IN THE ITAT HYDERABAD BENCH 'A'

Zavata India (P.) Ltd.

v.

Income-tax Officer, Ward 3(2), Hyderabad*

B. RAMAKOTAIAH, ACCOUNTANT MEMBER
AND SAKTIJIT DEY, JUDICIAL MEMBER
IT APPEAL NO. 628 (HYD.) OF 2008
[ASSESSMENT YEAR 2004-05]
JANUARY 31, 2013

ORDER

B. Ramakotaiah, Accountant Member - This is an appeal by the assessee against the orders of the CIT(A)-I, Visakhapatnam dated 24.01.2008.

2. The issue in this appeal is whether the Assessing Officer is correct in invoking the provisions of S.10A(7) read with S.80IA(10) of the Act on the basis of the Transfer Pricing Study undertaken by the assessee.

3. Briefly stated, the assessee is in the business of rendering back office processing services in the field of health-care administration. Its services are not akin to call centre services, wherein tele-communication expenses constitute more than 24%. The assessee's service centre is registered under the Software Technology Parks of India and provides services exclusively to Samsung Data Corporation USA (SDC US), its Associate Enterprise (AE). The SDC US markets services in USA. The revenue sharing policy was determined at the ratio of 85:15 on the gross receipts received from third parties.

4. For the financial year 2003-04, i.e. AY 2004-05, the assessee filed return of income and claimed deduction under S.10A to the extent of Rs. 3,15,69,530. The Assessing Officer selected the return for scrutiny and having noticed that the assessee has transactions with AE made a reference to the Additional Commissioner of Income-tax, Transfer Pricing under S.92CA(1) of the Act, for determination of Arm's Length Price(ALP) of the International transactions relating to BPO services.

5. The assessee made TP study and based on the functional analysis chose the Comparable Uncontrolled Price (CUP) method as the most appropriate method for determination of ALP. It justified its allocation of profits on the basis of the price paid by third party for services at US$10, wherein proper BPO services/call centre services are placed, and since the assessee is not having that much telecommunication services, was paid at US$8.50, and justified the price by the CUP method.

6. Without prejudice to the primary analysis undertaken under the CUP method, the assessee also supplemented International transactions being at Arms Length Price under Transactional Net Margin Method (TNMM) and selected some comparables and arrived at the Arithmetic mean at 8%. Since the assessee's profit margin was at 159.5% on the operating cost, it justified the Arms Length Price under the TNMM method.

7. Pursuant to detailed scrutiny of the TP documentation and the additional information provided, the TPO vide order dated 17.11.2006 concluded that the pricing of the assessee is within the Arm's Length Standard and no adjustment is required to be made to the value of the international transactions between the assessee and its AE. However, the Assessing Officer invoked the provisions of S.10A(7) read with S.80IA(10) to consider that the assessee has earned more than the ordinary profit and considering the same TP study submitted by the assessee under TNMM method, determined the excess profit at Rs.2,99,34,750 and denied deduction under S.10A while completing the assessment.

8. The other adjustment with reference to reducing internet charges from the export turnover was deleted by the CIT(A) and therefore, that aspect of the action of the Assessing Officer was not subject matter of this appeal.

9. Assessee contended before the CIT(A) that the order of the Assessing Officer in invoking the provisions of S.10A(7) relying on the TNMM study submitted for the Transfer Pricing purposes is not correct. It raised various contentions. However, the CIT(A) confirmed the order of the Assessing Officer by stating as under-

> "4.3 The next issue is whether the Assessing Officer was justified in invoking the provision of section 10A(7) r.w.s. 80IA(10) of the Act. The requirements for invoking the said sections are that (a) the must be close connection between the appellant and the other person and (b) the course of business between them should be so arranged that it produces the appellant more than the ordinary profit from such business. In the instant case, the fact of the close connection between the appellant and the other person, i.e. the AE is not disputed at all. The dispute is relating to the applicability of the conditions as specified in (b) as above. The appellant's argument is that the provisions of section 80-IA(10) are applicable only when both the closely connected persons are taxable in India. However, perusal of the said section indicates that no such stipulation has been made in the said section. Therefore, this argument of the appellant is not tenable. The provisions of section 10A(7) r.w.s. 80IA(10) are primarily meant to check the tendency of the assessees to show higher profits of the undertakings which are eligible for tax concession. Such provisions are found in most of the other sections in the Act for granting incentives in respect of profits of certain business activities. The other argument of the appellant is that the word 'arranged' suggest a motive to avoid tax by manipulating the profits of the company. In this context, it was argued that the appellant had no motive as where the profits are higher the appellant has to pay more taxes in the form of dividend distribution tax owing to the income in the amount of dividend available for distribution. The argument of the appellant is not acceptable in view of the transaction analysis contained in Chapter 4 of the Transfer Pricing Report. As per the said functional analysis, the entire Corporate Strategy and Management of the group, salary and marketing activities including customer identification, presentation of technical qualification, contract negotiations and fee collection, client satisfaction/relationship, responsibility of business development, marketing and advertisement strategy, concluding contracts, supervising the projects, delivery of the projects, quality control and performance review were all the responsibilities of the AE. Further, it is noted that all market risks with respect to services including business development and customer acceptance are borne by the AE. The other

risks like the service liability risk, credit and collection risk, foreign exchange risk, idle capacity risk, contractual risks, etc. was also on the AE. The appellant company had absolutely no responsibility in this regard. Further, it is noted that the value of the assets employed by the appellant company was not substantial. Therefore, it can be fairly concluded that as per the analysis of transaction the risks and responsibility of the appellant company in comparison to the AE was minimal and substantially lower. As against this, the revenue sharing ratio was heavily loaded in favour of the appellant company its sharing being 85%. Thus, this was clearly an arrangement vide which the Indian company was given a more of revenue in view of the fact that its income was totally exempted from tax u/s. 10A. This implies that the said income was ploughed back to the Directors and Share holders in the form of dividends. One of the Directors of the appellant company was Mr. Sriram Davaloor who held 50% of the share holding and being a resident of USA his income was not taxable in India. This was possibly the motive for giving bigger share of revenue to the appellant company which resulted in unjust enrichment of the foreign Director of the appellant company. Hence, this was clearly an arrangement within the meaning of such word employed in section 80IA(10). In view of the above, the AO is perfectly justified in invoking the provisions of section 10A(7) r.w.s. 80IA (10) in the case of the appellant company.

4.4 As per the primary transfer pricing analysis documented by the appellant under the CUP method, the price for the services rendered by the appellant was determined at US $ 50 per man hour which was the same as the price charged by the appellant to its AE. However, as per the additional supplementary analysis under TNMM, it is noted that the arithmetical mean of operating profit margin of comparable cases was 3.77% whereas it was 8.96% even in the cases figuring in the upper range. TNMM requires establishing comparability at a broad functional level. It requires comparison between the net margins derived from the operation of the uncontrolled parties and the net margins derived by an associate enterprise on similar operation. Under this method, the net profit margin realisation by an associate enterprise from an international transaction is computed in relating to a particular factor such as costs incurred, sales, assets., utilized etc. The net profit margin realized by an associate enterprise compared with net profit margin of uncontrolled transactions to arrive at the ALP. By making the said analysis, the appellant himself under the TNMM method indicated that the percentage of operating profit with reference to the operating cost in the case of the appellant company was 159.51%. As against this, for uncontrolled parties such margin of profit ranged between (-)1.42% to 8.96%, the arithmetical mean being 3.77%. This clearly establishes the fact that the profit of the appellant company by virtue of providing the services to the AE was very high. Therefore, the Assessing Officer is justified in fixing the ordinary profit at 8.5% keeping in view the fact that the ALP can vary upto 5% form arithmetical mean as per the proviso to sub-section 2 to section 92C. The application of the most appropriate method is essential to arrive at the most reliable measure of the ALP. Rule 10(c)(i1) of the Income-tax Rules defines the most appropriate method, which is best suited to the facts and circumstances of each particular international transaction and which provides the most reliable measure of an ALP in relation to an international transaction. Rule

10(c)(2), inter alia provides that the most appropriate method shall be selected having regard to the class or classes of Associate Enterprises entering into the transaction and the functions performed, assets employed and the risks assumed by them. In the instant case, as explained in earlier para, the entire risk of running the business by the appellant company is on the AE and the assets employed appellant company was negligible. Hence, the Assessing Officer is justified in treating the TN MM method as the most appropriate method for computation of the AKLOP. Accordingly, the Assessing Officer is justified in not considering the 151% profit i.e. 159,51% - 8.5% amounting to Rs.2,99,34,750/- as the profit of the eligible undertaking for the purposes of computation of deduction u/s. 10A of the Act. The said action of the Assessing Officer is hereby 'confirmed' and the grounds raised vide (i), (ii), (iii) and (iv) which are interrelated and pert5ains to the same issue, i.e. invoking the provisions of section 10(7) r.w.s. 80IA(10) are hereby 'dismissed'."

The assessee is aggrieved on the above.

10. The learned counsel referring to the TP study, order of the TPO and the order of the CIT(A) and the paper-book placed in this regard, submitted that the Assessing Officer was not correct in invoking the provisions of S.10A(7) read with S.80IA(10). He submitted that on a reading of Section 10A(7), CBDT Circular No 308 dated June 29, 1981 (wherein the reasons for applying Section 80IA(8) and (10) to an undertaking have been explained) and judicial precedents on the subject, the legislative intention for introduction of 80-IA(I)(10) was to apply provisions in following two situations, both of which do not apply to the facts of the case.

(*a*) Where both the closely connected persons are taxable in India:

The intention with reference to this situation is to cover two distinct taxable entities belonging to the same business group, in a situation, where the group may abuse such tax incentives by transferring profits of non-eligible assessees (which would be subject to tax in India) to eligible assessees (which would not be taxable). Such an abuse would result in reduction of the overall amount of tax liability in India, and consequently loss of legitimate revenue to the Indian Government exchequer. In the instant case, it is submitted, the AE is not taxable in India. The Assessing officer's contentions that the assessee could abuse the deduction claimed by routing back of funds to the AE is not correct, since the AE is not subject to tax in India. On the contrary, it is submitted, where the profits are higher and the Appellant routes back the funds, the Appellant has to pay more taxes in the form of dividend distribution tax owing to the increase in the amount of dividends available for distribution. It is, thus, there cannot be situation resulting in loss of revenue in subsequent years. It is further submitted in this context, that the assessee has never routed any funds by way of dividends or otherwise to the AE any time from the date of incorporation to date. All the profits of the assessee have been invested in the business of the Company in India. In the circumstances, it is submitted that there is no case to invoke the provisions of Section 10A(7) read with Section 80-IA(10).

(*b*) Business transaction are so arranged to produce more than ordinary profits:

Dealing with the applicability of this situation to the facts of the present case, it is explained that the word "arranged" has been interpreted to suggest a motive to avoid tax by manipulating the profits of the Company. Without appreciating the facts

of the assessee's case and performing an objective analysis, it is submitted, the learned assessing officer has concluded that the Appellant has arranged its business with a view to earn more than ordinary profits. In this regard, reliance is placed on the following rulings in the context of section 80IA(10), wherein it was held that avoidance of tax must be the main motive for provisions to apply and a mere incidental benefit is not sufficient.

- The Hon'ble Supreme Court in the case of *V. N. M. Arunachala Nadar* v. *Commissioner of Excess Profits-tax* [1962] 44 ITR 352
- The Bombay ITAT in context of 80IA(10) in the case of *ITO* v. *P.C.A. Engineers Ltd.* [1984] 8 ITD 518

In this context, it is submitted that the issue under appeal is no more *RES INTEGRA* and has been decided by the following benches of the Tribunals which are squarely applicable to facts of the present case of the assessee:

- *Visual Graphics Computing Services (India) (P.) Ltd.* v. *Asstt. CIT* [2012] 52 SOT 172/21 taxmann.com 145 (Chennai) (URO)
- *Tweezerman (India) (P.) Ltd.* v. *Addl. CIT* [2010] 133 TTJ 308 (Chennai) ;
- *CIT* v. *Schmetz India (P.) Ltd.* [2012] 211 Taxman 59/26 taxmann.com 336 (Bom.) (Mag.);
- *Weston Knowledge Systems & Solutions (India) (P.) Ltd.* v. *ITO* [2012] 52 SOT 120/23 taxmann.com 215 (Hyd.) (URO);
- *Digital Equipment India Ltd.* v. *Dy. CIT* [2006] 103 TTJ 329 (Bang.);

11. Further, the learned counsel also submitted that reliance on the same TP study of the assessee by the Assessing Officer is not correct, as the main TP study was under CUP method on the price was paid in relation to a third party, which is within Arm's Length Standard. It was further submitted that US revenue authorities have not questioned the transfer pricing policy of the SDC US for US Transfer Pricing purposes. It was further submitted that the Assessing Officer also wrongly concluded excess profit on the basis of arithmetic mean when comparables selected by the assessee has a margin varying from - 94.26 % to + 48.32 %. It was further submitted that the assessee has operational advantages as it has less cost on telecommunications and other operational advantage in staff salaries etc. whereas the comparable cases selected are not exactly in BPO business like assessee and they also have software development and other activities. Since the Transfer Pricing Officer accepted that the assessee's transactions are at Arms Length, the Assessing Officer was not correct in invoking the provisions of S.10A(7). It was further submitted that it has received a market price for its services and the reasons for good margin is the pricing policy, location, savings and low cost of work force. Since the operating cost is less, the percentage of profit looks more, but the assessee has received the standard price for its services rendered to the AE. Since the receipts of assessee were fixed, profits increased because of reduction in the operating costs. Therefore, operational efficiency cannot be taken to be detrimental to the assessee's interests as far as earning of profit is concerned. It was further submitted that there was no arrangement between the assessee and its AE and the observations of the Assessing Officer and the CIT(A) that assessee may pass on profit in the form of

dividend is not correct and placed a statement showing analysis of financials from assessment years 2003-04 to 2008-09, which reads as under-

Statement showing analysis of financials from FY 2003-04 to 2007-08

Financial Year	*Average No. of Employees*	*Capital*	*Assets (Net fixed assets- Current assets)*	*Turnover (Sales+ Other Income*	*Profits*	*Dividend paid*
2002-03		1,00,000	5,78,616	48,14,312	(87.069)	No
2003-04	123	1,00,000	3,42,02,207	5,15,14,464	3,16,88,225	No
2004-05	230	1,01,000	7,89,71,564	8,13,93,954	3,57,50,943	No
2005-06	310	1,01,000	11,46,09,415	12,70,92,840	1,08,71,480	No
2006-07	445	1,01,000	21,95,66,251	25,62,62,629	3,03,02,068	No
2007-08	587	1,01,000	21,56,00,194	29,68,43,890	3,59,64,101	No

12. It was further submitted that the assessee has not paid any dividend and all the profits earned in the period were ploughed back into the business. It was further submitted that in later years, the TPO considered the margins earned by the assessee are not at Arm's Length and he made adjustments in the TP assessments which are contested by the assessee, but as far as this year is concerned, assessee's transactions with the AE are at Arm's Length and therefore, the provisions of S.10(A)(7) do not apply.

13. Ld. Counsel further relied on the provisions of S.10A(7), more specifically, the expression "….so far as may be…" to submit that once the TPO accepted the Arm's Length pricing between the assessee and the AE there is no occasion for invoking these provisions, as there is no other party involved to increase the profit. It was further submitted that if the assessee were to receive more profits to be paid as dividend, the tax rate is more and the assessee would be at a disadvantageous position. Therefore, the argument of the Assessing Officer that the assessee may pass on profit in the guise of dividend to the foreign company or to the Director, is not correct.

14. The learned counsel further referred to the amendment brought to the provisions of S.80IA(10) by the Finance Act, 2012 with reference to domestic transfer pricing mechanism in order to provide objectivity in determination of income from domestic related party transactions. It was submitted that the adjustments made by the Transfer Pricing Officer is deemed to be the amount determined under S.80IA(10) with effect from assessment year 2013-14, and this indicates subjective approach being adopted by the Transfer Pricing authority. It was further submitted that the Assessing Officer interpreted the arithmetic mean of profit determined (3% on the sale in the instant case as ordinary profit) whereas the Transfer Pricing Officers themselves computed 39% at the maximum as profit of the BPO service companies and made adjustment to the income of the assessees, in making such analysis independent companies having profit margins of over 100% have been considered as comparables.

15. Summarising the arguments, it was submitted that provisions of S.10A(7) were wrongly invoked, the CIT(A) mixed up the issues with transfer pricing and S.10A(7) and further there is no arrangement between the party and the assessee has not earned any super profits so as to disallow the profits earned by the assessee under S.10A(7).

16. The Learned Departmental Representative in reply however, countered the arguments of the Ld. counsel to submit that there is no restriction under S.10A(7) that the transaction should be only between the two residents of India. The expression "other person" used can also be an AE. Further, the newly inserted proviso to S.80IA(10) with reference to the binding nature of TP adjustment is effective only from assessment year 2013-14. It was further submitted that the transfer pricing study indicates average mean prices at 8-9% whereas the assessee earned profits at 151 %, which is more than the normal profits. It was further submitted that in the case relied upon by the Assessing Officer and the CIT(A), viz. *Weston Knowledge Systems & Solutions India (P.) Ltd.* (*supra*) the ITAT restored the matter to the file of the Assessing Officer for considering the decisions relied upon by the assessee in the case of *Tweezerman (India) (P.) Ltd.* (*supra*) Chennai and *Digital Equipment India Ltd.* (*supra*). It was his submission that the matter can be set aside as additional evidence in the form of certification by the parent company about the Transfer Pricing acceptance by the US authorities are not filed before the Revenue authorities in India.

17. We have considered the issue and perused the orders of the Assessing Officer and the CIT(A). In our opinion, as far as the transfer pricing issues are concerned, the Transfer Pricing matters got settled with the orders of the TPO dated 17.11.2006 with the acceptance of the assessee's value of international transactions to be at Arm's Length. Therefore, as far as the TP study is concerned and justification made by the assessee both under the CUP method and TNMM method the matter should end there itself, and the Assessing Officer should have fresh evidence or details to invoke the provisions of S.10A(7) read with S.80IA(10). What we notice is that the TNMM study itself shows the profit range varying from '- 94.26 % to + 48.32%' as noted earlier. As seen from the comparable companies, most of the companies are in software development, outsourcing and call centre activities as per annexure-3 placed in the TP study. Even though these are selected by the assessee as comparable companies, since the Transfer Pricing Officer has not made any adjustments to the Arm's Length transactions, in our view, the issue of profit of comparable companies has lost its relevance. However, unfortunately, the Assessing Officer considered the arithmetic mean at 8% to be the profit margin of the comparable companies, ignoring various TP studies made by other TP officers in the BPO service sector to an extent of 39%. Further as already stated the profit margin of companies varies to a large extent. What we also notice is that the assessee's receipts are from services rendered to the US company who rendered the services to third parties at US$ 10 per hour, and out of the amount so received, it retained 15% for its marketing and front end expenses and passed on 85% of the price to the assessee. Therefore, the receipts are as considered by the TPO are at arms length. Further, as seen from the summary of the transactions analysed in executive Summary Chapter I of the TP Study, it was very clearly stated that as an investment for the future growth prospects, SDC US has rendered significant managerial, financial and technical support to SDC US free of charge. Therefore, as against Rs.5.14 crores received, the expenditure on payments to staff was only

Rs.88.35 lakhs and administrative and other expenses are Rs.108.54 lakhs with depreciation of Rs.1.34 lakhs. In view of the above, the profit for the years was at Rs.316.88 lakhs as against Rs.87,069 loss on receipts of Rs.48.09 lakhs for the year ending 31.3.2003. This indicates that the assessee's operational cost is very less. This operational cost being less was also justified by the nature of the BPO services undertaken by the assessee in the TP study. It is further mentioned while determining the 'arms' length price' during the financial year 2003-04, SDC US has sub-contracted voice based BPO services to Swift Response Inc USA(SWIFT), an unrelated entity at a rate of USD 10 per hour. Hence, the price paid by SDC US to SWIFT US has been identified as price paid/charged in a comparable uncontrolled transaction. Similarly, it was stated that based on the provisions of Rule 10B regarding application of CUP method, where differences exist between the controlled and uncontrolled transactions, reasonably accurate adjustments would be required. Though it may be difficult to determine reasonably accurate adjustments to eliminate the effect on price, the broadly cost difference between voice based BPO services and non-voice based BPO services has been considered for determining the arm's length price of services provided by SDC US. Telecom cost forms a unique feature of the voice-based BPO business. However, key variable such as bandwidth requirements, cost of international carrier, talk-time cost, etc. vary across different BPO models. As per an India centric study on BPO industry done by CLSA, direct telecom costs of call centre (voice based) BPO business operations average 25% of revenue. However, non-voice based BPO services do not have such high direct telecom costs due to lower utilisation of bandwidth, nil talk-time cost and insignificant cost of international carrier. In the case on hand, it was pointed out, direct telecom cost was only 2.03% of the revenue. The significant difference in the direct cost of voice and non-voice services was required to be adjusted to determine the arm's length price of services provided by SDC US. In the given case, the difference in cost between the voice based BPO services and non-voice based BPO services provided by SDC US is as high as 23%. However, on a conservative basis, the comparable uncontrolled price is adjusted for voice based BPO services by 15% to arrive at the arm's length price for non-voiced BPO services.

18. Therefore, as seen from the non-voice based BPO services rendered by the assessee, the direct telecommunication cost being only 2.03% of the revenue, the operational cost to the assessee is very less. Therefore, profit margin looks very high since the cost of the services to the US company are charged at arm's length price. The operational efficiency of the assessee cannot be considered as earning super profits.

19. In the case of *Tweezerman (India) (P) Ltd.* (*supra*), it has been held by the Chennai Bench of the Tribunal as under-

> 8. We have considered the rival submissions. A perusal of the order of the TPO for the relevant assessment year shows that the TPO has verified the ALP and has confirmed that no adjustment on account of transfer pricing was required to be made. The provisions of transfer pricing relate to international transactions between two or more AEs. The intention of the provisions of transfer pricing is to see to it that when international transactions are done between two or more AEs, the affairs of the enterprises are not adjusted in such a manner as to deprive the country or the local AE of the correct revenue, which would result in the reduction of the taxable income of the local AE in the country. In the present case, undisputedly, the

TPO has confirmed that the local AE being the assessee herein has received the revenue due to it and there is no adjustment made in the affairs of the AE so as to deprive the revenues of the assessee in the country. Reading of the provisions of s. 10B shows that the deduction of the profits and gains derived by the assessee from 100 per cent export-oriented undertaking is granted. The provisions of s. 10B(7) provide for the applicability of the provisions of s. 80-IA(10) and sub-s. (8) when computing the profits and gains of 100 per cent export oriented undertaking. The provisions of sub-s. (10) of s. 80-IA which have been invoked in the present case provide that if the AO is of the opinion that owing to the connection between the assessee carrying on the eligible business with another person the business between them is so arranged so that as a result of the business transacted between the eligible person and other person, the profit of the eligible person is inflated so as to claim the exemption provided, then the AO, while computing the profits and gains of the eligible business for the purpose of granting deduction can readjust the amount of profit as would reasonably be derived from such eligible business. Here, in the present case the TPO has categorically given a finding that the income of the assessee is at the arm's length. One must keep in mind that the intention of transfer pricing is also on similar lines as s. 80-IA(10) insofar as under the provisions 5 of transfer pricing it is to verify as to whether the local AE is getting its right share of revenue and as per s. 80-IA(10), it is to verify and adjust the profits of an eligible business so that under the garb of the eligible business the taxable income of an AE is not reduced by shifting its income to the eligible business. However, he has given a further fact in his order that the profit level indicator of the assessee is higher than the mean of the profit level indicator of the comparable cases. The assessee has been right from the beginning claiming that M/s Rahul Electricals & Electronics, which showed a low ratio of profit before tax to sales was not a comparable. This has not been refuted by either the TPO or the AO. In fact, with the comparable, which the assessee itself is pointing out being a sister-concern of the assessee showed the ratio of the PBT to sales at 90.1 per cent, if M/s Rahul Electricals & Electronics is being considered as comparable and had shown a PBT to sales at 7.3 per cent, has the TPO taken any action under transfer pricing against M/s Rahul Electricals & Electronics has also not been placed before us. This is because, afterall the assessee-company is showing a higher margin and complying with the intention of the transfer pricing policy in the country, whereas the comparable which has been taken by the TPO and the AO showed a far lower margin than even the mean of the profit level indicator of the so-called comparables. At the time of hearing, the learned Departmental Representative was vehemently of the view that the transfer pricing action by the TPO at the behest of the AO was a separate proceeding and the AO while completing the assessment by invoking the provisions of s. 10B(7) r/w s. 80-IA(10) was doing an independent action though using the evidence and documents which had been submitted before the TPO. Even if this submission of the learned Departmental Representative is accepted, then it becomes incumbent upon the AO to specify as to why he feels that the profits disclosed by the assessee are higher than the ordinary profits which might be expected to arise in the assessee's business. The provisions of s. 80-IA(10) do not give an arbitrary power to the AO to fix the profits of the assessee.

The AO has to specify as to why he feels that the profits of the assessee are being shown at a higher figure, which he has done by alleging the close proximity between the assessee and the USA company with whom the assessee is transacting. He has further to show as to how he has computed the ordinary profits which he deems to be the ordinary profits which the assessee might be expected to generate. Here, the AO failed insofar as he has blindly taken a calculation which the assessee has given before the TPO which the assessee himself has admitted to be erroneous and the errors have been corrected and the fresh calculation given. This calculation is also not a calculation for determining the ordinary profits which the assessee might be expected to Generate . The AO would be expected to use a comparable case to determine the possible ordinary profit which the assessee could be expected to generate from his business. In the absence of any other substantial evidence available with him, when using a comparable, the assessee's own past and future performance would obviously be the best comparable. Comparing the assessee's modus operandi of conducting its business with another when the same are not of equal terms would be a travesty of justice insofar as the financial charges, the use of the plant and machinery, the depreciation thereon, the location which would affect the cost of transportation as also the cost of the labour, cost of power and fuel would have to be seen. These are but only some factors which would affect the comparability when comparing two different enterprises. M/s Rahul Electricals & Electronics which has a turnover of only Rs. 1.28 crores, obviously cannot be compared with the assessee which has the turnover of more than Rs. 15.06 crores. Further, from the order of the TPO, M/s Rahul Electricals & Electronics is also in the business of making tools, which include tweezers, whereas manufacture of tweezers is nearly 90 per cent of the total manufacturing of the assessee. The fact that the AO has also not shown any calculation on the basis of which he has determined Rs. 3.54 crores is the excess profit received by the assessee cannot stand in view of the fact that he has not shown as to what he feels is the actual ordinary profit which the assessee could have generated nor has he shown any particulars he has used for arriving at such a figure especially when the assessee himself has filed the calculation showing the error in the difference between the profits and the ALP as filed before the TPO. Under these circumstances, we are of the view that the reduction of the eligible profits of the assessee by an amount of Rs. 3.54 crores as done by the AO by invoking the provisions of s. 80-IA(10) r/w s. 10B(7) of the Act is unsustainable and consequently the same is deleted *in toto*."

20. In the case of *Digital Equipment India Ltd.* (*supra*), which was relied upon by the Assessing Officer and the CIT(A), the coordinate bench has considered the issue as follows-

"Exemption u/s 10A-Computation-Applicability of sec 80-I(9) r.w.s. 10A(6)-For invoking sec 80-I (9), AO has to adduce evidence and cogent reasons-Profits earned being comparable with profits earned by other companies in the same industry, there was no case for further verification-One cannot presume the existence of close connection or possibility of an arrangement for earning more than ordinary profits within the meaning of sec 80-I(9)-Maintenance of separate books means only that books are kept in such a manner that results of the unit can

be shown separately-In the absence of any evidence and cogent reasons showing close connection and arrangement as envisaged in sec 80-I(9), addition made by the Assessing Officer by invoking sec 10A(6) r.w.s. 80-I(9) was not well founded:

Held:

The requirements u/s 80-I(9) are: (a) there must be a close connection between the appellant and other person; (b) the course of business between them should be so arranged that it produces to the appellant more than the ordinary profits from such business. To satisfy the above test the AO has to adduce evidence and reasons cogently and the same is open to verification by the appellate authorities. The primary rule of evidence is that "what is apparent is real" unless proved otherwise by the person alleging it otherwise. The manner of satisfaction outlined in the section should be based on evidence and not on surmise or suspicion. The question is not whether the onus is light or heavy but whether the AD has discussed objectively the conditions mentioned in the section to disturb the results declared by the appellant. In this case, the AD has failed to adduce any evidence or reason to satisfy the invoking of s. 80-1(9). First of all, a mere substantial profit does not give rise to any valid view that there could be any arrangement. It is a case of joint venture listed Indian company, where all arrangements are open for scrutiny and acceptance not only by digital group worldwide but also from joint venture partners and shareholders. Digital group overseas will not pay undue sum, which it cannot recoup entirely to exclusion of others. Hence nothing can be arranged to the exclusive benefit of overseas partner. One cannot presume the existence of close connection or possibility of an arrangement for earning more than ordinary profits. In this case the profits earned is comparable with the profits earned by other companies in the same industry. Hence, there is no case for further verification. The AD has compared the profit of software unit with that of hardware unit. Thus the foundation itself is on wrong premise. There cannot be comparison between an orange and an apple. It is known fact that profitability of software units is always higher than hardware unit. The test whether the appellant has earned more than ordinary profits, in this case, the answer is obvious no, even as found by the AD. When the profits earned are reasonable and not excessive, there is no reason to sustain the addition. Further there is no evidence of existence of any arrangement as contemplated under s. 80-1(9). Further on the issue of separate books one has to see whether the books maintained by the appellant enables computation of profits from the activity, if it is so, such records meet the test of separate books. Separate books do not mean it should be a separate daybook or ledger. It means such books or records from which profits can be computed. If the unit books are combined with other activities, the appellant should make efforts to cull out or separate the entries pertaining to the unit and maintain and produce records or statement separating the results. Such an effort would be sufficient to comply with the condition. In fact, s. 80-1(9) nowhere mentions maintenance of separate books. The addition made by AD in invoking 10A(6) r/w 80-1(9) is not well founded.

Conclusion:

In the absence of any evidence and cogent reason showing close connection and arrangement as envisaged in s. 80-1(9), addition made by AD by invoking s. 10A(6) r/w s. 80-1(9) was not sustainable."

21. In view of the decisions of the Coordinate Benches of the Tribunal we hold that the exercise undertaken by the Assessing Officer under S.10A(7) is neither sustainable on facts nor under the provisions of law. The learned DR requested for setting aside the order to AO on the reason that the decision in *Weston Knowledge Systems & Solutions (India) (P.) Ltd* (*Supra*) was set aside by the ITAT to the Assessing Officer and since Assessing Officer and the CIT (A) relied on that order, it is necessary to restore the matter to the Assessing Officer. We have considered this request also. The Coordinate Bench in the above referred case has relied on the decision in the case of *Tweezeman (India) (P.) Ltd* (*Supra*) and *Digital Equipments India Ltd.* (*Supra*). In that case the issue was set aside to the file of the Assessing Officer with a direction to verify the comparables where the issue was taken up under the transfer pricing provisions. In this case as already stated above, the transfer pricing study has not resulted in any addition and ALP was accepted. As rightly pointed out by the learned Counsel, the receipts are fixed at US$ 8.5 per hour and the margin of profit became higher only because the operation costs were less being in the non voice based BPO services. Even though the authorities relied on "arranged" transaction between the assessee and AE, we do not see any such arrangement on the facts of the case. Nor there is any passing of profits directly or indirectly. In view of this, since the assessee's operations are efficient enough to obtain more profits and since the receipts are at arms length and there is no passing of excess profits by the parent company (AE) to the assessee, we are of the opinion that Assessing Officer's action in restricting the profits is not correct. We also do not see any reason to restore it to the Assessing Officer since there is nothing else to examine. Accordingly, we allow the grounds of the assessee and direct the Assessing Officer to treat the profits declared by the assessee as ordinary profits and allow deduction under S.10A, without any further adjustment.

22. In the result, assessee's appeal is allowed.