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* **IN THE HIGH COURT OF DELHI AT NEW DELHI****Decided on : 24.02.2015**+ **ITA 115/2015, C.M. APPL.3043/2015, 3044/2015 & 3045/2015**

CIT-V

..... Appellant

Through : Sh. N.P. Sahni, Sr. Standing Counsel
with Sh. Nitin Gulati, Jr. Standing Counsel.

Versus

NORTEL NETWORKS INDIA A PVT. LTD. Respondent

Through : Sh. Deepak Chopra and Ms. Manasvini
Bajpai, Advocates.**CORAM:****HON'BLE MR. JUSTICE S. RAVINDRA BHAT****HON'BLE MR. JUSTICE R.K. GAUBA****MR. JUSTICE S. RAVINDRA BHAT (OPEN COURT)**

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1. The Revenue is in appeal against a common order of the Income Tax Appellate Tribunal (ITAT) in ITA 4765/Del/2011 and 425/Del/2013. The ITAT had allowed the assessee's appeals. The question of law urged in this case is:



“Whether the ITAT fell into error in directing inclusion of data and particulars pertaining to Cyber Media Events Limited in the transfer pricing studies, to determine arm’s length price (ALP) for the purpose of income tax.”

2. The assessee is engaged in installation, maintenance, repairing, sales and supply of plant, equipment and apparatus for the purpose of communication of all kinds. It also provides marketing and after sales services to Nortel Group of Companies. As it was obliged to, the assessee submitted a Transfer Pricing Report (TPR) for A.Y. 2007-08 and 2008-09. The Transfer Pricing Officer (TPO) accepted the ALP of all international transactions except one provision of marketing and after sales support services, concluding that the transaction was not at arm’s length. In this segment of the assessee’s activities, it had entered into service agreement for provision of marketing and after sales service on cost mark-up basis. The assessee provides marketing and after sales services to Associated Enterprises (AEs) in relation to sale of telecommunication equipments, software and other IT products to the customers in India. The assessee adopted Transactional Net Margin Method (TNMM) indicating Rule 10B(1)(e) of the Income Tax Rules as the most appropriate method and benchmark for turnover, taking operating profit/operating cost as the Profit Level Indicator (PLI). The TPO, even while accepting the TNMM method as the most appropriate, rejected its analysis so far as it related to interpretation of the comparables. The assessee had, in this context, relied upon the data relating to seven comparable enterprises whose average unadjusted profit margin worked to 11.5%. The TPO determined that two out of these seven



were not comparables. This determination, as it pertained to M/s. Cyber Media Events Private Limited was accepted by the assessee. The other – M/s. Capital Trust Ltd. was held not to be a comparable on account of its low revenue. The related party turnover in respect of this comparable exceeded 25% and was a diminishing revenue. The AO incorporated the report and framed final assessment order.

3. The assessee approached the DRP. The DRP accepted the TPO's reasoning that the segment turnover of the excluded company, i.e. M/s. Capital Trust Ltd. was only ₹25 lakhs and constituted less than 2% of the total turnover of the company and, therefore, the assessee could not use its data. The DRP concurred with the view of the TPO and held as follows:

“Thus the TPO held that Capital Trust Ltd. is not a comparable company. We are in agreement with the TPO. We decline to interfere and hold that the Capital Trust Ltd. is not a comparable company, because its revenue from “Foreign Consultancy” (not from Marketing & Sales Support Service) is only Rs.25 lacs. Though we agree that in service industry turnover as such does not play significant role and normally there is no discernible link between turnover and margins but companies with very low sales base it may not lead to a proper comparability as the data of these companies is not reliable due to their low cost/sale base. Further, the reliability of the financial data for companies with low levels of sales/operating income can be significantly reduced because the same persons are often both major shareholders and also the key employees, thereby obliterating the economic distinction between profits and salaries. Also the companies having very small turnover are to be excluded because the margins earned by these



companies fluctuate to extremes because of the narrow base. Such Companies lack Competitive Strength, lack operational efficiencies and also lack human resources, which is the main strength of service sector. Therefore a company with a small turnover of Rs.25 lacs cannot be taken as a comparable. Recently ITAT Delhi in the case of Haworth (India) Pvt. Ltd. (2011-TII-64-ITAT-DEL-TP) has held that 3 comparable having small turnover (Rs.18.78 lacs)) cannot be considered even if segmental information is available particularly when the comparable's main activity is different. This decision also pertains to MSS and squarely applies to the facts of this case. The TPO thus has rightly rejected this comparable.”

4. The ITAT reversed the findings of the TPO with respect to inclusion of M/s. Capital Trust Ltd. as a comparable and held as follows:

“7. We have heard the rival contentions and perused the material available on record. Apropos Capital Trust comparable, the TPO has observed that primary business of this company is automobiles sales and service. We are of the considered view that a company cannot be excluded from the comparables merely for the reason of having low turnover. It is to be appreciated that no turnover filter was applied by either of the parties. The comparable has been excluded because the total turnover of this comparable is Rs.13.92 crores. The analysis needs to be carried out on the basis of functional profile and not on an arbitrary or adhoc criteria. From the facts on record and argument advanced before us, it emerges that the functional profile of Capital Trust Limited's consultancy segment is similar to that of Nortel India the same needs to be included in the final comparables



for working the ALP. The AO will accordingly apply this comparable while working out the ALP, this ground of assessee is allowed.”

5. It is submitted by the Revenue that the reason for exclusion of M/s. Capital Trust Ltd. data is sound and reasonable and that the ITAT should not have placed over-emphasis on the question of size of the turnover, in relation to the segmental business activity of the comparable company. The assessee, which is represented and has been heard on the advance notice, on the other hand, highlights that the record indicates – and in fact the ITAT noticed that no turnover filter was applied by either of the parties at any stage and that the Revenue ought not to highlight this as a question of law in these given circumstances.

6. We are of the opinion that the ITAT's order does not raise a substantial question of law. As observed in the impugned order, as to whether the turnover filter is an appropriate one and applicable cannot be answered in the abstract and is entirely fact dependent. In the given facts of this case, the record indicates that the TPO chose to apply that filter but used it to exclude the data pertaining to M/s. Capital Trust Ltd. This inconsistency went unnoticed even by the DRP. The ITAT corrected the position and noticed that not having applied the turnover filter at the initial stage, the Revenue cannot take advantage, in the facts of the case, particularly when the turnover filter is not a test even in respect of the surviving comparable which are concededly part of the record. For the above reasons, no question of law arises.



7. The appeal is accordingly dismissed along with the pending applications.

S. RAVINDRA BHAT
(JUDGE)

R.K. GAUBA
(JUDGE)

FEBRUARY 24, 2015
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