

IN THE INCOME TAX APPELLATE TRIBUNAL  
“B” BENCH : BANGALORE

BEFORE SHRI N.V. VASUDEVAN, JUDICIAL MEMBER  
AND SHRI ABRAHAM P. GEORGE, ACCOUNTANT MEMBER

IT(TP)A Nos.1105/Bang/2011
Assessment year : 2005-06

The Deputy Commissioner of Income Tax, Circle 12(2), Bangalore.	Vs.	M/s. Novell Software Development (India) Pvt. Ltd., “Laurel”, Block-D, 65/2, Bagmane Tech Park, C V Raman Nagar, Byrasandra Post, Bangalore – 560 093. <b>PAN : AAACN 6992K</b>
APPELLANT		RESPONDENT

IT(TP)A Nos.1047/Bang/2011
Assessment year : 2005-06

M/s. Novell Software Development (India) Pvt. Ltd., Bangalore – 560 093. <b>PAN : AAACN 6992K</b>	Vs.	The Deputy Commissioner of Income Tax, Circle 12(2), Bangalore.
APPELLANT		RESPONDENT

Revenue by	:	Shri Farahat Hussain Qureshi, CIT-II(DR)
Assessee by	:	Shri T. Suryanarayan, Advocate

Date of hearing	:	04.02.2015
Date of Pronouncement	:	13.02.2015

**ORDER**

*Per N.V. Vasudevan, Judicial Member*

These are appeals filed by the Revenue as well as the assessee against the order dated 12.9.2011 of CIT(Appeals)-V, Bangalore relating to assessment year 2005-06.

2. The issue that arises for consideration in these appeals is relating to the addition made to the total income consequent to determination of Arm's Length Price (ALP) in respect of international transaction entered into by the Assessee with its Associated Enterprises (AE) u/s.92 of the Income Tax Act, 1961 (Act). The addition made consequent to determination of ALP by the TPO and addition on account of transfer pricing adjustment was a sum of Rs.9,16,77,074 which was reduced to Rs.3,36,89,845/- by the CIT(A) in the appeal filed by the assessee.

3. The assessee, Novell India, is a subsidiary of Novell, USA and is a captive service provider. It is engaged in the business of providing software development and support services to Novell, USA. During the financial year 2004-05 relevant to the assessment year 2005- 06, the only international transaction that took place between Novell India and Novell US was provision of software development and support services to Novell US at a price of Rs. 55,01,62,457/-.

4. In support of the assessee's claim that the price charged by it for services rendered to its AE was at arms' length, the assessee filed a report as required by the provisions of section 92E of the Act in Form 3EB together with detailed analysis. The assessee adopted Transaction Net Margin Method (TNMM) as the most appropriate method for determining the ALP. Operating profits to cost was adopted as the Profit Level Indicator ("PLI"). The PLI of the assessee was arrived at as follows:

Operating Revenue	Rs.55,01,62,457
Operating Cost	Rs.50,01,47,691
Operating Profit	Rs.5,00,14,766
Op.pr/cost%	10%

5. The Transfer Pricing Officer (**TPO**) arrived at a final set of 17 comparable companies. The set of 17 comparable companies is given as **Annexure-I to this order.**

6. The assessee raised various objections to the methodology adopted and the reasons assigned by the TPO for rejecting the comparable chosen by the assessee in its TP study. The TPO finally passed an order u/s. 92CA of the Act and on the basis of the profit margins of comparable companies set out in Annexure-I to this order, arrived at arithmetic mean of 28.33% after working capital adjustment and 26.59% before working capital adjustment. The computation of the ALP by the TPO in this regard was as follows:-

**“Computation of Arms Length Price:**

The arithmetic mean of the Profit Level indicators is taken as the arms length margin. (Please see Annexure B for details of computation of PLI of the comparables). Based on this, the arms length price of the software development services rendered by the taxpayer to its AE(s) is computed as under:

<b>Arithmetic mean PLI</b>	<b>26.59%</b>
<b>Less: Working capital Adjustment</b>	
<b>(Annexure-C)</b>	<b><u>-1.74%</u></b>
<b>Adj.Arithmetic mean PLU</b>	<b>28.33%</b>

**Arm’s Length Price:**

<b>Operating Cost</b>	<b>Rs.50,01,47,691</b>
<b>Arms Length Margin</b>	<b>28.33% of the operating cost</b>
<b>Arms Length Price (ALP) At 128.33% of operating cost</b>	<b>Rs.64,18,39,532/-</b>

**Price received vis-à-vis the Arms Length Price:**

The price charged by the tax payer to its Associated Enterprises is compared to the Arms Length Price as under:

<b>Arms Length Price (ALP) At 128.33% of operating cost</b>	<b>Rs.64,18,39,532/-</b>
Price charged in the international transactions	Rs.55,01,62,457
Shortfall being adjustment u/s.92CA	Rs.9,16,77,074

The above shortfall of Rs.9,16,77,074/- is treated as transfer pricing adjustment u/s 92CA.”

7. On appeal by the Assessee, the CIT(A) partly allowed the appeal of the Assessee, observing as follows:-

(i) Two companies viz., Exensys Software Solutions Ltd. and Thirdware Solutions Ltd. (which are Sl.No.3 & 7 of the final list of comparable companies chosen by the TPO given as annexure-I to this order) were rejected based on the ground that these companies had abnormal profits in AY 05-06 and hence should be excluded for the purpose of comparability. In coming to the above conclusion, the CIT(A) followed the decisions of this Hon'ble Tribunal in the case of Mentor Graphics (Noida) (P.) Ltd. vs DCIT (2007] 109 ITD 101 (Del), E-gain Communications (P.) Ltd vs. ITO, Ward 1(4), Pune[2008]-(023)- SOT-0385-TPIIN] and SAP Labs India Pvt. Ltd vs ACIT [2010] ITA No. 398 & 418 (Bang)].

(ii) One company, Satyam Computer Services Ltd (which is Sl.No.16 of the final list of comparable companies chosen by the TPO given as annexure-I to this order) selected by the TPO, was rejected for non-reliability of financial data. In doing so, the CIT(A) followed the decision of this Hon'ble Tribunal in Agnity India Technologies v. ITO (ITA 3856/Del/2010) and SAP India Pvt. Ltd v. ITO [ITA No. 398/8/2008].

(iii) One company, Infosys Technologies selected by the TPO, (which is Sl.No.17 of the final list of comparable companies chosen by the TPO given as annexure-I to this order) was rejected as a comparable based on high turnover and high risk. In doing so, the CIT(A) followed the decision of this Hon'ble Tribunal in Agnity India Technologies v. ITO and Genisys Integrated Systems (India) Pvt Ltd v. ITO (supra).

(iv) Nine other companies were rejected for having related party transactions (RPT filter). The CIT(A) applied an RPT filter of zero percent on the ground that even if one ideal comparable without any related party transactions is available for comparison, it would not be necessary to apply the filter. The following companies were therefore rejected:-

- (1) Sasken Network Systems Ltd
- (2) FourSoft Ltd
- (3) R S Software India Ltd
- (4) Geometric Software Solutions Ltd
- (5) Tata Elxsi Ltd
- (6) Sasken Communication Technologies Ltd
- (7) iGate Solutions Ltd
- (8) Flextronics Software Ltd
- (9) L&T Infotech Ltd

(which are Sl.No.12, 6, 8, 9, 10, 12, 13, 14, & 15 of the final list of comparable companies chosen by the TPO given as annexure-I to this order)

The CIT(A) also observed that on the exclusion of the above companies, the remaining four comparables were having a turnover between Rs. 1 cr and Rs. 200 Cr thus accepting that the turnover filter of Rs.1 cr. To Rs.200 crore was a filter to be applied in choosing comparable companies.

8. A summary of the set of final comparables selected by CIT(A) along with the reasons for rejection of comparables selected by TPO is as tabulated below:-

Sl. No.	Comparables Selected by TPO	Reason for rejection by CIT(A)
1	Bodhtree Consulting Ltd.	<b>ACCEPTED</b>
2	Lanco Global Systems Ltd.	<b>ACCEPTED</b>
3	Exensys Software Solutions Ltd.	Abnormal Profits
4	Sankhya Infotech Ltd.	<b>ACCEPTED</b>
5	Sasken Network Systems Ltd.	Co. having RPT>0%
6	Four Soft Ltd.	Co. having RPT>0%
7	Thirdware Solution Ltd.	- Co. having RPT>0% - Abnormal Profits
8	R S Software (India) Ltd.	Co. having RPT>0%
9	Geometric Software Solutions Company Ltd.	Co. having RPT>0%
10	Tata Elxsi Ltd.	Co. having RPT>0%
11	Visualsoft Technologies Ltd.	<b>ACCEPTED</b>
12	Sasken Communication Technologies Ltd.	Co. having RPT>0%
13	Igate Global Solutions Ltd.	Co. having RPT>0%
14	Flextronics Software Systems Ltd.	Co. having RPT>0%
15	L&T Infotech Ltd.	Co. having RPT>0%
16	Satyam Computer Services Ltd.	- Co. having RPT>0% - Non Reliability of Data
17	Infosys Technologies Ltd.	- Co. having RPT>0% - High risk, high turnover

9. Arithmetic mean of the comparables retained by the CIT(A): After giving effect to the findings given above, the following companies were selected as final comparables to determine the arm's length price:-

Sl. No.	Name of the Company	OP/OC (%)	OP/OC after working capital adjustment
1	Bodhtree consulting ltd.	24.01	26.08
2	Lanco Global Systems Ltd.	13.22	13.41
3	Sankhya Infotech Ltd.	26.63	24.97
4	Visual soft Technologies Ltd.	23.52	24.6
	<b>Arithmetical Mean</b>		<b>22.27</b>

10. Computation of arm's length price by the CIT(A): The arm's length price in relation to the international transactions of Novell was computed by the CIT(A) as under:-

A.	OPERATING COST (including foreign exchange loss)	50,26,42,816
B.	ARMS LENGTH MARGIN	122.27
C.	PRICE @ 122.27%	61,45,81,371
D.	ALP (95% of C) (giving effect to the proviso to Sec. 92C(2))	58,38,52,302
E.	PRICE RECEIVED	55,01,62,457
F.	<b>DIFFERENCE (ADJ U/S.92CA)</b>	<b>3,36,89,845</b>

11. Both the assessee as well as the Revenue is in appeal before the Tribunal. The Revenue is in appeal on two grounds as follows:-

(1) The CIT(A) erred in holding that the comparables ought to have been excluded even if related party transactions were less than 25% of the revenues.

(2) The CIT(A) erred in allowing a standard deduction of 5% from the arm's length price under Section 92C(2) of the Income-tax Act, 1961.

12. The assessee's grounds of appeal are as follows:-

(1) Assessment and reference to Transfer Pricing Officer are bad in law.

(2) Departure from earlier year's stand by the Transfer Pricing officer ('TPO')

The TPO having accepted the international transaction of the Appellant as being at arm's length in the assessment year 2004-05, the CIT(A) erred in law in confirming the different view adopted by the TPO in the assessment year 2005-06.

(3) The fresh comparable search undertaken by the TPO is bad in law.

(4) Determination of arm's length price by the TPO.

(5) Erroneous data used by the AO/TPO.

(6) Non-allowance of appropriate adjustments to the comparable companies, by the TPO.

(7) Confirmation of levy of interest under Section 234B and non-adjudication on the grounds raised as regards levy of penalty.

13. We have heard the rival submissions. As regards the improper application of the RPT filter by the CIT(A), it is not in dispute before us that this Tribunal, in the cases of *24/7 Customer Pvt. Ltd. (ITA*



*No.227/Bang/2010*), and *Sony India Private Ltd. reported in (2009) 315 ITR (80) 150 (Del.)* and various other cases has taken a view that comparables having RPT of upto 15% of total revenues can be considered. In view thereof, the Revenue's on this ground has to be allowed. It is held that the CIT(A) ought to have adopted a threshold limit of 15% of the total revenue attributable to related party transaction as ground for rejecting comparable companies. Consequently it is held that comparable companies having RPT upto 15% of the total revenues alone can be included. The Revenue's contention that comparables with RPT upto 25% can be considered is without any basis.

14. As regards the standard deduction of 5% of the arm's length price afforded to the Appellant by the CIT(A), it is not in dispute before us that in view of the substitution of the Second proviso to Section 92C(2) of the Income-tax Act by the Finance (No.2) Act, 2009, the second ground of appeal (Ground No.3 in the appeal filed by the Revenue) may have to be allowed. Consequently it is held that if the difference between the arithmetic mean of the profit margins comparable companies ultimately retained and the profit margin of the Assessee is more than 5% than no deduction under the proviso to Sec.92C(2) of the Act could be allowed to an Assessee.

15. In view of the conclusion above that exclusion of comparable companies with RPT of less than zero percent is not valid, and that

companies where RPT is less than 15% alone can be considered, then the comparables rejected by the CIT(A) on the basis of the said filter will have to be included along with the four comparables retained by the CIT(A). Although nine comparables which were rejected on the basis of RPT being more than zero percent, one comparable viz., Four Soft Ltd., will have to be excluded since the RPT is at 19.89% and thus in excess of 15%. The assessee has submitted before us that three comparables viz., Igate Global Solutions Ltd, Flextronics Software Systems Ltd and L&T Infotech Ltd. would have to be rejected applying the upper limit of Rs.200 crores to the turnover. In this regard he had placed reliance on the decision of this Tribunal in the case of Trilogy EBusiness Software India Pvt. Ltd. in ITA No.1054/Bang/2011. Also, Tata Elxsi Ltd would have to be rejected as being functionally incomparable in view of the decision of this Tribunal in Logica Pvt. Ltd. (ITA 1129/Bang/2011).

16. The submission of the Assessee in this regard and correct and in the light of the decisions referred in the earlier para, we hold that Igate Global solutions Ltd., Flextronics Software Systems Ltd. And L & T Infotech Ltd would have to be excluded as comparable companies as these companies have turnover above Rs.200 Crores. So also Tata Elxsi Ltd., would have to be excluded as not comparable in the light of the decision in the case of *Logica Pvt. Ltd.* (supra).

17. The learned counsel for the Assessee also seeks exclusion of one comparable chosen by the TPO as a comparable viz., Sankhya Infotech Limited. He also seeks inclusion of one of its comparables in the TP study viz. Melstar Information Technologies Limited which was excluded by the TPO. Besides the above, the learned counsel for the Assessee also submitted that an adjustment for depreciation ought to be allowed. The submissions on this aspect will be set out in the later paragraphs.

**Sankhya Infotech Limited ('Sankhya')**

18. It was submitted by the learned counsel for the Assessee that Sankhya is engaged in the business of development of software products & services and training. The company focuses on the development of niche products for the transport and aviation industry. However, segmental information in relation to the above mentioned activities is not available in public domain. Therefore, as Sankhya engages itself in products and services as well as software training, it cannot be considered as a comparable of the Appellant. The products developed and owned by Sankhya are listed below:

(1) SILICON™ Training Suite of Products: The products are a comprehensive enterprise wide training platform that covers the entire spectrum of training in a paperless environment. It comprises of four products:-

- SILICON™ LMS (Training Management Information
- SILICON™ QT (Online Assessment System)

- SILICON™ LCMS (Learning Content Management System)
- IRMAQ™ : This is an integrated resource planning, management tracking system exclusively developed for Airline operations. It is an end-to-end solution for all Flight Operations.
- Sakai CLE : This is a widely used and popular open source LMS used in many leading educational institutions and corporate. The relevant extract from the Annual report substantiating that the company also engages in different activities is reproduced below:

“2. Activities

The company as engaged in the business of development of Software Products & Services and training. The production of software is not capable of being expressed in any generic unit and hence it is not possible to give the information as required by certain clauses of paragraphs 3.4C and 4 D of Part II of Schedule VI of the Companies Act, 1956.”

19. The Delhi Tribunal in ITO v. Colt Technology Services India Pvt. Ltd. (judgment dated 23.10.2012 in ITA No. 6091/Del/2011 for the assessment year 2005-06) has held that the said company is not a comparable to the assessee therein which was also in the business of software development.

20. The submissions made by the learned counsel for the Assessee are considered. The activities set out above and the decision of the Delhi ITAT rendered in the context of a software development company such as the Assessee makes it amply clear that this company Sankhya cannot be regarded as a comparable. The same is directed to be excluded from the list of comparable companies.

21. Melstar Information Technologies Ltd. (Melstar): As far as this company is considered, the same was chosen as comparable company by the Assessee in its TP study. The TPO rejected Melstar stating the following:-

“As per the Director’s Report Melstar has faced adverse economic conditions during the FY 2004-05 and its margins are adversely affected by its peculiar circumstances. The business profile of Melstar is not aligned with the normal trend of the software industry in India. The company therefore is not treated as a comparable.” (page 82 of the TP order)

22. It is the submission of the learned counsel for the Assessee before us that that Melstar passes all filters applied by the TPO in his order and is functionally comparable. The filters applied by TPO and their satisfaction was tabulated as under:

<b>Filters applied by TPO</b>	<b>Particulars of Melstar</b>
Companies whose software development service income <Rs.1 cr. were excluded (Rs.in crores)	Rs. 25.16 Cr
Companies whose Software Development Service is less than 75% of the total operating revenues were excluded	99.94% software services revenue
Companies who have more than 25% related party transactions (sales as well as expenditure combined) of the sales were excluded	6.22% RPT

Companies who have less than 25% of the sales as export sales were excluded	84.49% export sales
Companies who have diminishing revenues/persistent losses for the period under consideration were excluded	Diminishing only in the current year, otherwise consistent
Companies having different financial year ending (i.e. not March 31,2005) or date is not available for 12 months, were rejected	Year ended 31.03.2005
Companies whose employee cost to sales is less than 25% were excluded	46.83% employee cost
Companies whose onsite income is more than 75% were excluded	N.A.

23. It was further pointed out by him that the TPO has concluded that Melstar is not comparable on the ground that there was an extraordinary debit of Rs. 2.85 Cr and on the ground that the company's sales are diminishing. A perusal of the revenues of the previous financial years (page 81 of the TP order) demonstrates that the revenues are more or less consistent for the previous financial years and has only substantially decreased in the financial year 2004-05. The relevant extract of the Annual Report (Page 4) is reproduced below:

C) Financial performance based on given indicators As per the audited financial results for the year ended 31.3.2005:

(Rs. in Lacs)

Revenues	2660.64
Operating Profit before unusual item	84.00
Extraordinary item	285.28
Net Loss	(248.33)
Paid up Share capital	142.83
Net Worth	4057.93

If the above extraordinary expense of Rs. 2.85 Cr is excluded from the operating cost, the mark-up on the cost works out to 3.26%. The detailed working was also give as below:-

<b>Particulars</b>	<b>Amount (in Rs. in Lacs)</b>
Revenues	2660.64
Operating Profit before unusual item	84.00
Cost	2576.64
<b>NCP (%)</b>	<b>3.26%</b>

24. In view of the above, it was submitted that since Melstar is functionally comparable to the assessee and clears all the filters applied by the TPO, the same should be considered as comparable with Net Cost Plus margin of 3.26%.

25. The submissions are considered and found to be acceptable. As rightly pointed out by the learned counsel for the Assessee, Melstar passes all the tests of comparability adopted by the TPO. The extraordinary item

of expenditure, if removed, would render this company as a company revenues of which are not diminishing. Melstar therefore deserves to be included as a comparable company. We hold accordingly.

**Adjustment for depreciation**

**Assessee's depreciation policy vis-à-vis depreciation policies of the comparables selected by the CIT(A)**

26. The learned counsel for the assessee submitted that the Assessee has a policy of charging a higher rate of depreciation as compared to the companies selected by the TPO and the CIT(A). It was therefore submitted by him that there is a need for making an adjustment to eliminate differences in the accounting policies of the assessee and the comparable companies. The learned counsel for the Assessee submitted that the assessee's depreciation policy for the year was as below (available in the annual report of the assessee at page 8 of the paper book filed):-

“ (iv) Depreciation

Depreciation is provided on Straight Line method pro-rata from the date of addition at the rates mentioned below, which are higher than the corresponding rates prescribed in Schedule XIV of the Companies Act, 1956:

	<u>Rate of depreciation</u>
Computer Systems	50.00%
Computer Software	33.33%
Plant and Machinery	20.00%
Office Equipment	33.33%
Furniture and Fixtures	20.00%
Vehicles	33.33%



27. Most other companies provide for depreciation at the rates specified in the Companies Act. The depreciation policies of a few comparables selected by CIT(A), as available in their annual reports, is as below:-

**“Bodhtree Consulting Ltd.**

3. Fixed Assets

Fixed Assets are accounted at cost of acquisition inclusive of other related expenses on such acquisition. Depreciation on fixed assets is provided on a prorata basis using straightline method at rates as per Schedule XIV to the Companies Act, 1956.

**Lanco Global Systems Ltd.**

Fixed Assets:

(i) Fixed assets are stated at cost less accumulated depreciation. Cost of acquisition of fixed assets is inclusive of freight, duties, taxes and incidental expenses thereto.

Depreciation and Amortisation

(i) Depreciation is provided on straight line method on prorata basis and at the rates and manner specified in the Schedule XIV of the Companies Act, 1956.

(ii) Preliminary Expenses are amortised over the period of 5 years.

(iii) Public Issue Expenses are amortised over the period of 5 years.

**Sankhya Infotech Ltd.**

5. Fixed assets

Fixed assets are stated at cost, less accumulated depreciation. Direct costs are capitalized until fixed assets are ready for use. “Cost” means cost of bringing the asset to its working condition for its intended use are capitalized as per the statement issued by the Institute of Chartered Accountants of India.

6. Depreciation and amortization

Depreciation on fixed assets is applied on the Written down value method based by following the rates prescribed in Schedule XIV of the Companies Act, 1956. Individual low cost assets (acquired for less than Rs.5,000/-) are entirely depreciated in the year of acquisition. Intangible assets are amortized over their respective individual estimated useful lives on a straight-line basis, commencing from the date the asset is available to the company for its use.

**Visual Soft Technologies Ltd.**

3. Fixed Assets:

Fixed assets are stated at cost less accumulated depreciation. All costs, directly attributable to bringing the asset to the present condition for the intended use, are capitalized.

4. Depreciation

- a) Depreciation on fixed assets has been provided on straight line method based on useful life of assets as estimated by the Management and depreciation on the assets acquired during the year is provided on pro-rata basis.
- b) Depreciation is charged at one hundred percent in respect of the individual assets costing less than Rs. 5,000 in the year of purchase.
- c) The management has estimated the useful lives of the assets as under:

Assets	Years
Buildings	28
Computers	2 - 5
Other Assets	5
Leasehold improvements	over the lease period or useful Life whichever is lower.

28. The learned counsel for the Assessee further submitted the rationale for making depreciation adjustment. He pointed out that Rule 10B of the Income-tax Rules, 1962 [‘the Rules’] provides the method in which the comparability analysis is to be conducted under the Transactional Net Margin Method. Under sub-clause (i) of Rule 10B(1)(e), the net profit margin realised by the taxpayer from an international transaction is computed having regard to a relevant base e.g. costs incurred, sales effected, etc. Under sub-clause (ii) of Rule 10B(1)(e), the net profit margin realised by an unrelated enterprise/comparable company is computed having regard to the same relevant base as was selected in sub-clause (i).

29. Sub-clause (iii) of the said Rule specifies that before a comparison of the net margins realised under sub-clauses (i) and (ii) is done, the net margin realised under sub-clause (ii) must be adjusted to take into account the differences which could materially affect the net profit margin in the open market. Relevant extracts of Rule 10B(1)(e)(iii) are reproduced as under:-

“(iii) the net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market,”

(emphasis supplied)

30. According to Id. counsel for the assessee, based on the above, there was a need for making an adjustment on account of difference between the net margin of the assessee and that of the comparable companies. It was further pointed out by him that Rule 10B(3) of the Rules provides that an uncontrolled transaction shall be considered as a comparable if:

- a) none of the differences between the comparable company and the controlled transaction are likely to materially affect the profit arising from such transactions in the open market; or
- b) reasonably accurate adjustments can be made to eliminate the material effect of such differences.

31. The learned counsel for the Assessee placed reliance on the judgments of this Hon'ble Tribunal in E-gain Communication Pvt. Ltd. vs. ITO [2008] 23 SOT 385 (Pune) (at page 36) and Honeywell Technology Solutions Lab P. Ltd. [judgment dated 28.03.2013 in IT(TP)A No. 1344/Bang/2011 at para 5.71]. Our attention was also drawn to the fact that though the assessee urged the above ground before the CIT(A) and filed written submissions also on the same, (at page 503 of the paperbook filed before this Tribunal), the CIT(A) has not adjudicated on the said ground. It was also pointed out by him that for the assessment year 2002-03, the CIT(A), in his order dated, 09.08.2012, allowed the adjustment of depreciation (para 4.7 at pages 27-28 of the order). A copy of the order was also filed before us. The learned counsel for the

Assessee thus submitted that the assessee is eligible for an adjustment in respect of depreciation.

32. The learned DR relied on the observations of the Tribunal in the case of *24/7 Customer Care.com Pvt.Ltd. 140 ITD 344 (Bang.)* wherein the Tribunal has made observations on when adjustment on account of different accounting policies being followed by comparable companies can be considered for adjustment in the matter of determination of ALP.

33. We have given a very careful consideration to the rival submissions. In the case of *E-gain communication Pvt.Ltd. (supra)*, the question of adjustment on account of different depreciation policy of comparable company and the tested party was never in issue. The issue arose in the case of *24/7 customercare.com (supra)*. The contention of the Assessee before the Tribunal was that depreciation cost as a percentage of the gross block of the Assessee during the financial year 2004 was 25 percent and the comparables reported an average depreciation cost as a percentage of the gross block of 10 percent. The Assessee argued that the difference in the depreciation cost arises due to differences in the accounting treatment across the comparables and the Assessee. The Assessee pleaded that considering the above fact, to achieve reliable comparability, the margins of the comparable companies post the adjustment of the depreciation should be considered. The Tribunal held on the above issue as follows:

“19.4 We have heard both parties and considered the rival submissions. We find force in the submissions of the learned Departmental Representative. Whether an adjustment towards depreciation is warranted or not may be, issue of principle. But whether the principle needs to be applied to a particular case or not would depend on the peculiar facts of that case. It cannot be anybody’s case that an adjustment has to be necessarily granted whenever and wherever there is difference in depreciation between the tested party and the comparables. An adjustment for difference in depreciation is a valid principle for comparability, but whether this case entails such an adjustment has to be examined in the light of the particular facts of the case. Hence, the additional ground raised by the assessee is as much as issue of fact as it is of principle.

19.5 Before us, the assessee has not been able to adduce any reason as to why this issue was not raised before the authorities below. It gives credence to the view of the learned Departmental Representative that this claim is only an afterthought, pursuant to the learned CIT (Appeals) confirming the adjustments proposed by the TPO.

19.6 Besides this, the adjustment for depreciation, sought for by the assessee, does not appear to be tenable even on merits. It has been stated in the additional grounds raised that while the depreciation of the assessee is 25 percent of its gross block, it is 10 percent of the gross block for the comparables. It is interesting to note that the assessee has compared the depreciation as a percentage of the gross block of the individual cases and not as a percentage to operating cost.

19.7 No case has been made out by the assessee that the difference in depreciation is due to any reason like capacity utilization, etc. The difference in depreciation could be due to many reasons as different companies have their own accounting problems in the matter of fixed assets and depreciation on the basis of technical estimates made of useful life of the assets. Depreciation provided under the Income Tax Rules or the minimum depreciation provided under the Companies Act may not be really exhibiting the actual position. Over a period of time, the difference of depreciation provided under different methods would almost be the same except for marginal difference. In the written down value (WDV) method, the depreciation for the

initial year would be more, whereas in straight line method, depreciation in the initial years would be less. However, at the end of the day, the depreciation off sets each by itself.

19.8 In the interest of equity and natural justice, we feel constrained to admit the additional ground raised by the assessee on the issue of depreciation. However, mere claim for an adjustment will serve no purpose unless it is backed by proper details. The additional ground states that the depreciation of the assessee is a ratio of its gross block of 25 percent as against 10 percent of the comparable companies. The assessee has not stated the depreciation as a percentage of operational cost nor has any evidence been placed on record to show that the difference in depreciation is due to any operational reasons. As discussed (supra), there could be several reasons for difference in depreciation between companies like, rates of depreciation, age of the assets, etc. and therefore adjustment towards depreciation can be granted only if there are operational differences that affect comparability. We remit the issue of depreciation as raised by the assessee in the additional grounds (supra) to the file of the Assessing Officer / TPO with direction to examine and consider the claim for adjustment towards depreciation in the light of our observations from paras 19.3 to 19.8 of this order and to dispose the matter expeditiously after affording adequate opportunity of being heard to the assessee. It is ordered accordingly.”

34. The above observations were referred to by the Tribunal in the case of *M/S. Honeywell Technology Solutions Lab P Ltd. (supra)*. We however do not find any quantification of adjustment to be allowed given by the Assessee.

35. We are of the view that it would be just and appropriate to remand the issue to the AO for fresh consideration in the light of the decisions referred to above. We are also of the view that the Assessee should be directed to give the quantification of adjustment to be allowed, if found

eligible, applying the ratio laid down in the case of 24/7 customercare.com (supra). We hold and direct accordingly.

36. According to the learned counsel for the Assessee, if the submissions of the assessee are accepted, then the arithmetic mean of the comparables retained would be within the range of +/- 5% of the Assessee's Net Margin. Therefore, the other grounds raised in the memorandum of appeal are not pressed at this stage. He has however sought liberty to urge the said grounds in any future proceeding, appellate or otherwise, and in these proceedings at a future point in time. The prayer sought by the learned counsel for the Assessee in this regard is accepted.

37. In the result the appeal by the Assessee and the Revenue are partly allowed.

Pronounced in the open court on this 13<sup>th</sup> day of February, 2015.

Sd/-

( ABRAHAM P. GEORGE )  
Accountant Member

Sd/-

( N.V. VASUDEVAN )  
Judicial Member

Encl: Annexure-I

Bangalore,

Dated, the 13<sup>th</sup> February, 2015.

/D S/



Copy to:

1. Appellant
2. Respondents
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.
6. Guard file

By order

Assistant Registrar /  
Senior Private Secretary  
ITAT, Bangalore.