

ITAT: Includes comparables, rejects Revenue's observation qua persistent losses

Aug 13, 2021

Morgan Stanley Advantage Services Pvt Ltd [TS-336-ITAT-2021(Mum)-TP]

Conclusion

Mumbai ITAT rules on selection of comparables for assessee (a captive service provider providing ITes to its AE) for AY 2008-09; Considers CIT(A)'s observation of holding assessee to be a routine ITES/BPO service provider engaged in providing back office support services; Accepts assessee's plea and excludes 3 comparables, namely, E-clerx Services Ltd, Coral Hubs Ltd (earlier known as Vishal Information Technologies Limited) and Crossdomain Solution on grounds of being KPO companies, having abnormally low employee cost, outsourcing its vendors etc, relies on precedents; Further, ITAT accepts assessee's plea and includes Allsec Technologies and CG Vak Software & Exports Ltd, rejects Revenue's plea of excluding these companies on the premise of being consistent loss making companies; Notes that since these companies had shown profit in the preceding two AYs and it is only during current AY that the companies have reported loss, these companies cannot be considered as consistent loss making companies; Also accepts assessee's plea and includes R Systems International Ltd, rejects ground of different FY ending by noting that Revenue has not examined whether contemporaneous data of the company relating to the FY corresponding to the FY of the assessee is available or not; Accordingly, after exclusoin and inclusion of the aforesaid companies, ITAT directs AO to compute the ALP of the international transactions. :ITAT Mum

Decision Summary

The ruling was delivered by ITAT bench of Shri Saktijit Dey and Shri Manish Borad.

Mr. Sunil M Lala argued on behalf of the assessee while Revenue was represented by Mr. Manpreet Duggal.

AY 2008-09

International transaction in dispute- Provision of ITES

| Name of the comparable | Proposed by | PLI considered | ITAT conclusion | ITAT observation |
|--|-------------|----------------|-----------------|--|
| Comparables sought to be excluded by the assessee | | | | |
| eClerx Services Ltd | TPO | 65.88% | Excluded | <p>Before ITAT, assessee plea that these companies on the grounds of being KPO companies were engaged in providing back office support services against assessee's routine ITES/BPO service provider.</p> <p>ITAT noted that it was a well settled law that KPO service providers are not eligible for inclusion as comparables. ITAT further noted that these companies were KPO service providers.</p> <p>Further noted that it had been held in several precedents including the decision in the case of Rampgreen Solutions Pvt Ltd where these companies were excluded as they were KPO service providers.</p> <p>ITAT further stated that CIT(A) was in error by including these two companies as comparables.</p> |

| | | | |
|---------------------|--------------|--------|----------|
| Crossdomain Limited | SolutionsTPO | 29.96% | Excluded |
|---------------------|--------------|--------|----------|

that it had held the assessee w

ITAT further relied on coordina
own case for earlier AYs which
HC decision in case of Rampg
these companies were exclude
dissimilarity as these compani
KPO services, which substantia
service provider.

| | | | |
|--|--|--------|----------|
| Coral Hubs Limited (earlier,TPO Vishal Information Technologies Limited) | | 50.68% | Excluded |
|--|--|--------|----------|

Following the aforementioned
exclusion of these compan
comparables

ITAT noted that this company
cost, which, pre-supposed th
company was outsourced to
assessee itself provided service

In this backdrop, ITAT opined t
company was completely differ

ITAT further stated that the as
this company in the TP analys
data available in public domain

Further noted that this cor
comparable in host of rulings i
HC in case of Rampgreen Solu
business model.

ITAT further relied on coordin
yearswherein this company wa
the function performed of thi
different as this company ha
against assessee wherein the
employing own employees
infrastructure.

Following the aforementioned
exclusion of this company from

Comparables sought to be included by the assessee

| | | | |
|---------------------|----------|----|----------|
| Allsec Technologies | Assessee | NA | Included |
|---------------------|----------|----|----------|

ITAT noted that these comp
CIT(A) on the ground that thes
loss making companies.

On perusal of annual reports o
that both the companies had
two AYs and that it was only
companies had reported loss.

In this backdrop, ITAT held th
as consistent loss making comp

Further noted that comparabi
squarely covered by coordina
case for earlier AYs wherein th
as comparables sans any spec
TPO and that the said compa
comparable in earlier AY by the

| | | | | |
|-----------------------------------|------------------------|----|----------|--|
| CG Software Exports Ltd R Systems | VakAssessee & Assessee | NA | Included | Accordingly, ITAT directed the in the final list of comparables. |
| International Ltd | | NA | Included | ITAT noted the Revenue had comparable on the sole reason ending. However, ITAT noted that, whether contemporaneous data to the FY corresponding to is available or not. Further noted that comparables squarely covered by coordinating case for earlier AYs wherein included as comparables as provided by the TPO and that accepted as comparable in earlier Accordingly, ITAT directed the the final list of comparables. |

Ruling Relied Upon

- ITAT: Rules in assessee's favour; Excludes 11 comparables for ITeS provider
- [TS-722-ITAT-2019\(Mum\)-TP](#)
- ITAT: Rejects characterization of ITeS-provider as KPO; Includes 3 comparables rejected without specific-reasoning
- [TS-368-ITAT-2020\(Mum\)-TP](#)

Case Law Information

Taxpayer Name

- Morgan Stanley Advantage Services Pvt Ltd

Judicial Level & Location

- Income tax Appellate Tribunal Mumbai

Date of Ruling

- 2021-08-12

Ruling in favour of

- Assessee

Section Reference Number

- [92B](#)
- [92C](#)
- [92D](#)

Nature of Issue

- Availability of Data
- Captive service provider
- Financial year
- High end services vis--vis Low end services
- KPO vs BPO
- Loss Making comparables
- Rulings having discussion on comparability of specific companies
- Provision of Information Technology Enabled Services (ITeS)
- Rule of Consistency

Judges

- Shri Saktijit Dey

Counsel for Tax Payer

- Shri Sunil M Lala

Counsel for Department

- Mr Manpreet Duggal

Industry

- Information Technology enabled Services

IN THE INCOME TAX APPELLATE TRIBUNAL
“J” BENCH, MUMBAI

BEFORE SHRI SAKTIJIT DEY (JUDICIAL MEMBER)
AND
SHRI MANISH BORAD (ACCOUNTANT MEMBER)

I.T.A. No.6522/Mum/2014
(Assessment year 2008-09)

| | | |
|--|----|---------------------------|
| Morgan Stanley Solutions Advantage Services Pvt Ltd (As a successor of Morgan Stanley Solutions India Pvt Ltd), Athena Building no. 5, Sector 30, Mindspace, Goregaon (W), Mumbai-400 090 PAN : AADCM7403M | vs | Dy.CIT,Range 9(2), Mumbai |
| APPELLANT | | RESPONDENT |

| | |
|---------------|---------------------------|
| Appellant by | Shri Sunil M Lala, (AR) |
| Respondent by | Shri Manpreet Duggal (DR) |

| | |
|-----------------------|------------|
| Date of hearing | 09-08-2021 |
| Date of pronouncement | 12-08-2021 |

ORDER

Per Saktijit Dey (JM)

Captioned appeal by the assessee arises out of order dated 29-08-2014 of learned Commissioner of Income Tax (Appeals)-11, Mumbai for the assessment year 2008-09.

- The grounds raised by the assessee are in respect of a common issue relating to addition made on account of transfer pricing adjustment.

3. Briefly the facts are, the assessee, a resident company, is a part of Morgan Stanley group and as a captive service provider, provides back office support services to group entities, worldwide. Thus, the services provided by the assessee are in the nature of information technology enabled services (ITES). In the year under consideration, the assessee had entered into international transactions with its overseas associated enterprises (AEs) by providing back office support services and has earned revenue of Rs.33,62,71,615/-. Assessee has benchmarked the transactions with the AEs by adopting transactional net margin method (TNMM) as the most appropriate method. For comparability analysis, the assessee selected 13 companies which was subsequently reduced to 7 with arithmetic mean of 16.91%. Since, the margin shown by the assessee was higher than the average margin of the comparables, the transaction with AEs was claimed to be at arm's length. The transfer pricing officer, however, did not accept the benchmarking of the assessee. After analyzing the functionality of the assessee, he held that the services provided by the assessee are in the nature of knowledge process outsourcing (KPO) services which falls within the broad category of ITES/BPO services. Thus, he was of the view that the companies providing KPO services would be functionally similar to assessee; hence, have to be selected as comparables. Whereas, he observed, the assessee has excluded all KPO companies. Further, applying certain additional filters, he rejected almost all the comparables of the assessee. Having done so, the TPO proceeded to select comparables independently. In the process, he shortlisted the following companies as the final set off of comparables with average margin of 49.88%:-

| | | |
|---|---|-------|
| 1 | Accropetal Technologies Limited (Segmental) | 35.30 |
| 2 | Coral Hubs Limited (earlier, Vishal Information Technologies Limited) | 50.68 |

| | | |
|---|-------------------------------|-------|
| 3 | Crossdomain Solutions Limited | 29.96 |
| 4 | Eclerx Services Limited | 65.88 |
| 5 | Mold-Tek Technologies Limited | 96.66 |
| 6 | Triton Corp Limited | 23.81 |
| | Average | 49.88 |

4. Applying the average margin of 49.88% to the operating cost, the TPO determined the ALP at Rs.43,93,06,335/-. Thus, the resultant shortfall of Rs.10,30,34,720/- was proposed as adjustment to the ALP. Assessee contested the aforesaid adjustment before learned Commissioner (Appeals). After considering the submissions of the assessee, learned Commissioner (Appeals) excluded three comparables, viz. Accropetal Technologies Limited (Segmental), Mold-Tek Technologies Limited, and Triton Corp Limited, out of the comparables selected by the TPO while retaining the balance three. Being aggrieved, the assessee is before us.

5. Though, the assessee has raised multiple grounds on various aspects of the TP adjustment; however, at the time of hearing, learned counsel for the assessee restricted his argument to selection/rejection of certain comparables.

6. He submitted, the first appellate authority has accepted assessee's contention that it is not providing KPO services. Therefore, he submitted, the companies which have been finally retained, being KPO companies, cannot be treated as comparable. He submitted, the benchmarking done by the assessee in the preceding three assessment years by characterizing it as an ITES/BPO company was accepted by the TPO. Therefore, there is no justifiable reason to treat the assessee as a KPO company. He submitted, before the merger with the present assessee, the merged company, Morgan Stanley Solutions India Pvt Ltd was carrying out the same services as is being carried out by the present assessee.

He submitted, for the impugned assessment year, two parallel proceedings were undertaken in case of Morgan Stanley Solutions India Pvt Ltd, the merged company and Morgan Stanley Advantage Solutions India Pvt Ltd, the successor company. He submitted, identical orders were passed by TPO and learned Commissioner (Appeals) in respect of both the companies selecting same set of comparables. He submitted, even in the case of successor company, the TPO had re-characterized the services as KPO services. He submitted, when the successor company disputed the selection/rejection of comparables before the Tribunal in order dated 23-07-2020, the Tribunal, holding that the assessee as an ITES/BPO service provider, rejected KPO companies, such as, eClerx Services Ltd, Coral Hubs Limited (Vishal Information Technologies Limited) and Crossdomain Solutions Limited. Further, the Tribunal directed inclusion of three comparables selected by the assessee, viz. Allsec Technologies, R Systems International Ltd and CG Vak Software & Exports Ltd. Thus, he submitted, issue is squarely covered by the decision of the Tribunal.

7. The learned departmental representative submitted, the assessee has not properly applied the filters which otherwise are applicable for selection of comparables. He submitted, the nature of services provided by the assessee would categorize it as a high end BPO service provider. He submitted, the comparables selected should be retained.

8. As regards inclusion of certain comparables selected by the assessee, the learned departmental representative submitted, Allsec Technologies and CG Vak Software & Exports Ltd are consistent loss making companies. He submitted, the reasons for which the companies have made loss are not forthcoming. He

submitted, whether loss is on account of any extraordinary event, such as, merger / demerger, requires to be examined.

9. In rejoinder, learned counsel for the assessee submitted, Allsec Technologies and CG Vak Software & Exports Ltd cannot be considered as consistent loss making company, as, they have incurred loss only in the current year, whereas, they have shown profit in the preceding two assessment years.

10. We have considered rival submissions and perused materials on record. As discussed earlier, the dispute before us is confined to selection/rejection of certain comparables. Before, we proceed to deal with the acceptability or otherwise of the comparables disputed before us, it is necessary to observe, the assessee, undoubtedly, provides back office support services to its group entities. The assessee has claimed itself to be a routine ITES/BPO service provider, whereas, the TPO has re-characterized the assessee as a KPO company and accordingly, has selected similar nature of companies. However, learned Commissioner (Appeals) has accepted assessee's contention that it is not a KPO service provider. Admittedly, the department has not challenged the aforesaid decision of the first appellate authority. Thus, keeping in perspective the aforesaid factual position, we have to examine whether certain companies are comparables to the assessee or not.

11. At the outset, we will deal with the companies selected by the TPO, viz. eClerx Services Ltd, Coral Hubs Limited (Vishal Information Technologies Limited) and Crossdomain Solutions Limited. As far as eClerx Services Ltd and Crossdomain Solutions Limited are concerned, now it is fairly well settled that these two companies are KPO service providers. This has been held in a number of judicial precedents including the decision of the Hon'ble Delhi High Court in case of

Rampgreen Solutions Pvt Ltd vs Commissioner of Income Tax 377 ITR 533 (Del). In our view, learned Commissioner (Appeals) has made a fundamental error by including these two companies in spite of the fact that he himself was satisfied that the assessee is not a KPO service provider. As regards Coral Hubs Limited (earlier, Vishal Information Technologies Limited), it is a fact on record that it has abnormally low employee cost, which, pre-supposes that most of the work of this company is outsourced to third party vendors. Whereas, assessee itself provides services without outsourcing. Therefore, the business model of the company is completely different from the assessee. Though, it may be a fact that in the TP study analysis, the assessee has included Vishal Information Technologies Limited as a comparable, may be, due to insufficient data available in public domain, however, as has been held in a number of judicial precedents including the decision of the Hon'ble jurisdictional High Court in case of Rampgreen Solutions Pvt Ltd vs CIT (supra), due to its different business model the company cannot be treated as comparable. Therefore, the aforesaid three companies cannot be treated as comparable to the assessee.

12. As regards assessee's contention regarding inclusion of three comparables, viz. Allsec Technologies, CG Vak Software & Exports Ltd and R Systems International Ltd, the primary objection of the learned departmental representative is, Allsec Technologies and CG Vak Software & Exports Ltd are consistent loss making companies. However, on perusal of material on record including the statement of fact filed before learned Commissioner (Appeals), we have noticed that both these companies have shown profit in the preceding two assessment years. Only in the current assessment year, the companies have reported loss. Therefore, they cannot be considered as consistent loss making

companies. As far as R Systems International Ltd is concerned, the only reason for exclusion is it has a different financial year ending. The departmental authorities have not examined whether contemporaneous data of the company relating to the financial year corresponding to the financial year of the assessee is available or not. In the aforesaid factual positions, we do not find any strong reason to uphold the decision of the departmental authorities in excluding the aforesaid three companies selected by the assessee.

13. Pertinently, while framing the order under section 92CA(3) of the Act in case of the successor company (the present assessee) with whom the erstwhile company merged, the transfer pricing officer had passed an identical order selecting/rejecting the very same comparables by re-characterizing the successor company as a KPO service provider. In an identical order learned Commissioner (Appeals), though, held that the successor company is not a KPO service provider; however, he retained some of the companies selected by the TPO while upholding the rejection of companies selected by the concerned assessee. While deciding the appeal filed by the concerned assessee in *Morgan Stanley Advantage Services (P) Ltd vs DCIT* (2020) 118 taxmann.com 112 (Mum–Trib), the Tribunal has held, as under:-

10. We have carefully considered the submissions and perused the records. The assessee in the present case is a subsidiary of Morgan Stanley International Holdings Incorporated USA. The assessee provides back office support functions to its associated enterprises. The transactions of IT Enabled Support Services to its associated enterprises and the arms length price computed by the assessee was accepted by the revenue in A.Y. 2005-06 and A.Y. 2006-07. The same was also upheld by the ITAT for assessment year 2007-08. For the current assessment year, the Transfer Pricing Officer characterized the assessee's functions as knowledge process outsourcing KPO. Thereafter, the Transfer Pricing officer made general comments on the selection systems adopted by the assessee. He proceeded to reject the same. He did not specify as to which of the comparables is being rejected for which specific reasons thereof. Thereafter, the transfer pricing officer mentioned his own criteria and proceeded to select comparables and accordingly made the transfer pricing adjustment. Upon the assessee's appeal, the Id. CIT(A) has accepted that the

characterization by the transfer pricing ' officer of the assessee's functions as knowledge process outsourcing was not correct. Thereafter, the Id. CIT(A) contradicted himself by stating that the functions of the assessee are in alignment with the knowledge process outsourcing comparable dealt with by the transfer pricing officer. In this regard, the learned CIT appeals relied upon the ITAT decision in the case of Maersk Global Centers (India) (P.) Ltd. Thereafter, the learned CIT(A) upheld the assessing officer's action of selection of four of the comparables and accepted the assessee's contention in rejection of the two comparables.

Now in appeal before us, the submission of the learned counsel of the assessee is that assessee's functions are that of ITES which has been duly accepted by the revenue as well as by the ITAT in earlier years. Hence, the re-characterisation of the assessee's functions as knowledge process outsourcing is not sustainable. We are in full agreement with this contention. Furthermore, we find that the Id. CIT(A) has clearly contradicted himself by stating both that assessee is not a KPO and at the same time accepting the comparables selected by the Transfer Pricing Officer from the database for knowledge process outsourcing companies.

13. As regards the rejection of four companies, it is the submission of learned counsel of the assessee that the functions of Eclerx Services Ltd. and Vishal Information Technologies Ltd. (earlier Coral Hub Ltd.) has been held to be not comparable to the assessee by the ITAT for the assessment year 2007-08. In this regard, we find that ITAT in the aforesaid order has observed as under:

“32. As noted earlier the Id. AR for the assessee submitted that the assessee submits that Eclerx Services Ltd. has not considered as a comparable in earlier years. Eclerx Services Ltd. is a Knowledge Process Outsourcing (KPO) Service provider which is not comparable to assessee; assessee is engaged in providing back office support services. In support of his submission, the Id. AR of the assessee relied upon the decision of Delhi High Court in *Rawpgreen Solution (P.) Ltd. v. (77 (20 151 377 ITR 533 (Delhi))*. The TPO included this comparable by taking his view that this company is in date process and analytical services. The Id. CIT(A) confirmed the action of the TPO by taking his view that this comparable company is into the health care receivable management and therefore renders ITeS services. The Hon'ble Delhi Court in *Rampgrech Solution (P.) Ltd. (supra)* held entities rendering voice call center services for customer support and a KPO service provider employ IT-based delivery systems, but characteristics of services, functional aspects, business environment, risks and quality of human resource employed are materially different; and therefore, benchmarking international transactions on basis of comparison of PLI of high-end KPO service providers with PLI of Voice Call Centers, would be unreliable. Further, Mumbai Tribunal in *Wills Processing Services (India) Ltd. v. ACIT (supra)* on considering similar contentions excluded this comparable.

services to overseas markets and included in the list of comparable. The Id. CIT(A) confirmed the action of TPO holding that the TPO conducting benchmarking after calling information under section 133(6) and is benchmarking analysis arc correct. We have noted that, though the Id. AR has relied upon a number of decisions of Tribunal/co-ordinate bench. We have noted that in a recent decision of Tribunal in *Wills Processing Services (I) (P.) Ltd. (supra)* on comparability, the Tribunal held as under:

We though in light of our aforesaid observations had partly disagreed with certain grounds as had been averred by the Ld. AR to facilitate exclusion of the aforesaid comparable, however as observed by us hereinabove that the aforesaid comparable *viz.* Coral Hub Limited (earlier known as Vishal Information Technology Limited) had a business model where services are outsourced, as against the business model of the assessee where services are rendered by employing own employees and using one's own infrastructure, on the basis of which we are of the considered view that it can safely be concluded that the said comparable was functionally different, and as such was liable to be excluded from the final list of comparables. That our aforesaid view stands fortified by the aforesaid order passed by the Tribunal while disposing of the appeal of the assessee's own appeal for A.Y. 2005-06, as well as the judgment of the Hon'ble High Court of Delhi in the case of *Rampgrcen Solutions (P.) Ltd. (supra)*. Thus as there has been no material shift in the facts involved in the case of the assessee for the year under consideration, as observed by us hereinabove, we are thus of the considered view that as the business model of the aforesaid comparable, *viz. Coral Hub Ltd. (supra)* is substantially different from that of the assessee, therefore the same cannot be accepted as a comparable and hence is directed to be excluded from the list of comparables."

14. Accordingly, following the aforesaid decision of the tribunal, we holding that the Eclerx Services Ltd. and Vishal Information Technologies Ltd. (earlier Coral Hub Ltd.) are liable to be rejected as invalid comparable.

As regards the other comparables namely Crossdomain Solutions and Datamatics Financial Services, we find ' that the Transfer Pricing officer and the Id. CIT(A) have found their functions to be similar to that of KPO I and that of Eclerx and Vishal technologies. Since, the ITAT has duly upheld the rejection of the aforesaid /. companies, *i.e.*, these two companies are also liable to be rejected. Furthermore, Datamatics Financial// Services also fails the export filter of 75% which has been adopted by the transfer pricing officer. Hence, inl ' the background of aforesaid, we hold that following comparable are to be rejected:

* Eclerx Services Ltd.

* Vishal Information Technologies Ltd.

* Crossdomain Solutions

* Datamatics Financial Services.

15. Now we deal with the following comparables which were selected by the assessee, but have been rejected by the Transfer Pricing officer:

* Allsec Technologies

* R Systems International Ltd.

+ CG Vak Software & Exports Ltd.

16. The Transfer Pricing Officer has not mentioned the specific reasoning in rejecting the above comparable. While discussing his general reasoning for election/rejection, the transfer pricing officer mentioned that he is only accepting comparables where the current year data are available. In this regard, we note that though initially the assessee had submitted two-year data, subsequently, it has duly submitted the current year data. The transfer pricing officer has also mentioned that he is rejecting the persistent loss making companies. Though some of these companies have suffered loss in the current assessment year the average of two years showed the robust positive figure. Hence, it cannot be said that these are persistently loss making

company. Furthermore, we note that these comparables have been duly accepted as comparable in earlier assessment year by the officer himself. Hence, taking a contrary stand by the transfer pricing officer without giving a specific reasoning is not sustainable. Accordingly, we direct for inclusion of these comparables.”

14. Thus, as could be seen, in parallel proceedings undertaken in case of the successor company having identical business model, the Tribunal has already decided issues relating to selection/rejection of comparables as are disputed in the present appeal. Thus, facts being identical, the aforesaid decision of the co-ordinate bench would squarely apply.

15. In view of the aforesaid, we direct the assessing officer to include R System International Ltd, Allsec Technologies and CG Vak Software & Exports Ltd as comparables. Whereas, he is directed to exclude eClerx Services Ltd, Coral Hubs Limited (earlier, Vishal Information Technologies Limited) and Crossdomain Solutions Limited from the list of comparables. After completing the aforesaid exercise, he must compute the ALP of the international transactions. Grounds 4 and 6 are allowed. Whereas, other grounds being purely of academic interest are dismissed.

16. In the result, appeal is allowed as indicated above.

Order pronounced on 12/08/2021.

Sd/-

sd/-

| | |
|--------------------------|------------------------|
| (MANISH BORAD) | (SAKTIJIT DEY) |
| ACCOUNTANT MEMBER | JUDICIAL MEMBER |

Mumbai, Dt : 12/08/2021

Pavanan

Copy to :

1. Appellant
2. Respondent
3. The CIT concerned
4. The CIT(A)
5. The DR, ITAT, Mumbai
6. Guard File

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By Order

Asstt. Registrar, ITAT, Mumbai