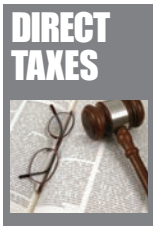
Legal Decisions[1]



Income Tax

LD/64/68

Ram Piyari Devi Charitable Trust and Anr
vs.
Director General of Income Tax
24th September 2015 (DEL)

Section 10(23C) of the Income Tax Act, 1961-Exemption.

HC grants exemption to assessee trust u/s 10(23)(via), holding that while allowing exemption only two things to be considered a) whether there was an existence of educational institution and, secondly, whether an application in the standardized form in terms of the first proviso to Section 10(23C) (vi) and (via) had been moved by the petitioner or not. Holds matter with regard to application of funds is a matter to be considered only post approval and thus was determinative in allowing exemption; Also relies on SC ruling in Queens Educational Society and coordinate bench ruling in Digambar Jain society.

The assessee, Ram Piyari Devi Charitable trust, is a registered trust u/s 12 A of the act and is running a school in the name of Delhi Public School at New Town, Kolkata. Assessee filed an application and claimed exemption u/s 10(23C)(via) for AY 2011-12. The application was rejected by the DIT on the ground that the provisions u/s 10(23)(via) relate to hospitals and medical relief and since the assessee was running a school, it was not eligible to apply in the said category. While rejecting the application, DIT also held that for the purposes of claiming exemption under the said provisions, the institution should be existing solely for educational purposes and since in the Statement of Objects of the Trust various activities were mentioned, the assessee was not eligible for grant of exemption. Aggrieved assessee thus filed a writ before Delhi HC.

Before HC, assessee contended that for grant of exemption u/s 10(23)(via), what was relevant to be considered was the activity that the trust was indulging in and the trust was running a school and apart from that, no other activity was being carried on by the trust. Assessee thus argued that merely because there were other objects mentioned in the object clause of the Trust, this would not *ipso facto* imply that the trust did not exist solely for educational purposes.

Assessee further argued that for the purposes of grant of an approval, the Competent Authority had to only examine two things firstly, whether there was an existence of educational institution and, secondly, whether an application in the standardized form in terms of the first proviso to Section 10(23C) (vi) and (via) had been moved by the petitioner or not. It was submitted that with regard to the actual application of funds, the matter is to be considered at a later stage after grant of approval. In case there is application of funds contrary to the conditions stipulated for grant of permission, the Competent Authority was always empowered to withdraw/deny the benefits of the exemption.

HC after carefully analysing the facts of the case and hearing the parties stated that the inquiry conducted by the Director General with regard to the application of funds and generation of profit was to be conducted post the grant of approval. HC remarked *"The inquiry whether the conditions had been complied with or not, as envisaged by the third proviso to Section 10(23C), is to be conducted post grant of approval and not as a condition precedent to grant of approval. Further, merely because some profit is generated does not ipso facto imply that the educational institution is existing for profit motive..."*

HC thus set aside DIT's order and granted approval u/s 10(23C) to assessee. HC held that the Competent Authority went to the stage post grant of approval for considering whether approval can be granted in the first instance or not. While granting approval HC relied on SC case in *Queen's Educational Society vs. Commissioner of Income Tax* and coordinate bench ruling in *Digambar Jain Society for Child Welfare vs. Director General of Income Tax.*

HC thus ruled in favour of assessee.

LD/64/69

Vodafone South Ltd.
vs.
Commissioner of Income Tax
21st September, 2015 (DEL)

Section 57(iii) of the Income-tax Act, 1961-Income from other sources to be computed after deducting expenditure laid out wholly and exclusively for the purpose of making or earning such income.

Bank-interest expense allowed to be net-off

[1] *Contributed by CA. Sahil Garud and ICAI's Editorial Board Secretariat, Indirect Taxes Committee, CA. Hinesh Doshi & International Taxation Committee. Readers are invited to send their comments on the selection of cases and their utility at eboard@icai.in. For full judgment, write to eboard@icai.in*

Legal Update

against interest income (earned from advancing loan to holding co.) under the head "income from other sources"; SC ruling in Tuticorin Alkali Chemicals distinguished; Observes that assessee availed Bank loan and transferred the same to its Holding Co. on the same day and so there was direct nexus between earning of interest income and payment of interest in terms of Sec 57(iii).

The Assessee, Vodafone South Ltd., commenced its business from June, 2002. During AY 2002-03, assessee availed of financing facilities from HSBC Bank. HSBC's sanction letter dated 02/08/2001, stated that assessee could advance funds availed by it to any other concern, other than in the usual course of business, after receiving bank's prior approval. By a Board Resolution, it was resolved that a sum of ₹100 crore would be made available to its holding company, Sterling Cellular Limited ('SCL'). An amount of ₹25 crore was availed as a loan from HSBC @ 11.60% interest p.a. on 24/12/2001. On that very date, assessee advanced a loan of ₹25 crore to SCL @ 11.75% interest p.a. Assessee in its revised return disclosed interest earned from SCL as income from other sources ('IFOS') after adjusting interest expenses.

During assessment proceedings, AO disallowed the set off on the ground that there was no nexus between earning of interest income and payment of interest to the bank. AO noted that the loan advanced was out of surplus from total loans raised by the assessee for the purpose of its business and that assessee was not engaged in the business of money lending. AO placed reliance on SC decision in *Tuticorin Alkali Chemicals and Fertilizers Ltd. vs. CIT* [(1997) 6 SCC 117] and held that interest paid to the bank would have to be treated as business expense but since assessee's business was yet to commence they would form part of the pre-operative expenses to be capitalised. For AY 2003-04, a similar assessment order was passed. The CIT (A) and ITAT upheld AO's order.

HC noted that the Revenue was under a basic misconception that assessee was using a part of its 'surplus' borrowed funds to advance loan to its holding company. HC thus distinguished SC ruling in *Tuticorin Alkali*, which was relied upon by the Revenue, wherein the company had invested its surplus funds borrowed for the purpose of its business in fixed deposits. In the said SC ruling, it was held that expenditure incurred for the purpose of setting up of business in pre-operative phase cannot be allowed as deduction, nor can it be adjusted against any other income under any other head.

HC ruled that advancing of loan to SCL was a business decision taken by the assessee out of commercial expediency. HC observed that sanction letter from the bank made it clear that assessee could utilise money borrowed to advance loans to others. HC observed that the sum of ₹25 crore drawn by the assessee on 24/12/2001 in terms of HSBC's sanction letter was transferred to SCL on the very same date. Without HSBC's credit facility, assessee could not have advanced loan to SCL. Thus, there was a direct nexus between earning of interest on loan advanced by the assessee to SCL and payment of interest on the loan drawn to HSBC, in terms of the sanction letter dated August 02/08/2001.

Ruling in favour of assessee, HC held that income earned on loan advanced to SCL was rightly offered to tax as Income from other sources and since, interest paid on loan availed was in the nature of an expenditure *"wholly and exclusively laid out for the purpose of earning the interest income"*, it ought to be permitted to be netted against such income in terms of Section 57 (iii). With respect to AY 2003-04, HC observed that the CIT (A) and the ITAT mechanically followed the earlier order for the AY 2002-03 although the business of the assessee had commenced in June 2002. Since this was no longer a pre-operative phase, the interest paid to HSBC would in any event have been allowable as business expenditure under Section 36 of the Act for AY 2003-04.

HC referred to rulings in case of *Eastern Investments Limited vs. CIT* [(1951) 20 ITR 1], *CIT vs. Rajendra Prasad Moody* [(1978) 115 ITR 519] and *S. A. Builders Limited vs. CIT* (Appeals) Chandigarh [(2007) 1 SCC 781], *Delhi HC ruling in CIT vs. Taj International Jewelers* [2012 Law Suit (Del) 4834] to analyse the legal position.

Excise Law

LD/64/70

Commissioner of Central Excise
vs.
M/S King Steel Rolling Mills
17th August, 2015

Rule 96ZP(3) of the Central Excise Rules, 1944

Assessee failed to discharge the duty liability according to the determined annual capacity of production; Tribunal allowed appeal of assessee in terms of judgment of Punjab and Haryana HC in Bansal Alloys & Metals Pvt. Ltd; Revenue's appeal dismissed by HC.

The assessee, King Steel Rolling Mills, was working under the compounded levy scheme

during September, 1997 to March 2000 and opted to discharge their duty liability under Rule 96ZP(3) of the Central Excise Rules, 1944 r.w. Section 3A of the Act. It failed to discharge the duty liability according to the determined annual capacity of production and was served with the detention order for recovery of short payment. Assessee filed a writ petition and this Punjab and Haryana HC allowed assessee to file appeal before the Tribunal. Revenue's appeal before Punjab and Haryana HC was dismissed by HC. Subsequently, the Revenue preferred an appeal before SC.

SC set aside the order of the Tribunal and restored that of the Commissioner. Pursuant thereto, assessee deposited the duty but without interest and the penalty and along with some other assessees filed a representation before Commissioner regarding the relevant date for the payment of interest and penalty who clarified that the interest was payable from the date of decision of SC and the penalty was not imposable.

Aggrieved, assessee filed an appeal before the Tribunal who allowed the appeal in terms of judgment of this Court in *Bansal Alloys & Metals Pvt. Ltd. vs. Union of India*, 2010 (260) ELT 343 (P&H). Hence, Revenue preferred an appeal before Punjab and Haryana HC.

HC relied on its own ruling in *CCE vs. Pee Iron & Steel Co. (P) Ltd.* where following the earlier decision of this Court in *Bansal Alloys and Metals Pvt. Ltd.*, the appeal filed by the revenue was dismissed.

Thus, the HC dismissed the appeal.

LD/64/71

M/S Mohan Breweries & Distilleries Ltd

vs.

Commissioner of Central Excise

16th September 2015 (MAD)

Rule 2 & 12 of Cenvat Credit Rules, 2002– Section 11A of the Central Excise Act, 1944

HC holds no error in the order of Tribunal; Under the Exemption Notifications, if the importers produced DEPB scrip and availed the exemption for clearance of goods, the goods become non-duty paid goods; The value of DEPB scrip, once used, gets extinguished and hence there would be no question of seeking Cenvat Credit thereafter.

The assessee, Mohan Breweries & Distilleries Ltd., imported certain raw-materials under a Bill of Entry and availed Cenvat Credit on the additional duty of customs. Assessee availed the benefit of the 'Notification No.34/97-Cus' dated 7.4.1997 and cleared the goods by debiting the DEPB for both customs duty payable under the Customs Act, 1962 and the additional customs duty leviable under Customs Tariff Act, 1975.

The Department issued a show cause notice calling upon the appellant to show cause as to why the Cenvat Credit availed by them would not be recovered under Rule 12 of Cenvat Credit Rules, 2002 r.w.s. 11-A of the Central Excise Act, 1944. The appellant submitted a reply to the show cause notice. However, by an Order-in-Original passed on 31.3.2005, the Deputy Commissioner of Central Excise followed the decision of a Larger Bench of CESTAT in ESSAR *Steel Ltd., vs. Commissioner of Central Excise* and held that the appellant was not entitled to take credit of CVD based on the debit entry under DEPB Scheme. Therefore, the Original Authority directed the recovery of the amount of Cenvat Credit availed by the appellant and also imposed penalty.

On appeal, the Commissioner (A) confirmed the order of recovery and directed the appellant to pay interest. However, the Appellate Commissioner set aside the penalty. Assessee's further appeal was dismissed by the Tribunal. Aggrieved, the assessee preferred an appeal before Madras HC.

HC referred Notification No. 31/97 and noted that under this Notification, issued in exercise of the powers conferred by Section 25(1) of the Customs Act, 1962, the Central Government exempted the goods imported into India both from the whole of the customs duty and from the whole of the additional customs duty, subject to certain conditions. One of the conditions stipulated in the Notification is that the importer has been issued a Duty Entitlement Passbook DEPB by the licensing authority and the importer had been permitted credit entries in the DEPB. HC further noted that subsequently, a Circular bearing No.5/2005-Cus dated 31.1.2005 was issued.

HC noted that that the prescription contained in the last line of para 4.3.5 of Exim Policy was deleted under a Notification bearing No.28, dated 28.1.2004. HC further noted the contention of assessee that para 4.3.5 of Exim policy dealt with export and it did not deal with a manufacturer making a DTA clearance. HC observed that Rule 5 of the Cenvat Credit Rules, 2002 made it clear that where any inputs were used in the final products which were cleared for export under Tariff or Letter of Undertaking as the case may be, are used in the intermediate product cleared for export the Cenvat Credit in respect of the inputs so used shall be allowed to be utilised by the

manufacturer towards payment of duty of Excise on any final product cleared for home consumption or for export on payment of duty.

HC observed that Commissioner (Appeals) as well as the Tribunal relied upon a Larger Bench decision of the CESTAT in *ESSAR Steel Limited v. Commissioner*. It was further observed that the said decision was not overruled so far by any High Court. But according to the learned counsel for the appellant, the decision of the Larger Bench was watered down to a great extent by this Court in *Commissioner of Central Excise vs. Spic Limited* [2014 (305) ELT 484].

HC distinguished its own ruling in *Spic Limited* case, reasoning that after a specific prohibition was introduced under the Scheme from 1.4.2000, it was not possible for assessee to claim the benefit in respect of the Bill of Entry of the year 2003. Therefore, the decision in Spic, even if it was taken to water down the decision of the Larger Bench in ESSAR Steel Limited, did so only in respect of the period prior to 2000.

Thus, HC dismissed the appeal of assessee.

LD/64/72

M/S RMG Polyvinyl India Ltd.

vs.

Union of India

30th September, 2015 (ALL)

Section 32-E of the Central Excise Act, 1944

Order of Settlement Commission shall be void if it is subsequently found by the Settlement Commission that it was obtained by fraud or misrepresentation of facts; Power given to the Settlement Commission under Section 32-L can be exercised, if it finds that any person who has made an application for settlement under Section 32-E, has not co-operated with the Settlement Commission in the proceedings before it.

Assessee, RMG Polyvinyl India Ltd, is engaged in the manufacture of PVC Sheeting, PVC flooring and coated cotton fabrics, and is registered with the respondents-Department. A search was conducted by the Officers of the Central Excise Department at the factory premises of assessee and certain records were resumed. Physical verification of stock was also carried on in which excess stock of finished goods i.e. laminated sheeting, flooring, tiles, met of certain varieties. Two private ledgers and two writing pads (kachcha records) were recovered from the briefcase found in the official cabin of Executive Director of assessee.

On scrutiny of these ledgers and writing pads, it was revealed that it contained entries of transactions related to clandestine removal of finished goods. On the basis of preliminary scrutiny of resumed records, follow up searches were conducted at 11 different places in which certain records, computer, hard disc and a computer were resumed from the factory situated at Sikanderabad and office premises assessee at Ghaziabad and New Delhi. During investigation, the statements of various persons including Executive Director were recorded u/s. 14 of the Act. A show cause notice was issued to assessee requiring to show cause as to why duty and Cenvat Credit be not demanded u/s. 11- A of the Act and penalty be imposed under Rule 25 of the Central Excise Rule 2002 r.w.s 11 AC of the Act. Penalty was also proposed to be imposed on Executive Director and Director under Rule 26 of the Rules.

The assessee moved Settlement Application u/s. 32-E of the Act. During the course of hearing of the application the petitioners accepted the allegations in the show cause notice only for those documents in the seized records which were marked as 'R' on the ground that only these documents pertain to the petitioners' company. It was claimed that the other invoices do not pertain to the petitioners' company but are the private business record.

Settlement Commission came to the conclusion that once the petitioners accepted part of the information given in the private record, they could not simply brush aside the other information. It was also found that the stand taken by the applicant and the Department are at huge variance inasmuch as the petitioners merely accepted 10% of the demand and has contested the evidence collected by the Revenue without any convincing explanation.

On appeal, Allahabad HC asserted that it did not find any error of law in the findings recorded by the Settlement Commission in the impugned order and the impugned order was within the four corners of the provisions of Sec 32-F of the Act.

HC relied on its own ruling in the case of *Vinay Wire and Poly Product P. Ltd. vs. Dir. General of Central Excise* [2014(307) E.L.T. 438(All)] where it considered the provisions of Section 32-F and 32-L of the Act and held that a plain reading of provisions of sub-sections (5) and (8) of Section 32-F makes it clear that the Settlement Commission has to pass such order as it thinks fit and it has the power not only to provide the terms of the settlement but

also to reject the application, in which eventuality, reasons have to be recorded. It was further held that the power conferred on the Settlement Commission under Section 32-L to send the case back to the Central Excise Officer is in addition to the aforesaid powers of the Settlement Commission and such a power given to the Settlement Commission under Section 32-L can be exercised, if it finds that any person who has made an application for settlement under Section 32-E, has not co-operated with the Settlement Commission in the proceedings before it.

HC held that the power given to the Settlement Commission under Section 32-L does not and cannot take away the powers conferred on the Settlement Commission under sub-section (5) and (8) of Section 32-F.

HC further distinguished Gujarat HC ruling in case of *Mann Pharmaceuticals Ltd.* [2014(307) E.L.T. 642] on facts since in the said case, the facts were that the assessee accepted duty liability to a large extent along with interest thereon and deposited the same and also satisfied all the requirements of Section 32-E of the Act. However, without passing any final order u/s. 32-F(5), the Commission rejected the application by an order under Section 32-L. Thus, HC held that the facts of the present case were different as discussed in the foregoing paragraphs.

Thus, HC dismissed the appeal preferred by assessee.

International Taxation

LD/64/73

Reuters Limited

vs.

DCIT

(ITA 7985/Mum/2011) (Mumbai ITAT)

Income from distribution of news and information is not taxable in India and deputation of Bureau Chief does not form Service PE in India.

The assessee, Reuters Limited is a UK company having a worldwide business of providing news and financial information through Reuters Global Network. In India, assessee entered into distribution agreement with Reuters India Private Limited (RIPL) for distribution of news and information service compiled by the 'Reuters' and for further distribution to subscribers in India independently.

In ordinary assessment, AO treated the income from distribution as FTS and taxed it @20% under Article 13 of the DTAA. AO was further of opinion that RIPL constitutes dependent agent Permanent Establishment ('PE') of assessee in India within Article 5(5) and thus computed income u/s 44D.

ITAT remanded the matter back to the AO and show cause notice was issued on assessee against which the assessee filed detailed submissions but was rejected by the AO. The AO concluded that the assessee has an agency PE in India as RIPL has done exclusive business for assessee.

Further, the assessee had also deputed one employee as Bureau Chief of Bombay and hence the AO held that this formed a service PE in India. The DRP rejected the assessee's objection and AO passed an order considering the entire distribution fee income as FTS.

Issue arose as to whether the assessee had formed a Service PE in India by deputing the Bureau Chief and whether the income from distribution fee is taxable as FTS.

ITAT took note of the distribution agreement whereby assessee had agreed to provide Reuters Services to RIPL for further re-distribution in India. The agreement contemplated that RIPL will put best of its efforts to promote and sell the Reuter services/products throughout India. ITAT with reference to distribution agreement observed that in the agreement there was nothing which showed that RIPL would habitually exercise the authority to negotiate and conclude the contracts on behalf of the assessee. ITAT opined that it merely envisaged delivery of Reuter services for a price which can be further distributed by the RIPL for earning of its own revenue.

RIPL had independent contract with the subscribers and files suits independently for any recovery of debts. ITAT further noted that material was being supplied to RIPL on principal to principal basis and RIPL did not habitually maintain any stock of any goods and merchandise for which it can be held that it is regularly delivering goods on behalf of Reuters. ITAT explained that character of an agent under Article 5(4) which can be said to be dependent is that the commercial activities of the agent for the enterprise are subject to instructions or comprehensive control and it does not bear the entrepreneur risk. Also, the fact that revenue from third parties were higher than transaction with assessee moves on to prove that RIPL was not completely or wholly doing activity for 'Reuters' and earning income wholly from 'Reuters' only. ITAT thus concluded that the agency PE conditions laid down in Article 5(5) are not fulfilled.

Further, ITAT discussed the role of a News Bureau Chief and observed that he is responsible for collecting and analysing the news and holds a management position in the news centre or news room. Thus ITAT with reference to Clause 3 of the distribution agreement pointed out that in present case Mr. Simon Moore was assigned as a 'Text Correspondent' to perform functions of a Bureau Chief and that his functions and duties had nothing to do with distribution agreement.

ITAT concluded that Mr. Moore was merely delivering Reuters services to the Distributors and was not furnishing no services which could help the assessee to earn income.

ITAT thus ruled in favour of assessee and held that assessee did not have a PE in India either under Article 5(2)(k) nor under Article 5(4). Accordingly, ITAT concluded that "the distribution fee received by the assessee can not be held to be taxable in India"

LD/64/74

Cincom Systems Inc.

vs.

DDIT

(ITA 952/Del/2006) (Delhi ITAT)

Section 9(1)(vi) of the Income-tax Act 1961– Article 12(3)(a) of India-USA DTAA

Payment towards the use of networking facilities is Royalty.

Cincom System Inc. ('the assessee') is a foreign company engaged in the business of providing software solution including creating personalised document, management of solutions, managing complex manufacturing operations and building and maintaining personalised ebusiness software, development and solutions.

The assessee company entered into a communication agreement with Cincom Systems (India) Pvt. Ltd. ('Cincom India') wherein it was agreed that assessee shall provide access to Cincom India to internet and other email and networking facilities along with other group concern.

For AY 2002-03, assessee itself offered the sum received to tax as fees for included services. However, before CIT(A), it was contended that the amount was not taxable in India. CIT(A) held that the payment was not in the nature of fee for included services, but it in the nature of royalty by placing reliance on *AAR ruling [238 ITR 296]*.

For subsequent years, the AO followed the CIT(A) order and held that the payments were in the nature of royalty. However, on further appeal, CIT(A) held that such payments were in the nature of fees for included services.

Hence, against the order of AY 2002-03, the assessee filed an appeal in ITAT while in subsequent years, the department filed an appeal in the ITAT.

Issue arose whether consideration paid towards the usage of networking policy was taxable as "Royalty".

The assessee argued that services rendered did not fall within the definition of 'royalty' and placed reliance on Delhi HC's ruling in *Asia Satellite Telecommunication Co. Ltd. vs. DDIT (332 ITR 340)*.

The Department argued that services fell within the definition of 'royalty' as defined in Sec 9(1)(vi). It was further argued by the Revenue that payment were not made for simple use of equipment but for the use of protected software and placed reliance on AAR ruling in *ABC In. Re [238 ITR 296]*.

The Department further contented that in view of the amendment to Section 9(1)(xi), introduced with retrospective effect from April 1, 1996, Delhi HC's ruling in *Asia Satellite Telecommunication Co. Ltd*. was no longer valid.

On perusal of the agreement entered by the assessee and the Cincom India, the ITAT was of the opinion that assessee rendered access to its internet, by which it provided a gateway that facilitated call centres to incoming and outgoing calls from India to people in USA, referred as Cincom Gateway. This was in the nature of payment towards the usage of a facility and hence it should be considered as a royalty under Section 9(1)(vi) of the Act.

Royalty under DTAA

The case of the assessee was of embedded software's use, owned by the assessee for the purpose of enabling customer from India to call residents of USA. The ITAT relied upon the AAR ruling in the case of 238 ITR 296 and held that the use of CPU was not merely use of equipment as provided in Article 12(3)(b) of the DTAA but more than that. It was for the use of embedded secret software (an encryption product) developed by the applicant for the purpose of processing raw data transmitted by the Indian company which clearly fell within the ambit of Article 12(3)(a) of the DTAA.

It was held that transaction was related to a "scientific work" and would partake the character of intellectual property and thus, payments received towards use of intellectual property were taxable as royalty, under Article 12(3)(a) of India-USA DTAA.

Applying the ratio laid down by AAR to the facts of assessee's case, ITAT held that consideration received by the assessee was in the nature of royalty within the meaning Article 12(3) of DTAA.

Thus following the AAR ruling, the ITAT held that the payments made by the Cincom India were in the nature of Royalty.

Transfer Pricing

LD/64/75

Rampgreen Solutions (P.) Ltd.

vs.

CIT

(Delhi HC) (60 taxmann.com 355)

Rule 10(B)(2)(a) of the Income Tax Rules 1962

Entities rendering KPO services are incomparable with mere call centre services.

The assessee, Rampgreen Solutions, is engaged in providing voice-based customer care services to the clients of the AE's. The assessee rendered call centre services which fell under the category of Information Technology Enabled Services ('ITeS'). The assessee is remunerated on cost plus basis. The AE bore all the business risks and the assessee only acts as an offshore service provider to the customers of the AE.

Out of all the comparables selected, the TPO, DRP considered eClerx Services Limited ('eClerx') and Vishal Information Technology Limited ('Vishal') as a comparable to the assessee. The assessee objected that these companies were involved in the provision of KPO services and were not comparable to the assessee who was involved in providing low end ITeS services.

The HC held that 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. Further, 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.

Further, 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.

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.

Accordingly, the entities providing low end ITeS cannot be compared with the entities involved in KPO services.

LD/64/76

Open Silicon Research Private Limited

vs.

ITO

(ITA 1128/Bang/2011) (Bangalore ITAT)

Comparable selected by the assessee can be objected at any stage of appeal proceedings

The assessee, Open-Silicon Research Private Limited is a subsidiary of Open-Silicon Holding Corporation, Mauritius which in turn, is a wholly owned subsidiary of Open-Silicon Inc, U.S.A. ('Open-Silicon Inc'). Assessee is engaged in providing contract software development services to its Associated Enterprise ('AE') for which it is compensated with a fixed mark-up on the cost incurred.

During AY 2007-08, assessee rendered software development services to its AE for an amount of ₹13.00 crore. Assessee adopted TNMM as Most Appropriate Method ('MAM') and 18 comparables with average margin of 11% (after working capital adjustment). Though TPO accepted that TNMM as MAM, he rejected 16 of assessee's comparables (accepted only 2 comparables viz. SIP Technologies & Exports Ltd. and Mindtree Consulting Ltd), selected a final set of 26 comparables and proposed a TP-addition of ₹1.22 crore, which was confirmed by DRP.

Aggrieved, assessee filed an appeal before Bangalore ITAT. During the ITAT proceedings, the assessee contended that due to oversight and inadvertent mistake, it had not raised any ground for rejecting Mindtree Ltd. This comparable needed to be rejected since it had a turnover of more than Rs. 200 crore. Further the assessee also submitted that further 8 companies selected by the TPO should be rejected.

Issue arose as to whether the comparables once selected by the assessee can be rejected during the course of hearing.

The ITAT for this purpose relied upon the judgement of Chandigarh ITAT in the case of Quark Systems and observed that:

"It is well settled that assessee is entitled to raise an objection regarding comparability at any stage of proceedings and even in a case where the assessee has not raised objection for including the same as a comparable before the lower authorities, or the assessee had chosen in its TP study a company which it seeks to exclude as a comparable.

However, an opportunity has to be given to the TPO to examine the comparables under TP study in such a case where the assessee raises an objection with respect to comparability in the appellate stage."

Accordingly, the ITAT remitted the matter back to AO/TPO for fresh examination of the comparables after giving the assessee adequate hearing opportunity.

Thus, the assessee was allowed to reject the comparables selected while preparing the TP study. ■