

**IN THE INCOME TAX APPELLATE TRIBUNAL
Hyderabad ' A ' Bench, Hyderabad**

**Before Smt. P. Madhavi Devi, Judicial Member
AND
Shri S.Rifaur Rahman, Accountant Member**

**ITA No.279/Hyd/2016
A.Y.2011-12**

M/s. Planet Online Private Limited, Hyderabad PAN: AAECs1624F (Appellant)	Vs	Asstt. Commissioner of Income Tax, Circle 16(2) Hyderabad (Respondent)
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For Assessee :	Shri P. Murali Mohan Rao
For Revenue :	Shri J. Siri Kumar, DR

Date of Hearing:	03.05.2018
Date of Pronouncement:	18.07.2018

Per Smt. P. Madhavi Devi, J.M.

ORDER

This is assessee's appeal for the A.Y 2011-12 against the assessment order passed u/s 143(3) r.w.s. 92CA(3) r.w.s. 144C(5) of the I.T. Act by the Asstt. Commissioner of Income Tax, Circle 16(2), Hyderabad. The assessee has raised the following grounds of appeal:

"Each of the grounds of appeal is mutually exclusive of, independent and without prejudice to each other.

Based on the facts and the circumstances of the case and in law, the learned Assessing Officer (AO), learned Transfer Pricing Officer (TPO) and the Honourable Dispute Resolution Panel (DRP)-

1. The AO has erred in law in making reference to the TPO without meeting the preconditions for such reference under section 92CA of the LT. Act, 1961.

1.a The AO ought to have appreciated that there was neither necessity nor expediency for such reference to the TPO as there was no attempt on the part of the appellant to understate wilfully the value of its international transactions.

1.b The AO has erred in not providing opportunity of being heard to the appellant before referring the transfer pricing issues to the TPO which is in violation of principles of natural justice.

1.c The AO ought to have independently applied his mind to the order of the TPO with due cognizance to the appellant's various rebuttals before accepting mechanically, the conclusions stated in the TPO's order.

1.d The TPO erred in making the TP addition where the tax rate in the country of the AE s is higher than the rate of tax in India and where the establishment of tax avoidance or manipulation of prices or establishment of shifting of profits is not possible.

2. Erred in making the TP addition of Rs. 9,72,84,721/- towards the shortfall of ALP adjustment in respect to the transactions of Software Development Services.

3. Erred in calculating the operating margin of the company i.e. Profit Level Indicator (PLI) (OP / OC) of -0.79% without accepting the assessee's PLI(OP/OC) of 25.44% .

3.a Erred in not re-calculating the operating cost of the assessee company as per the directions of Hon'ble DRP issued in its order dated 29.12.2015, wherein it has been directed that deferred revenue expenditure and finance cost should be kept out for the computation of margin.

3.b Erred in not excluding the deferred revenue expenditure of Rs. 1,17,49,359/ - from operating cost as per the following Directions of the Hon'ble DRP dated 29.12.2015.

"in our view the amortization of deferred revenue expenditure should be kept out of the margin computation exercise "

3.c Erred in not excluding the finance cost of Rs. 29,02,092.92/- from operating cost as per the following Directions of the Hon'ble DRP dated 29.12.2015:

"the TPO was not justified in not excluding the finance cost while working out the margin in the case of assessee company. The AO is directed to re-compute the margin of the assessee company."

3.d Erred in not excluding the excess capacity cost of employees which is 15 % of the total employee cost, from the operating cost of the assessee as it is non-operating in nature and ought to have followed the assessee's own case for the AY 2009-10 whereas the Hon'ble ITAT allowed the excess capacity cost.

3.e Ought to have appreciated that the excess capacity cost is non-operating cost in nature because it does not generate any revenue on a regular basis and the assessee has to maintain excess staff capacity as company cannot quickly hire people with required skills, knowledge and experience.

3.f Ought to have appreciated the fact that assessee company has started to incur extra capacity cost from AY 2009-10 and accordingly employee cost has increased from 9.25 crores to 33.35 crores in AY 2008-09 to AY 2011. 12, which is huge increase in employee cost due to the excess capacity cost.

3.g Ought to have appreciated that the ratio of employee cost to turnover has been drastically increased from 38.65% to 76.00% in Asst. Years 200809 to 2011-12.

3.h. Ought to have appreciated the fact that ratio of employee cost to turnover borne by the assessee is 76% whereas the 3 comparables retained by the DRP bears an average of 58% on turnover.

3.i Erred in not appreciating the fact that the comparable companies do not bear any idle costs in terms of excess staff capacity costs whereas the assessee company incurs significant idle employee cost.

3.j Erred in not excluding the foreign exchange loss of Rs.90,93,482j - from the operating cost, as such loss has not been incurred during normal course of business and same cannot be considered as operating in nature.

3.k Erred in not excluding the expenditure of donation of Rs.10,50,000jfrom the operating cost as same cannot be considered as operating in nature.

4. Erred in rejecting the TP Documentation, Search process, Filters, Comparability Analysis implemented by the assessee in accordance with the provisions of section 92C and Rule 10D of IT, Rules.

5. Erred in eliminating the following company which is not objected by the assessee from the final set of comparables selected by the TPO:

1. Akshay Software Technologies Ltd

5.a Ought to have followed the provisions of section 144C(11) of the Act in providing opportunity of being heard to the assessee before rejecting Akshay Software Technologies Ltd as the comparable to the assessee company.

5.b Ought to have appreciated the fact that Akshay Software Technologies Ltd has been considered as a comparable to the assessee company in earlier years by the TPO as well as by the assessee company in its comparability analysis.

6. Erred in not eliminating the following companies from the final set of comparables selected by the TPO:

1. Persistent Systems & Solutions Ltd
2. Persistent Systems Ltd
3. Sasken Communication Technologies Ltd

6.a Ought to have appreciated the fact that, in the assessee's own case for the A.Y 2009-10, the Hon'ble ITAT Hyderabad vide order in ITA No.464 & 608/Hyd/2014 dated 30.01.2015, has excluded the following comparables with accompanying reasons which holds good even for the year under consideration.

<u>Company Name</u>	<u>Reason for rejection</u>
Persistent Systems Ltd	Engaged in product Development& product design services; Segment data is not available.
Sasken Communication Technologies Ltd	Segment data is not available.

6.b Ought to have appreciated the fact that the above 3 comparables cannot be considered as comparables due to the following reasons:-

- ~ Functionally Dissimilar
- ~ Engaged in rendering of software product services
- ~ Segmental details not available in the Annual Report ~ High Turnover exceeding 200 crores
- ~ High Brand value

6.c Erred in calculating the operating margin of Persistent Systems Ltd at 26.68% by considering the miscellaneous income of Rs.11.51 million as part of operating income.

7. Erred in calculating adjusted Arm's Length Margin (ALM) of comparable companies at 22.75% (ALM at 20.81 % - WCA at (-)1.94%).

7.a Ought to have appreciated the fact that the transaction entered into by the assessee is within the arm's length price and no negative working capital adjustment is warranted.

7.b Erred in making the adjustment towards working capital of (-) 1.94% without appreciating the fact that the assessee has

incurred interest expenditure of Rs. 29,02,092/ - which is 0.71 % on operating income.

8. Erred in not giving the risk adjustment to the assessee company without appreciating the fact that assessee company is having low risk in the market.

8.a Ought to have appreciated that the assessee assumes limited risk, being a captive service provider in comparison to full - fledged risk bearing comparable companies.

8.b Ought to have appreciated that as per Rule 10B (l)(e)(iii) of the IT Rules, an adjustment should be made to the profit margin of independent comparable companies to take into account the differences in functions and risks.

8.c Ought to have appreciated that the Central Board for Direct Taxes, has issued Instruction No. 5/2011 dated 5 March 2011 directing the Tax Authorities to take the opinion of technical experts in cases involving complex technical issues. Hence, the TPO/AO ought to have quantified the risks in consultation of the technical experts.

9. Erred in not giving the benefit of +/-5%, as provided under first proviso to section 92C(2) of the Act.

10. Erred in confirming the disallowance of the claim of assessee company u/ s 80G of the Act amounting to Rs. 1,12,790/-.

11. Erred in confirming the disallowance of the deduction claimed by the assessee company u/ s 10AA of the Act for Rs. 61,644/-.

11.a Ought to have appreciated the fact that profit from SEZ unit is allowable u/ s 10AA of the Act.

11.b Ought to have appreciated that the claim u/s 10AA is being allowed by the department for the earlier years.

12. Erred in initiating penalty proceedings u/ s. 271G and 271(1)(c) of the Income Tax Act.

13. The assessee may add, alter or modify any other point to the Grounds of appeal at any time before or at the time of hearing of the appeal”.

2. Thereafter, the assessee filed the precise grounds of appeal and also the additional grounds of appeal. However, at the

time of hearing, the learned Counsel for the assessee submitted that he is not pressing the additional grounds of appeal as they are already part of the original grounds of appeal. He submitted that the assessee is only pressing Grounds 3.a, 3.h and 11 and the remaining grounds are not pressed. Therefore, those grounds are rejected as not pressed.

3. Brief facts relating to the issues before us are that the assessee company, provides a range of software development services to its AEs to enable them to upgrade/enhance specific software solutions, which includes preparation of functional specification documents, preparation of technical designs, coding, testing etc., and the AE is providing solutions relating to the insurance and financial industry. The assessee is a wholly owned subsidiary of Planet Soft Inc. USA. It had entered into international transaction of providing software development services to the AEs and after the economic analysis, has arrived at the profit margin of 15.96% as against the margin of the comparables at 14.48% and thus, treated the transaction to be at Arms' Length.

4. Since the assessee has entered into international transactions with its AE, the AO referred the determination of the ALP of the transactions to the TPO. The TPO observed that the search process undertaken by the assessee is not in conformity with the TP recommendations and also that the choice of filters has resulted in inappropriate comparables. Therefore, he rejected the TP documentation of the assessee and conducted an

independent analysis by aggregating all the transactions under the TNNM. Thereafter, the TPO proposed 19 companies as comparable to the assessee. The assessee filed its objections, but the TPO rejected the same and after allowing the working capital adjustment has arrived at 18 companies as comparables and therefore, their average margin to be at 22.75%. He accordingly proposed the adjustment u/s 92CA(3) of the Act. The AO proposed the draft assessment order in accordance with the TP orders. Aggrieved, the assessee preferred its objections before the DRP. The DRP partially accepted the assessee's contentions and the final assessment order was passed, against which, the assessee is in appeal before us.

5. Ground No.3a is against the non-recalculation of the operating cost of the assessee company as per the directions of the Hon'ble DRP issued on 29.9.2015 to keep the deferred revenue expenditure and finance cost out of the computation of margin. We find that though the DRP has given a direction, the AO has not calculated the margin in accordance with the directions of the DRP. We therefore, remand this issue to the file of the AO with a direction to re-compute the operating cost of the assessee in accordance with the directions of the DRP. Ground No.3.a is accordingly treated as allowed for statistical purposes.

6. As far as Ground No.3h is concerned, it is the case of the assessee that the employee cost of the assessee is 76% as compared to the employee cost of the 3 comparables retained by the DRP being 58% of the turnover. He submitted that the

comparable companies did not bear any idle cost in terms of excess staff, whereas the assessee company has borne significant idle employee cost. Therefore, he prayed that for the purpose of computing the ALP, the disparity in the employees cost margin should be taken note of and proper adjustments should be made.

7. The learned DR was also heard.

8. On going through the material on record and having regard to the rival contentions, we find that the DRP has retained Persistent Systems & Solutions Ltd, Persistent Systems Ltd and Sasken Communication Technologies Ltd as comparables and the average ratio of the employee cost to sales of these three companies is 58% as against the employee cost of the assessee at 76% and the difference is 18%. This difference is not negligible to be ignored. Every difference which is likely to affect the comparability analysis has to be taken note of and suitable adjustment has to be made to bring the comparables on par with the assessee for comparing of their operating margin. In view of the same, we deem it fit and proper to remit this issue also to the file of the AO with a direction to make suitable adjustment to the employee cost of the assessee if there is any underutilization of employees available with the assessee and thereafter re-compute the operating margin of the comparables for arriving at their average margin. Ground of appeal No.3h is accordingly treated as allowed for statistical purposes.

9. Regarding Ground No.10, assessee submitted that the assessee does not wish to press the same and therefore, it is rejected as not pressed.

10. As regards Ground No.11, we find that the AO has disallowed the deduction u/s 10A of the Act on the ground that the assessee has not submitted the evidences/receipts in support of the claim of deduction u/s 10AA of the Act. At the time of hearing, the learned Counsel for the assessee has drawn our attention to the assessee's petition filed before the Tribunal seeking admission of the additional evidence being Form No.56F in support of the claim and sought admission of the same. Since these documents goes to the root of the matter, we deem it fit and proper to remand this issue to the file of the AO for verification of the documents and consider the allowability of deduction u/s 10AA of the Act on the basis of such documents.

11. In the result assessee's appeal is partly allowed for statistical purposes.

Order pronounced in the Open Court on 18th July, 2018.

Sd/-
(S.Rifaur Rahman)
Accountant Member

Sd/-
(P. Madhavi Devi)
Judicial Member

Hyderabad, dated 18th July 2018.

Vinodan/sps

Copy to:

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- 4 Pr. CIT - Hyderabad
- 5 The DR, ITAT Hyderabad
- 6 Guard File

By Order