXURE-B : Brief Description of Software Development process :

(Please Refer Para No.2 of the Notice)

Sir, please note that our Company is a pure Software Development Company according to the categories mentioned under Para. 2 of your notice. Our company does not generate any intellectual property for its own.

B.11.3 The assessee has also brought to differentiate the work being carried out by the comparable and the work being carried out by it by submitting that the comparable is engaged in providing highly end complex-A, it can be seen from the about discussion reproduced from the reply received under section 133 (6), the entity is nothing else but a pure software development company which provides there development services in a different vertical, as compared to the taxpayer. From perusal of the agreement between the assessee and its AE, it can be seen that the following are the scope of work to be provided by the assessee to its AE, the relevant portions of the agreement are reproduced below :

xxx xxx xxx

Thus, it can be seen that the comparable as well as the tested party are engaged in providing similar software development services and consequently there is no reason why this entity should not be considered as comparable."

9. The Tribunal in the impugned judgment observed as under :

"10. Before us, Revenue has not brought any contrary binding decision in its support. With respect to E-Infochip Bangalore Ltd., we find that in the annual accounts of the company, with respect to the segment information it is stated that the company is primarily engaged in software development and IT enabled services which is considered the only reportable business segment as per Accounting Standard AS-17 "segment reporting" prescribed in Companies (Accounting Standard) Rules, 2006. We thus find that no segmental information is available. With respect to E-infochip Ltd. assessee had raised objection against its inclusion to which TPO in the order had directed to verify the facts and it was held that it cannot be included on the basis of diminishing of Revenues so long it was a not a consistent loss making company. Considering the aforesaid facts, we are of the view that the aforesaid two companies needs to be excluded while working out the comparability analysis and therefore uphold the plea of the assessee in excluding the margins of the aforesaid 2 companies. We therefore deem it fit to restore the issue back to the file of A.O./TPO, who after excluding the aforesaid 2 companies rework the addition as per facts and law. Needless to state that A.O./TPO shall grant adequate opportunity of hearing to the assessee. The issue of respect to determination of ALP is thus set aside to the file of A.O./

TPO and the ground of appeal raised by the assessee is thus allowed for statistical purpose."

10. It can thus be seen that the Tribunal did not take into account the finding of the TPO that E-Infochip Bangalore Ltd. was engaged in software development services alone and that the assessee's contention to the contrary was not borne out from the record. If the Tribunal had perused the material on record and come to a conclusion different from that of the TPO by giving reasons, the situation would stand on a different footing. In the present case, the Tribunal merely considered whether in absence of segmental information available with respect to E-Infochip Bangalore Ltd., the margin of such company could have been considered by the TPO. This issue completely ignores the fundamental question whether E-Infochip Bangalore Ltd. was engaged in any services other than software development services. Only if answer to the question was in the affirmative, the question of availability or non-availability of segmental information would arise. The Tribunal thus without overruling the finding of the TPO, without giving any specific finding of its own much less recording the reasons, proceeded to hold that in absence of segmental information E-Infochip Bangalore Ltd. must be excluded from consideration, directed exclusion of E-Infochip Bangalore Ltd. We find that the Tribunal has committed a serious error.

11. Under the circumstances, to the limited extent of the Tribunal's directions to exclude E-Infochip Bangalore Ltd. from working out the transfer pricing, the judgment is reversed. The issue is placed back to the Tribunal for reconsideration of the question within the parameters of observations made above. Tax Appeal disposed of accordingly.