

DCIT vs. Vertex Customer Services (India) Pvt. Ltd (ITAT Delhi)

Expl. 7 to s. 271 (1) (c) provides that in the case of an assessee who has entered into an international transaction, **any amount added or disallowed** in computing the total income u/s 92C (4) shall for purposes of s. 271 (1) (c) **be deemed** to represent income in respect of which particulars have been **concealed** or inaccurate particulars furnished **unless the assessee shows that the s. 92C computation was made in good faith and with due diligence.**

The assessee, a call centre, adopted the Transactional Net Margin Method (“TNNM”) and showed an operating profit to operating cost at 10.12% on the basis of comparables. The assessee, however, showed a loss of Rs. 4.27 crs from the international transaction after making adjustment for (i) cost relating to first year operation, (ii) cost relating to excess capacity and (iii) provision for doubtful debts towards sums due from the parent company. The adjustments were made on the ground that these were extraordinary costs and required to be excluded in computing the arms’ length price under **Rule 10B (e) (iii)** which provides that the net profit margin arising in comparable uncontrolled transactions can be adjusted for differences between the international transaction and the comparable transaction or between the enterprises entering into such transactions which could materially affect the amount of net profit margin in the open market. The TPO rejected the third adjustment on the ground that it being an ordinary item of expenditure did not qualify for adjustment. On merits, the assessee accepted the addition though it challenged the levy of penalty. The CIT (A) allowed the appeal on the ground that the treatment of the provision for doubtful debts as an extraordinary item and not as operational cost was justified. On appeal by the Revenue, HELD dismissing the appeal:

(i) The question whether the provision for bad debt in respect of sum owed by the parent company is a matter falling in the ordinary course of trade or whether it is an extraordinary item warranting exclusion from operational cost is **a debatable point on which there can be two opinions. The fact that the assessee accepted the addition and did not challenge the same will not change this aspect;**

(ii) In accordance with the law in **Hindustan Steel 83 ITR 26 (SC)** and **Nath Bros 288 ITR 670 (Del)**, penalty u/s 271 (1) (c) cannot be imposed where there is merely a difference of opinion. Penalty also cannot be imposed unless the party obliged either acted **deliberately in defiance of law** or was **guilty of conduct contumacious** or **dishonest**, or acted in **conscious disregard of its obligation;**

(iii) On facts, there was also a full disclosure of the relevant facts by the assessee. The conduct of the assessee was **not mala fide or contumacious.** The computation claiming exclusion of the provision for doubtful debts in arriving at comparable profit margins cannot be said to have been done **not in good faith or without due diligence.** Accordingly penalty under Expl. 7 to s. 271 (1)(c) could not be levied.