

IN THE HIGH COURT OF JUDICATURE AT MADRAS

RESERVED ON : 05.08.2020

PRONOUNCED ON: 19.08 .2020

CORAM

THE HONOURABLE MR.JUSTICE T.S.SIVAGNANAM
and
THE HONOURABLE MRS.JUSTICE V.BHAVANI SUBBAROYAN

T.C.A.No.414 of 2018

The Commissioner of Income Tax,
Corporate Circle-3
Chennai.

..Appellant

Versus

Visual Graphics Computing
Services India Private Limited
1-4. 10th Floor, 'Zenith'
Ascendas International Tech Park
CSIR Road, Chennai 600 113
PAN:AAACV3342H

..Respondent

Prayer:- Tax Case Appeal filed under Section 260-A of the Income Tax Act, 1961, against the order of the Income Tax Appellate Tribunal, D Bench, Chennai, dated 26.07.2017 made in I.T.A.No.3458/Mds/2016 relating to the Asst Year 2012-2013. Appeal against the order dated 30-11-2016 made in GIR NO/PAN AAACV3342H on the file of the Assistant Commissioner of Income Tax, Corporate circle-3(2), Chennai-34, for the Assessment year 2012-2013 & as against the order dated 14-09-2016, 27-01-2016 respectively made in PAND No.AAACV3342H on the file of the Deputy Commissioner of Income Tax, Transfer pricing officer 3 (2), Chennai for the Assessment year 2012-2013.

For Appellant : Mr.M.Swaminathan, Senior Standing Counsel
assisted by Ms.V.Pushpa Venkatesan,
Junior Standing Counsel

For Respondent :Mr.Nishant Thakkar
assisted by Ms.Jasmine Amalsadwala
Mr.R.Venkatanarayanan

JUDGMENT

T.S.SIVAGNANAM, J.

This appeal filed by the Revenue under Section 260A of the Income Tax Act, 1961 ('the Act' for brevity) is directed against the order dated 26.07.2017 in I.T.A.No.3458/Mds/2016, on the file of the Income Tax Appellate Tribunal 'D' Bench, Chennai ('the Tribunal' for brevity) for the assessment year 2012-13. The appeal is admitted on the following Substantial Questions of Law:

(i) Whether the Tribunal was right in holding that inclusion of companies with different financial years ending as comparables though Rule 10 B (4) of the Income Tax Rules refers only to data relating to the financial year of the assessee in which the international transaction has been entered into?

(ii) Whether the Tribunal was right in granting risk adjustments of 2% on adhoc basis, when the assessee neither demonstrated the same nor quantified the adjustment?

(iii). Whether the Tribunal was right in directing and granting working capital adjustment for the assessee based on the order for the assessment year 2008-2009 when it has not demonstrated the influence the working capital intensity on the transfer price of the assessee?

(iv). Whether the Tribunal was right in directing for removal comparable companies merely on the basis of higher turnover as compared to the tested party when no correlation exists between the turnover and profits in service industry?

(v). Whether the Tribunal was right in holding that the provisions of Section 14A read with Rule 8D will have no applicability if there is no exempt income earned or received during the previous year though the disallowance is linked to expenditure incurred on investment fetching exempt income?

The background facts:

2.1. The assessee is a wholly owned subsidiary of McKinsey & Co Inc., USA (AE). It is a captive service provider to its AE - primarily to render visual aid services and back office services relating to global finance and accounting. The assessee has two units - one at Chennai and another at Tiruvananthapuram. The

Chennai Unit carries out accounting and payment process through its AE's. The assessee clubbed both the services and treated the same to be falling within the domain of ITES. The assessee adopted Transactional Net Margin method (TNMM) to arrive at Arms Length Price ('ALP' for brevity). The PLI adopted his operating profit / operating cost. The assessee stated that its standalone ITS profit margin is 11.89% as against the comparables weighted average margin of 10.33% after seeking adjustment for working capital and risk (before adjustment the margin of the comparables margin stood at 10.85%). The Department issued show cause notice dated 11.09.2015 and ultimately, the margin was reworked at 10.06% vide letter dated 29.09.2015, to which the assessee filed their objections. The objections were regarding the process adopted for undertaking fresh search was not mentioned; use of single year data is not appropriate; working capital adjustment was not considered and risk adjustment was not considered. The assessee was provided with names of 10 comparables with their margin in percentage. They objected to the inclusion of M/s.Capgemini Business Services, HGS International and TCS e-serve international on the ground that these companies had related party transaction exceeding 25%. These objections found favour with the Department and they were dropped from the final list of comparables. The assessee objected to inclusion of Infosys BPO Ltd on account of large turnover of the said Company.

2.2. The contention was rejected by referring to the decision of the Delhi Tribunal in Ameriprise India Ltd (2015) 62 taxmann.com 237 (Delhi-Trib). The assessee also sought for removal of Cosmic Global Ltd from the list of comparables on the ground of functional dissimilarities. This contention was also rejected stating that the assessee had originally included this Company as one of its comparables in the TP study. The assessee's request to include Datamatics Financial Services was not accepted, as this comparable was rejected in the TP study by the assessee since there were persistent losses. With these observations, the Transfer Pricing Officer ('TPO' for brevity) arrived at the final set of comparables, listed out names of 10 companies with the margin in percentage; computing the average margin at 16.62%. TPO stated that the margin of the assessee is only 10.06% as per the show cause notice dated 11.09.2015 and there is a short fall of 6.56% and the adjustment to the ALP was worked. The TPO held that there is an upward adjustment of Rs.6,16,39,089/- required to the ALP of International transactions entered into by the assessee. The TPO made it clear that the findings and discussions are only confined to the assessment year 2012-13.

2.3. Pursuant to the order of the TPO dated 27.01.2016, the Assessing Officer drew the draft Assessment Order dated 09.02.2016. The assessee filed their objections before the Dispute Resolution Panel - II, Bangalore (hereinafter 'DRP' for brevity) on 15.03.2016. The DRP by its order dated 14.09.2016 issued directions as per Section 144C(5) of the Act and giving effect to, order was passed by the TPO on 25.11.2016 and the Assessing Officer on 30.11.2017. Aggrieved by the same, the assessee preferred appeal to the Tribunal. The Tribunal with regard to the inclusion of Infosys BPO Limited as a comparable while determining ALP, took note of the decision in the assessee's own case for the assessment year 2008-09 in I.T.A.No.2340/mds/2012 dated 10.02.2017 and directed the Assessing Officer to exclude Infosys BPO Limited from the list of comparables. With regard to the order rejecting the comparables selected by the assessee having different financial year, even though the said companies were functionally comparable, the Tribunal took note of its coordinate Bench decisions in the case of R R Donnelley India Outsource Private Limited Vs. DCIT (2016) 75 taxmann.com 306 (Chennai Trib) and remitted the matter back to the Assessing Officer by directing to furnish data for the financial year 2009-10 (1st April and 31st March) to the TPO, who after verification shall consider the same as comparable to the assessee's case so as to determine the ALP.

2.4. While issuing such a direction, the Tribunal referred five other decisions of the Tribunals, with regard to retaining Cosmic Global Limited as a comparable. The Tribunal took note of its decision in the assessee's own case in I.T.A.NO.2340/mds/2012 dated 10.12.2017 and directed the Assessing Officer to exclude M/s.Cosmic Global Ltd from the list of comparables. With regard to the adjustments which were sought for by the assessee, to account for differences in the working capital position of the assessee vis-a-vis the comparables, the Tribunal took note of the assessee's own case in I.T.A.No.2340/mds/2012 and remitted the matter back to the Assessing Officer to rework the working capital adjustment, necessary after considering the value of advances and deposits recoverable in cash or kind or for the value to be receivable from the four Companies on the issue relating to risk adjustment.

2.5. The Tribunal took note of its decision in the case of M/s.KOB Medical Textiles Pvt. Ltd Vs. DCIT (ITA No.855/Mds/2015, dated 09.03.2017 and directed the Assessing Officer to grant 2% towards risk adjustment on adhoc basis. With regard to disallowances under Section 14A of the Act to the tune of

Rs.4,15,359/- in computing the income under the provisions of the Act, the Tribunal held that the assessee has not earned any exempt income during the subject assessment year and accordingly deleted the disallowance under Section 14 A of the Act. In doing so, it referred to the decision of the Honble Division Bench of this Court in CIT Vs. Chettinad Logistics (P) Ltd (2017) 80 taxmann.com 221.

3. The Revenue is on appeal on all the five grounds decided by the Tribunal.

4. We have elaborately heard Mr.S.Swaminathan, learned Senior Standing counsel assisted by Ms.V.Pushpa Venkatesan, learned standing counsel appearing for the appellant and Mr.Nishant Thakkar, learned counsel assisted by Ms.Jasmine Amalsadwala and Mr.R.Venkatanarayanan, learned counsel appearing for the respondent.

5. It was argued by Mr.M.Swaminathan, learned Senior Standing Counsel that the order passed by the Tribunal while remanding two of the issues out of the five issues arising in the matter, the Tribunal has not assigned any reasons and the Transfer Pricing Officer would not be in a position to decipher as to the scope of the remand and this would be a good reason to interfere with the impugned order. With regard to exclusion of Infosys BPO Limited, it is submitted that the DRP had elaborately considered this issue and without referring to the reasons assigned, the Tribunal had mechanically followed the decision in the assessee's own case for the assessment year 2008-09 and directed exclusion of Infosys BPO Limited from the list of comparables. Further it is submitted that the decision in the assessee case for the assessment year 2008-09 has not been accepted by the Department and T.C.A.No.137 of 2018 has been admitted by the Division Bench of this Court and the matter is pending.

6. It is pointed out by Mr.Nishant Thakkar, learned counsel for the assessee that the Substantial Questions of Law raised by the Revenue in T.C.A.No.137/2018 does not cover the said issue regarding exclusion of Infosys BPO Limited from the list of comparables and in this regard, drew our attention to the memorandum of grounds of appeal in T.C.A.No.137/2018, wherein five Substantial Questions of Law were raised by the Revenue, but, only four Substantial Questions of Law were admitted and this issue is not of a Substantial Question of Law which has been entertained in this appeal.

7. On perusal of the memorandum of grounds of appeal as well as the order of the Hon'ble Division Bench dated 03.04.2018, we find that this issue has not been agitated by the Revenue, insofar as the assessee's own case for the assessment year 2008-09. Therefore we confirm the finding of the Tribunal directing the exclusion of Infosys BPO Limited from the list of comparables. The conclusion arrived at by us is duly supported by the decision of the Hon'ble Division Bench of the Karnataka High Court in PCIT Vs. Swiss Re Global Business Solutions India P. Ltd. (2018) 96 taxmann.com 643 (kar.HC). The order impugned in the said appeal passed by the Tribunal noted that the Turnover of Infosys BPO Limited is Rs.649.56 Crores while the Turnover of the assessee Company therein was Rs.11 Crores, which is much more than 65 times of the said assessee's Turnover and therefore, the Court held that there is no illegality or infirmity in the order passed by the Commissioner of Income Tax (Appeals) ['CIT (A)' for brevity] excluding the said Company out of the comparables. The Court also take note of the decision of the High Court of Punjab and Haryana in the case of Agilant Technologies (International) Pvt. Ltd Vs. ACIT 2015 SCC OnLine P&H 10135 and held that the Companies having turnover of more than 23 times of the assessee's turnover cannot be compared with the assessee. The decision of Bombay High Court in the case of CIT vs. M/s.Pentair Water India Pvt. Ltd [(2016) 381 ITR 216] was also taken note of in PCIT Vs. Sanvih Info Group Private Limited (I.T.Appeal No.420 of 2019 (Del.HC) dated 16.05.2019. The Court noted the discussion in Chry Capital Investment Advisors India (P.) Ltd., Vs. Deputy Commissioner of Income Tax, [2015 376 ITR 183 (Del)], wherein it was stated that Infosys Technologies Ltd. cannot be compared with the respondent assessee (therein), as seen from the financial data and it should be excluded from the list of comparables for the reason that it was a giant Company in the area of development of software.

8. In PCIT Vs. Symphony Marketing Solutions India Pvt. Ltd., [2020 113 taxmann.com 77 (Delhi)], it was held that where assessee was rendering ITES services to its AE as a captive service provider, a company having huge turnover and brand value assuming all risks leading to higher profits, could not be accepted as comparable. The Court noted the decision in the case of CIT Vs. Pentari Water India (P) Ltd., (2016) 69 taxmann.com 180 (Bom) and the decision of the High Court of Delhi in CIT V. Agnity India Technologies (P.) Ltd., (2013) ITA 1204/2011 dated 10.07.2013. Similar view was taken by the High Court of Karnataka in Principal Commissioner of Income Tax V. M/s.Obopay Mobile Technoloty India Private Ltd., (I.T.A.No.586 of 2016) dated 23.07.2018.

9. In Commissioner of Income Tax-2, Pune vs. Principal Global Services (P.) Ltd. (2018) 95 taxmann.com 315 (Bombay), the Court dealt with the correctness of exclusion of Infosys BPO Limited by the Tribunal from the list of comparables to determine ALP and following the decisions in Agnity India Technologies (P.) Ltd., (supra) and M/s.Pentair Water India Pvt. Ltd (supra), affirmed the order passed by the Tribunal. The above decisions will come to the aid and assistance of the assessee squarely to hold that the order passed by the Tribunal on the said issue is proper.

10. On the next issue with regard to rejection of comparable selected by the assessee having different financial year as pointed out, the Tribunal followed the decision in R R Donnelley India Outsource Private Limited Vs. DCIT (cited supra) and remanded the matter back to the Assessing Officer by issuing similar direction as issued in the said order.

11. The argument of the Revenue is that the direction is devoid of reasons. We do not agree with the said submission because the Tribunal had referred to the decision of R R Donnelley India Outsource Private Limited Vs. DCIT (supra). All the directions contained thereunder were issued and the position of law as applied by the Tribunal merits acceptance. Our views/conclusion is strengthened by the decision of the High Court of Delhi in PCIT Vs. Baxter India Pvt. Ltd (ITA No.260 of 2018) dated 26.07.2018. It is also a case arising out of an assessment for the year 2012-13, wherein the Court took note of the decision in the case of CIT-II Vs. Mckinsey Knowledge Centre Pvt. Ltd. (ITA.NO.217/2014) dated 27.03.2015, wherein it was held that if from the available data, the results for financial year can reasonably be extrapolated then the comparable cannot be excluded. Therefore, we find no error in the order passed by the Tribunal on this issue

12. Next issue is with regard to the assessee plea to remove the Cosmic Global Limited from the list of comparables. The Tribunal followed the assessee's own case in I.T.A.No.2340/mds/2012 arising for the assessment year 2008-09 and as noted by us while recording the submissions of Mr.Nishant Thakkar, learned counsel for the respondent, the appeal filed by the Revenue before the Division Bench of this Court in T.C.A.No.137 of 2018 though a question of law has been admitted on the said issue, in the present appeal the Revenue has not raised a question on the said issue and therefore the direction issued by the Tribunal to the Assessing Officer to exclude Cosmic Global Limited from the list of comparables does not call for interference.

13. The next issue is with regard to making suitable adjustment to account for differences in working capital position, wherein, the Tribunal remanded the matter to the Assessing officer to rework the working capital adjustment. We find that the issue to be fully factual and no substantial question of law flows from it. While on this issue, we refer to the decision of the Division Bench of this Court in the case of Commissioner of Income Tax Vs. Same Deutz-Fahr India (P) Ltd., [(2018) 253 Taxman 32 (madras)], wherein it was held that the right of appeal under Section 260A of the Act is not automatic and it is limited right of appeal restricted only to cases which involve substantial questions of law and it is not open to the High Court to sit in appeal over the factual findings arrived at by the Tribunal. Similar view was taken by the High Court of Karnataka in I.T.A.No.536 of 2015 connected with I.T.A.No.537 of 2015 dated 25.06.2018 (PCIT Vs. M/s.Sofbrands India Pvt Ltd.,) which was followed in the decision of the High Court of Karnataka in PCIT Vs. LM Wind Power Technologies India Pvt. Ltd., in ITA.No.213 of 2017 dated 05.07.2018. Therefore the order of the Tribunal remitting the matter to the Assessing Officer to rework the working capital adjustment is affirmed and is not interfered as no substantial question of law arises for consideration on the said issue.

14. The next issue is with regard to the order granting risk adjustment at 2% before the TPO. The assessee stated that risk adjustment can be computed based on 'Sharpe Ratio' which appears to be the operating profit margin earned by the comparable Companies over and above the risk free interest rate with risk assumed by the comparable Companies and computes the additional return earned on account of risk adjustments. The additional operating profit margin earned by the Company on account of risk adjustment, multiplied with the capital employed to arrive at additional operating profit.

15. The TPO had denied adjustments on the ground that the information is not readily available in the public domain to fine tune the margins of the comparables on the basis of standard benchmarks to adjust for the differential functional profile of the entities. The TPO relied on the decision of the Chennai Tribunal in Mobis India Ltd in ITA 2112/mds/2011 dated 14.08.2013 and held that the adjustments cannot be a matter of routine while computing operating margins of the comparables and more particularly, the Statute itself has given another relief by way of adjusting price by another 5% before resorting to any adjustment by TPO. The correctness of the said finding of the TPO was challenged before the DRP by the assessee. The DRP while rejecting the submission of the assessee distinguished the decision of the ITAT in M/s.Lason India Pvt. Ltd., Vs. Joint Commissioner of Income Tax (I.T.A.No.1026/Mds./2014 for the

assessment year 2009-10 by observing that in the case of Lason india, no examination regarding existence of risk or how the risk has to be calculated is done and in the case of the assessee, they have provided calculation based on 'Sharpe's Ratio' and therefore, the facts are different. The DRP referred to the decision of the Bangalore ITAT in Zyme Solutions in IT (TP).A.No.465/Bang/2015, wherein the Tribunal held that the DRP ought not to have directed the TPO to consider the risk adjustment at 1%. Secondly, the DRP took up for consideration the alternate submission of the assessee based on the 'Sharpe's ratio' calculation. However the contention stood rejected on the ground that the claim of the assessee has not sufficiently substantiated. The Tribunal while examining the correctness of the finding of the DRP, took note of the decision in M/s.KOB Medical Textiles Pvt. Ltd. Vs. DCIT in ITA.NO.855/Mds/2015 dated 09.03.2017 and directed the Assessing Officer to grant 2% towards risk adjustment on adhoc basis.

16. The Revenue argued before us stating that such adhoc adjustment could not have been done by the Tribunal. The Tribunal took note of the arguments of the assessee that they function under limited risk because they are a wholly owned subsidiary of their AE and they are a captive service provider and whereas the comparable Companies has independent entities, the assessee being a captive service provider is a very relevant factor. After noting the factual position, the Tribunal referred to the decision in M/s.KOB Medical Textiles Pvt. Ltd (supra), wherein the Tribunal held that the risk adjustment could be given only to Company to Company basis, considering the level of risk involved between the assessee and the comparable Companies adopting the percentage of risk adjustment granted thereunder. The Tribunal directed the Assessing Officer to grant 2% towards risk adjustment on adhoc basis. We find that no substantial question of law flows from this issue as it is entirely factual. Accordingly, the finding of the Tribunal on this issue does not call for any interference.

17. The next issue is with regard to applicability of provision of Section 14(A) read with Rule 8D of the Act. This issue has been decided by the Hon'ble Division Bench of this Court in the case of Commissioner of Income Tax, Central Board, Chennai Vs. Chettinad Logistics Private Limited (2017) 80 taxmann.com 221 (madras), wherein it was held that Section 14A cannot be invoked. We note that no exempt income was earned by the assessee in the relevant assessment year. The Special Leave Petition filed by the Revenue as against this decision was dismissed by the Hon'ble Supreme Court on the ground of delay as well as on merits in the judgment reported in CIT, Chennai Vs. Chettinad Logistics Pvt. Ltd., (2018) 95 taxmann.com 250 (SC). Therefore the Substantial question of law no.5 has to be

answered against the Revenue.

18. In the result, the appeal filed by the Revenue is dismissed and the Substantial Questions of Law nos.(i), (iii), (iv) and (v) are answered against the Revenue and Insofar as the question no.(ii) is concerned, we find that the same to be fully factual and no substantial question of law arises on the said issue and accordingly the same stands rejected. No costs.

Sd/-

Assistant Registrar

//True Copy//

Sub Assistant Registrar

To

- 1.The Income Tax Appellate Tribunal,
'D' Bench, Chennai.
- 2.The Assistant Commissioner of Income Tax,
Corporate Circle-3(2), Chennai-34.
- 3.The Deputy Commissioner of Income Tax
Transfer pricing Officer 3(2),
Chennai.

+1cc to Mr.Subbaraya Aiyar, Advocate SR No.27187.

Predelivery Judgment in
T.C.A.No.414 of 2018

EV (CO)
RV (07/09/2020)

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