

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

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

IT(TP)A No.1244/Bang/2011
Assessment year : 2007-08

AMD India Private Ltd., Plot No.102 & 103, Export Promotion Industrial Park, Whitefield, Bangalore – 560 066. PAN: AAECA 6756C	Vs.	The Income Tax Officer, Ward 11(1), Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	Shri Padamchand Khincha, CA
Respondent by	:	Shri G.R.Reddy, CIT-I(DR)

Date of hearing	:	21.09.2015
Date of Pronouncement	:	23.09.2015

ORDER

Per N.V. Vasudevan, Judicial Member

This is an appeal by the Assessee directed against the order dated 30.9.2011 of the ITO, Ward 11(1), Bangalore passed u/s.143(3) read with Sec.144 C of the Income Tax Act, 1961 (Act), for the assessment year 2007-08.

2. The Assessee viz., AMD India Private Limited [‘AMD IPL’ or ‘the Appellant’ or ‘Assessee’] was incorporated on March 15, 2004 and is a subsidiary of Advanced Micro Devices Inc., USA [‘AMD US’]. AMD IPL is a unit registered under the Software Technology Park of India scheme and is engaged in the provision of software development services to its Associated Enterprise [‘AE’]. AMD IPL is a

captive service provider and is being remunerated at 'cost plus an arm's length mark-up basis.

2. During the previous year relevant to AY 2007-08, AMD IPL had, inter alia, rendered software development services amounting to Rs.40,12,49,022/- to AMD US. The Appellant had conducted a transfer pricing study ['TP study'] in terms of section 92D of the Act. In the TP Study, in respect of its software development services the Appellant arrived at a set of 48 comparable companies, having an average net cost plus margin of 12.43% as against that of 10.47% before working capital adjustment and 12.43% after working capital adjustment, of the Appellant. Since the Appellant's margin was in the 5% (as provided in the second proviso to section 92C(2) of the Act) range of the arithmetical mean of the comparables, the international transactions of the Appellant were claimed by the Assessee to be at arm's length.

3. The financial results of the assessee in its software development services segment were as follows:-

Description	Amount (Rs.)
Operating revenues	40,12,49,022
Operating Expenditure (*)	36,32,11,814
Operating Profit	3,80,37,208
OP/TC	10.47%

4. The TPO to whom the question of determination of Arm's Length Price (ALP) of the international transaction which the Assessee had with its Associated Enterprise (AE) was referred by the AO, passed an order under section 92CA of the Act, determining the mean margin of the comparables at 25.14% (after working

capital adjustment) thereby proposing a transfer pricing adjustment of Rs.5,49,45,016.

5. Subsequently, the AO issued a draft assessment order under section 143(3) read with 144C, dated 9.12.2010, proposing a transfer pricing adjustment of Rs. 5,49,45,016 and disallowance of excess claim under section 10A of the Act.

6. The Appellant filed objections before DRP but the same were not accepted by the DRP. The AO thereafter passed the impugned order in accordance with the directions of the DRP.

7. Comparables ultimately selected by TPO and their arithmetic mean were as follows:-

Sl. No	Name of company	OP / TC	Turnover Rs. In Crores
1	Accel Transmatic Ltd (Seg.	21.11%	9.68
2	Avani Cimcon Technologies Ltd	52.59%	3.55
3	Celestial Labs Ltd	58.35%	14.13
4	Datamatics Ltd	1.38%	54.51
5	E-Zest Solutions Ltd	36.12%	6.26
6	Flextronics Software Systems Ltd (Seg.)	25.31%	848.66
7	Geometric Ltd (Seg.)	10.71%	158.38
8	Helios & Matheson Information Technology Ltd	36.63%	178.63
9	iGate Global Solutions Ltd	7.49%	747.27
10	Infosys Technologies Ltd	40.30%	131.49
11	Ishir Infotech Ltd	30.12%	7.42
12	KALS Information Systems Ltd (Seg.)	30.55%	2.00
13	LGS Global Ltd (Lanco Global Solutions Ltd)	15.75%	45.39
14	Lucid Software Ltd	19.37%	1.70
15	Mediasoft Solutions Ltd	3.66%	1.85
16	Megasoft Ltd	60.23%	139.33

17	Mindtree Ltd	16.90%	590.35
18	Persistent Systems Ltd	24.52%	293.75
19	Quintegra Solutions Ltd	12.56%	62.72
20	R S Software (India) Ltd	13.47%	101.04
21	R Systems International Ltd (Seg.)	15.07%	112.01
22	S I P Technologies & Exports Ltd	13.90%	3.80
23	Sasken Communication Technologies Ltd (Seg.)	22.16%	343.57
24	Tata Elxsi Ltd (Seg.)	26.51%	262.58
25	Thirdware Solutions Ltd	25.12%	36.08
26	Wipro Ltd (Seg.)	33.65%	961.09
Arithmetic Mean		25.14%	
Assessee's OP / TC for FY 2006-07		10.47%	

8. The TPO finally passed an order u/s. 92CA of the Act and on the basis of the comparables set out above, arrived at arithmetic mean of 25.14%. After factoring the working capital adjustment of (-)0.46%, the adjusted arithmetic mean was determined at 25.60%. 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 you is computed as under:

Arithmetic mean PLI	25.14%
Less: Working capital	
Adjustment(Annexure-C)	<u>(-)0.46%%</u>
Adj.Arithmetic mean PLI	<u>25.60%</u>
Arm's Length Price:	

Operating Cost	Rs.36,32,11,814
Arms Length Margin	25.60% of the

	operating cost
Arms Length Price (ALP) at 125.60% of operating cost	Rs.45,61,94,038

Price received Rs.40,12,49,022

Shortfall being adjustment u/s.92CA Rs.5,49,45,016

The above shortfall of Rs.5,49,45,016/- is treated as transfer pricing adjustment u/s 92CA.”

9. The assessee filed a chart explaining as how some of the comparable companies chosen by the TPO were not comparable for the reason that these companies were not functionally comparable. The Chart also gives the cases decided by various Benches of the ITAT where the comparable companies have been held to be not comparable with that of an Assessee providing IT Software development Services for reasons of functionally being different, turnover being huge, employee cost not being upto the threshold limit.

10. Before we proceed to consider the chart filed by the Assessee, we have to deal with the application for admission of additional ground filed by the Assessee. In the additional ground of appeal, the Assessee has prayed for exclusion of the comparable chosen by the TPO viz., Mintree Consulting Limited, Sasken Communication Technologies Ltd., Accel Transmatic Limited and Tata Elxsi Ltd., even though these companies were chosen as comparable by the Assessee in their transfer pricing study. According to the Assessee the aforesaid companies (excluding Accel Transmatic) have very high turnover and Accel Transmatic Ltd., has been excluded as functionally not comparable to a software service provider such as the Assessee in several decisions rendered by the Tribunal in several cases. The

Assessee seeks to exclude the aforesaid companies from the final list of comparable companies chosen by the TPO. The Assessee had considered the aforesaid companies as comparable in its TP study. The TPO also expressed the opinion that the aforesaid companies satisfied all the filters applied by him for choosing comparable companies. Even before DRP the Assessee did not object to choosing these two companies as comparable companies.

11. The learned counsel for the Assessee in support of the admission of additional ground placed reliance on the decision of the Hon'ble Special Bench in the case of the ITAT Chandigarh Bench in the case of *DCIT v. Quark Systems Pvt. Ltd.* 38 SOT 207 wherein it was held that a taxpayer is not estopped from pointing out a mistake in the assessment though such mistake is the result of evidence adduced by the taxpayer. The learned counsel further submitted that the aforesaid two companies were held to be software product companies and therefore not comparable with software development service provider such as the Assessee in several decisions rendered by the Tribunal. The decisions rendered by the Tribunal are later in point of time to the Transfer Pricing Study undertaken by the Assessee. The Assessee is entitled to take note of the subsequent judicial pronouncement and seek to exclude a company which is functionally not comparable with that of the Assessee. The learned DR opposed the prayer for admission of additional ground. He pointed out that the Assessee in their Transfer Pricing study accepted these companies as comparable and therefore cannot now seek to exclude the said companies.

12. We have given a very careful consideration to the rival submissions. We are of the view that the question as to whether the aforesaid two companies are

comparable or not with the Assessee company in terms of FAR analysis, has to be decided on the basis of data which is available in the public domain i.e., published annual report of these two companies.. Therefore facts necessary to apply the filter sought to be relied upon by the Assessee in the additional ground of appeal are already available on record. Therefore there can be no valid objection to deciding the question of applying the aforesaid filter, if otherwise it is found to be a valid filter. On the question of the Assessee having chosen the aforesaid two companies as comparable and therefore cannot be permitted to change its stand now, we are of the view that the decision of the Special Bench, Chandigarh in the case of *Quark Systems (supra)* clearly supports the plea of the Assessee. The Special Bench in the aforesaid decision in the case of *Quark Systems (supra)* has after considering the OECD Commentaries observed as follows:

35. In para 4.16 of latest report, the OECD provides the following guidelines :

"In practice, neither countries nor taxpayers should misuse the burden of proof in the manner described above. Because of the difficulties with transfer pricing analysis, it would be appropriate for both taxpayers and tax administrations to take special care and to use restraint in relying on the burden of proof in the course of the examination of a transfer pricing case. More particularly, as a matter of good practice the burden of proof should not be misused by tax administrations or taxpayers as a justification for making groundless or unverifiable assertions about transfer pricing. A tax administration should be prepared to make good faith showing that its determination of transfer pricing is consistent with the arm's length principle even where the burden of proof is on the taxpayer, and the taxpayers similarly should be prepared to make good faith showing that their transfer pricing is consistent with the arm's length principle regardless of where the burden of proof lies."

36. The aforesaid decisions and guidelines may not be exactly on identical facts before us but they emphatically show that taxpayer is not

estopped from pointing out a mistake in the assessment though such mistake is the result of evidence adduced by the taxpayer.

37. When substantial justice and technical considerations are pitted against each other, the cause of substantial justice deserves to be preferred. For the other side cannot claim to have a vested right in injustice being done due to some mistakes on its part.

38. Accordingly, on facts and circumstances of the case, we hold that taxpayer is not estopped from pointing out that Datamatics has wrongly been taken as comparable. While admitting additional ground of appeal raised by the assessee to require us to consider whether or not Datamatics should be included in the comparable, we make no comments on merit except observing that assessee from record has shown its prima facie case. Further claim may be examined by the Assessing Officer. This course we adopt as objection to the inclusion of Datamatics as comparable has been raised now and not before revenue authorities. Therefore, we deem it fit and proper to remit the matter to the file of the Assessing Officer for consideration of claim of the taxpayer and make a de novo adjudication of the arm's length price after providing reasonable opportunity of being heard to the assessee. We order accordingly.”

13. We also find that Accel Transmatic Ltd., has been held to be not comparable with software development service provider such as the Assessee in several decisions rendered by the Tribunal, the main decision being in the case of *Trilogy E-Business Software India Pvt. Ltd.*, ITA No.1054/Bang/2011 Bangalore ITAT. The decisions rendered by the Tribunal are later in point of time to the Transfer Pricing Study undertaken by the Assessee. The Assessee is entitled to take note of the subsequent judicial pronouncement and seek to exclude a company which is functionally not comparable with that of the Assessee. Even in respect of the other companies high turnover has been held to be a criteria to reject a company as a comparable in the aforesaid decision of ITAT Bangalore in the case of *Trilogy E-Business Software India Pvt.Ltd.* (supra). As held by the Special Bench in the case of *Quark Systems* (supra), there cannot be any tax liability on the basis of

admission and the determination of tax liability has to be in accordance with law. In the light of the aforesaid judicial pronouncement, we are of the view that the additional ground of appeal deserves to be admitted for adjudication. Accordingly, the additional ground is admitted for adjudication.

14. We will proceed to consider the comparability of companies chosen by the TPO and listed in the earlier part of this order.

15. As far as comparable companies listed at Sl.No.1,2,3 and 12 of the final list of comparable companies chosen by the TPO viz., M/S.Accel Transmatic Limited (seg.), Avani Cincom Technologies Ltd., Celestial labs Limited and KALS Infosystems Ltd., are concerned, this Tribunal in the case of *First Advantage Offshore Services Pvt. Ltd. Vs. DCIT IT (TP) No.1086/Bang/2011 for AY 07-08* held that the aforesaid companies are not comparable companies in the case of software development services provider. The nature of services rendered by the Assessee in this appeal and the Assessee in the case of *First Advantage Offshore Services Pvt.Ltd.(supra)* are one and the same. This fact would be clear from the fact that the very same 26 companies were chosen as comparable in the case of the Assessee as well as in the case of *First Advantage Offshore Services Pvt.Ltd.(supra)*. In coming to the aforesaid conclusion, the Tribunal in the case of *First Advantage Offshore Services Pvt.Ltd.(supra)* followed the decision rendered in the case of *Trilogy E-Business Software India Pvt.Ltd. Vs. DCIT ITA No.1064/Bang/2011 for AY 07-08 order dated 23.11.2012*. The following were the relevant observations in the case of *First Advantage Offshore Services Pvt. Ltd.(supra)*:

“18. As regards the group 2 companies which are to be excluded as functionally different based on the Tribunal’s order in the case of Trilogly E-Business Software India Pvt.Ltd., we find that these companies are-

- 1) Accel Transmatic
- 2) Avani Cimcon Technologies Ltd.
- 3) Celestial Labs Ltd.
- 4) KALS Information Systems Ltd.

19. The Tribunal in the case of *Trilogly E-Business Software India Pvt.Ltd.*, while considering the issue of improper selection of comparables has held as under:

(b) Avani Cimcon Technologies Ltd.

39. As far as this company is concerned, the plea of the Assessee has been that this company is functionally different from the assessee. Based on the information available in the company’s website, which reveals that this company has developed a software product by name “DXchange”, it was submitted that this company would have revenue from software product sales apart from rendering of software services and therefore is functionally different from the assessee. It was further submitted that the Mumbai Bench of the Tribunal to the decision in the case of *Telcordia Technologies Pvt. Ltd. v. ACIT – ITA No.7821/Mum/2011* wherein the Tribunal accepted the assessee’s contention that this company has revenue from software product and observed that in the absence of segmental details, Avani Cincom cannot be considered as comparable to the assessee who was rendering software development services only and it was held as follows:-

“7.8 Avani Cincom Technologies Ltd. (‘Avani Cincom’):

Here in this case also the segmental details of operating income of IT services and sale of software products have not been provided so as to see whether the profit ratio of this company can be taken into consideration for comparing the case that of assessee. In absence of any kind of details provided by the TPO, we are unable to persuade ourselves to include it as comparable party. Learned CIT DR has provided a copy of profit loss account which shows that mainly its earning is from software exports, however, the details of percentage of export of products or services have not been given. We, therefore, reject this company also from taking into consideration for comparability analysis.”

It was also highlighted that the margin of this company at 52.59% which represents abnormal circumstances and profits. The following figures were placed before us:-

Particulars	FYs 05-06	06-07	07-08	08-09
Operating Revenue	21761611	35477523	29342809	28039851
Operating Expns.	16417661	23249646	23359186	31108949
Operating Profit	5343950	12227877	5983623	(3069098)
Operating Margin	32.55%	52.59%	25.62%	- 9.87%

40. It was submitted that this company has made unusually high profit during the financial year 06-07. The operating revenues increased 63.03% which indicates that it was an extraordinary year for this company. Even the growth of software industry for the previous year as per NASSCOM was 32%. The growth rate of this company was double the industry average. In view of the above, it was argued that this company ought to have been rejected as a comparable.

41. We have given a careful consideration to the submissions made on behalf of the Assessee and are of the view that the same deserves to be accepted. The reasons given by the Assessee for excluding this company as comparable are found to be acceptable. The decision of ITAT (Mumbai) in the case of *Telcordia Technologies Pvt. Ltd. v. ACIT (supra)* also supports the plea of the assessee. We therefore accept the plea of the Assessee to reject this company as a comparable.

(c) **Celestial Labs Ltd.**

42. As far as this company is concerned, the stand of the assessee is that it is absolutely a research & development company. In this regard, the following submissions were made:-

- i. In the Director's Report (page 20 of PB-II), it is stated that "the company has applied for Income Tax concession for in-house R&D centre expenditure at Hyderabad under section 35(2AB) of the Income Tax Act."
- ii. As per the Notes to Accounts - Schedule 15, under "Deferred Revenue Expenditure" (page 31 of PB-II), it is mentioned that, "Expenditure incurred on research and development of new products has been treated as deferred revenue expenditure and the same has been written off in 10 years equally yearly installments from the year in which it is incurred."

An amount of Rs. 11,692,020/- has been debited to the Profit and Loss Account as "Deferred Revenue Expenditure" (page

30 of PB-II). This amounts to nearly **8.28 percent** of the sales of this company.

It was therefore submitted that the acceptance of this company as a comparable for the reason that it is into pure software development activities and is not engaged in R&D activities is bad in law.

43. Further reference was also made to the decision of the Mumbai Bench of the Tribunal in the case of *Teva Pharma Private Ltd. v. Addl. CIT – ITA No.6623/Mum/2011 (for AY 2007-08)* in which the comparability of this company for clinical trial research segment. The relevant extract of discussion regarding this company is as follows:

“The learned D.R. however drew our attention to page-389 of the paper book which is an extract from the Directors report which reads as follows:

‘The Company has developed a *de novo* drug design tool “CELSUITE” to drug discovery in, finding the lead molecules for drug discovery and protected the IPR by filing under the copy if sic (of) right/patent act. (Apprised and funded by Department of Science and Technology New Delhi) based on our insilico expertise (applying bio-informatics tools). The Company has developed a molecule to treat *Leucoderma and multiple cancer* and protected the IPR by filing the patent. The patent details have been discussed with Patent officials and the response is very favorable. The cloning and purification under wet lab procedures are under progress with our collaborative Institute, Department of Microbiology, Osmania University, Hyderabad. In the industrial biotechnology area, the company has signed the Technology transfer agreement with IMTECH CHANDIGARH (a very reputed CSIR organization) to manufacture and market initially two Enzymes, Alpha Amylase and Alkaline Protease in India and overseas. The company is planning to set up a biotechnology facility to manufacture industrial enzymes. This facility would also include the research laboratories for carrying out further R & D activities to develop new candidates’ drug molecules and license them to Interested Pharma and Bio Companies across the GLOBE. The proposed Facility will be set up in Genome Valley at Hyderabad in Andhra Pradesh.’

According to the learned D.R. celestial labs is also in the field of research in pharmaceutical products and should be considered as comparable. As rightly submitted by the learned counsel for the Assessee, the discovery is in relation to a software discovery of new drugs. Moreover the company also is owner of the IPR. There is however a reference to development of a molecule to treat cancer using bio-informatics tools for which patenting process was also being pursued. As explained earlier it is a diversified company and therefore cannot be considered as comparable functionally with

that of the Assessee. There has been no attempt made to identify and eliminate and make adjustment of the profit margins so that the difference in functional comparability can be eliminated. By not resorting to such a process of making adjustment, the TPO has rendered this company as not qualifying for comparability. We therefore accept the plea of the Assessee in this regard.' ”

44. It was submitted that the learned DR in the above case vehemently argued that this company is into research in pharmaceutical products. The ITAT concluded that this company is owner of IPR, it has software for discovery of new drugs and has developed molecule to treat cancer. In the ultimate analysis, the ITAT did not consider this company as a comparable in clinical trial segment, for the reason that this company has diverse business. It was submitted that, however, from the above extracts it is clear that this company is not into software development activities, accordingly, this company should be rejected as a comparable being functionally different.

45. From the material available on record, it transpires that the TPO has accepted that up to AY 06-07 this company was classified as a Research and Development company. According to the TPO in AY 07-08 this company has been classified as software development service provider in the Capitaline/Prowess database as well as in the annual report of this company. The TPO has relied on the response from this company to a notice u/s.133(6) of the Act in which it has said that it is in the business of providing software development services. The Assessee in reply to the proposal of the AO to treat this as a comparable has pointed out that this company provides software products/services as well as bioinformatics services and that the segmental data for each activity is not available and therefore this company should not be treated as comparable. Besides the above, the Assessee has point out to several references in the annual report for 31.3.2007 highlighting the fact that this company was develops biotechnology products and provides related software development services. The TPO called for segmental data at the entity level from this company. The TPO also called for description of software development process. In response to the request of the TPO this company in its reply dated 29.3.2010 has given details of employees working in software development but it is not clear as to whether any segmental data was given or not. Besides the above there is no other detail in the TPO's order as to the nature of software development services performed by the Assessee. Celestial labs had come out with a public issue of shares and in that connection issued Draft Red Herring Prospectus (DRHP) in which the business of this company was explained as to clinical research. The TPO wanted to know as to whether the primary business of this company is software development services as indicated in the annual report for FY 06-07 or clinical research and manufacture of bio products and other products as stated in the DRHP. There is no reference to any reply by Celestial labs

to the above clarification of the TPO. The TPO without any basis has however concluded that the business mentioned in the DRHP are the services or businesses that would be started by utilizing the funds garnered through the Initial Public Offer (IPO) and thus in no way connected with business operations of the company during FY 06-07. We are of the view that in the light of the submissions made by the Assessee and the fact that this company was basically/admittedly in clinical research and manufacture of bio products and other products, there is no clear basis on which the TPO concluded that this company was mainly in the business of providing software development services. We therefore accept the plea of the Assessee that this company ought not to have been considered as comparable.

(d) KALS Information Systems Ltd.

46. As far as this company is concerned, the contention of the assessee is that the aforesaid company has revenues from both software development and software products. Besides the above, it was also pointed out that this company is engaged in providing training. It was also submitted that as per the annual report, the salary cost debited under the software development expenditure was Q 45,93,351. The same was less than 25% of the software services revenue and therefore the salary cost filter test fails in this case. Reference was made to the Pune Bench Tribunal's decision of the ITAT in the case of *Bindview India Private Limited Vs. DCI*, ITA No. ITA No 1386/PN/IO wherein KALS as comparable was rejected for AY 2006-07 on account of it being functionally different from software companies. The relevant extract are as follows:

“16. Another issue relating to selection of comparables by the TPO is regarding inclusion of Kals Information System Ltd. The assessee has objected to its inclusion on the basis that functionally the company is not comparable. With reference to pages 185-186 of the Paper Book, it is explained that the said company is engaged in development of software products and services and is not comparable to software development services provided by the assessee. The appellant has submitted an extract on pages 185-186 of the Paper Book from the website of the company to establish that it is engaged in providing of I T enabled services and that the said company is into development of software products, etc. All these aspects have not been factually rebutted and, in our view, the said concern is liable to be excluded from the final set of comparables, and thus on this aspect, assessee succeeds.”

Based on all the above, it was submitted on behalf of the assessee that KALS Information Systems Limited should be rejected as a comparable.

47. We have given a careful consideration to the submission made on behalf of the Assessee. We find that the TPO has drawn conclusions on

the basis of information obtained by issue of notice u/s.133(6) of the Act. This information which was not available in public domain could not have been used by the TPO, when the same is contrary to the annual report of this company as highlighted by the Assessee in its letter dated 21.6.2010 to the TPO. We also find that in the decision referred to by the learned counsel for the Assessee, the Mumbai Bench of ITAT has held that this company was developing software products and not purely or mainly software development service provider. We therefore accept the plea of the Assessee that this company is not comparable.

(e) **Accel Transmatic Ltd.**

48. With regard to this company, the complaint of the assessee is that this company is not a pure software development service company. It is further submitted that in a Mumbai Tribunal Decision of *Capgemini India (F) Ltd v Ad. CIT 12 Taxman.com 51*, the DRP accepted the contention of the assessee that Accel Transmatic should be rejected as comparable. The relevant observations of DRP as extracted by the ITAT in its order are as follows:

“In regard to Accel Transmatics Ltd. the assessee submitted the company profile and its annual report for financial year 2005-06 from which the DRP noted that the business activities of the company were as under.

(i) Transmatic system - design, development and manufacture of multi function kiosks Queue management system, ticket vending system

(ii) Ushus Technologies - offshore development centre for embedded software, net work system, imaging technologies, outsourced product development

(iii) Accel IT Academy (the net stop for engineers)- training services in hardware and networking, enterprise system management, embedded system, VLSI designs, CAD/CAM/BPO

(iv) Accel Animation Studies software services for 2D/3D animation, special effect, erection, game asset development.

4.3 On careful perusal of the business activities of Accel Transmatic Ltd. DRP agreed with the assessee that the company was functionally different from the assessee company as it was engaged in the services in the form of ACCEL IT and ACCEL animation services for 2D and 3D animation and therefore assessee's claim that this company was functionally different was accepted. DRP therefore directed the Assessing Officer to exclude ACCEL Transmatic Ltd. from the final list of comparables for the purpose of determining TNMM margin.”

49. Besides the above, it was pointed out that this company has related party transactions which is more than the permitted level and therefore should not be taken for comparability purposes. The submission of the Id. counsel for the assessee was that if the above company should not be considered as comparable. The Id. DR, on the other hand, relied on the order of the TPO.

50. We have considered the submissions and are of the view that the plea of the assessee that the aforesaid company should not be treated as comparables was considered by the Tribunal in *Capgemini India Ltd (supra)* where the assessee was software developer. The Tribunal, in the said decision referred to by the Id. counsel for the assessee, has accepted that this company was not comparable in the case of the assessee engaged in software development services business. Accepting the argument of the Id. counsel for the assessee, we hold that the aforesaid company should be excluded as comparables.”

16. Respectfully following the decision of the Tribunal referred to above, we direct the AO/TPO to exclude the aforesaid companies from the final list of comparable companies for the purpose of determining ALP.

17. As far as comparable companies listed at Sl.No.11 & 14 of the final list of comparable companies chosen by the TPO viz., M/S.Ishir Infotech Ltd. And Lucid Software Ltd., is concerned, this Tribunal in the case of *First Advantage Offshore Services Pvt. Ltd. Vs. DCIT IT (TP) No.1086/Bang/2011 for AY 07-08* held that the aforesaid companies are not comparable companies in the case of software development services provider. The nature of services rendered by the Assessee in this appeal and the Assessee in the case of *First Advantage Offshore Services Pvt.Ltd.(supra)* are one and the same. This fact would be clear from the fact that the very same 26 companies were chosen as comparable in the case of the Assessee as well as in the case of *First Advantage Offshore Services Pvt.Ltd.(supra)*. The

following were the relevant observations in the case of *First Advantage Offshore Services Pvt.Ltd.(supra)*:-

“22. The learned counsel for the assessee submitted that these two companies are also to be excluded from the list of comparables on the basis of the finding of this Tribunal in the case of Mercedes Benz Research & Development India Pvt. Ltd. dt 22.2.2013, wherein at pages 17 and 22 of its order the distinctions as to why these companies should be excluded are brought out. He submitted that the facts of the case before us are similar and, therefore, the said decision is applicable to the assessee's case also.

23. The learned DR however objected to the exclusion of these two companies from the list of comparables. On a careful perusal of the material on record, we find that the Tribunal in the case of Mercedes Benz Research & Development India Pvt. Ltd. (cited supra) has taken a note of dissimilarities between the assessee therein and Lucid Software Ltd. As observed therein Lucid Software Ltd. company is also involved in the development of software as compared to the assessee, which is only into software services. Similarly, as regards Ishir Infotech Ltd., the Tribunal has considered the decision of the Tribunal in the case of 24/7 Co. Pvt. Ltd to hold that Ishir Infotech is also out-sourcing its work and, therefore, has not satisfied the 25% employee cost filter and thus has to be excluded from the list of comparables. As the facts of the case before us are similar, respectfully following the decision of the co-ordinate bench, we hold that these two companies are also to be excluded.”

18. Respectfully following the decision of the Tribunal referred to above, we direct the AO/TPO to exclude the aforesaid companies from the final list of comparable companies for the purpose of determining ALP.

19. As far as comparable companies listed at Sl.No.16 of the final list of comparable companies chosen by the TPO viz., M/S.Megasoft Limited is concerned, this Tribunal in the case of *First Advantage Offshore Services Pvt.Ltd. Vs. DCIT IT (TP) No.1086/Bang/2011 for AY 07-08* held that the aforesaid companies are not comparable companies in the case of software development services provider. The nature of services rendered by the Assessee in this appeal and the Assessee in the

case of *First Advantage Offshore Services Pvt.Ltd.(supra)* are one and the same. This fact would be clear from the fact that the very same 26 companies were chosen as comparable in the case of the Assessee as well as in the case of *First Advantage Offshore Services Pvt.Ltd.(supra)*. In coming to the aforesaid conclusion, the Tribunal in the case of *First Advantage Offshore Services Pvt.Ltd.(supra)* followed the decision rendered in the case of *Trilogy E-Business Software India Pvt. Ltd. Vs. DCIT ITA No.1064/Bang/2011 for AY 07-08 order dated 23.11.2012*. The following were the relevant observations in the case of *First Advantage Offshore Services Pvt.Ltd.(supra)*:

“27. As far as adoption of Mega Soft Ltd., as one of comparables, the learned counsel for the assessee submitted that there is an error in computing its net margin. He has drawn our attention to the order of the Tribunal in the case of *Trilogy E-Business Software India Pvt.Ltd.*, at para 24 to 27 at page 18, wherein the error in computing the net margin of this company has been taken note of and it has been directed as under:

(a) Megasoft Ltd. :

24. This company was chosen as a comparable by the TPO. The objection of the assessee is that there are two segments in this company viz., (i) software development segment, and (ii) software product segment. The Assessee is a pure software services provider and not a software product developer. According to the Assessee there is no break up of revenue between software products and software services business on a standalone basis of this comparable. The TPO relied on information which was given by this company in which this company had explained that it has two divisions viz., BLUEALLY DIVISION and XIUS-BCGI DIVISION. Xius-BCGI Division does the business of product software. This company develops packaged products for the wireless and convergent telecom industry. These products are sold as packaged products to customers. While implementing these standardized products, customers may request the company to customize products or reconfigure products to fit into their business environment. Thereupon the company takes up the job of customizing the packaged software. The company also explained that 30 to 40% of the product software would constitute packaged product and around 50% to 60% would constitute customized capabilities and expenses related to travelling, boarding

and lodging expense. Based on the above reply, the TPO proceeded to hold that the comparable company was mainly into customization of software products developed (which was akin to product software) internally and that the portion of the revenue from development of software sold and used for customization was less than 25% of the overall revenues. The TPO therefore held that less than 25% of the revenues of the comparable are from software products and therefore the comparable satisfied TPO's filter of more than 75% of revenues from software development services. The basis on which the TPO arrived at the PLI of 60.23% is given at page-115 and 116 of the order of the TPO. It is clear from the perusal of the same that the TPO has proceeded to determine the PLI at the entity level and not on the basis of segmental data.

25. In the order of the TPO, operating margin was computed for this company at 60.23%. It is the complaint of the assessee that the operating margins have been computed at entity level combining software services and software product segments. It was submitted that the product segment of Megasoft is substantially different from its software service segment. The product segment has employee cost of 27.65% whereas the software service segment has employee cost of 50%. Similarly, the profit margin on cost in product segment is 117.95% and in case of software service segment it is 23.11%. Both the segments are substantially different and therefore comparison at entity level is without basis and would vitiate the comparability (submissions on page 381 to 383 of the PB-I). It was further submitted that Megasoft Limited has provided segmental break-up between the software services segment and software product segment (page 68 of PB-II), which was also adopted by the TPO in his show cause notice (Page 84 of PB-I). The segmental results i.e., results pertaining to software services segment of this company was:

Segmental Operating Revenues	Rs.63,71,32,544
Segmental Operating Expenses	Rs.51,75,13,211
Operating Profit	Rs.11,96,19,333
OP/TC (PLI)	23.11%

26. It was reiterated that in the given circumstances only PLI of software service segment viz., 23.11% ought to have been selected for comparison.

27. It was further submitted that the learned TPO in case of other comparable, similarly placed, had adopted the margins of only the software service segment for comparability purposes. Consistent with such stand, it was submitted that the margins of the software segment

only should be adopted in the case of Megasoft also, in contrast to the entity level margins.

28. Computation of the net margin for Mega Soft Ltd. Is therefore remitted to the file of the TPO to compute the correct margin by following the direction of the Tribunal in the case of Trilogy E-Business Software India Pvt. Ltd.”

20. Respectfully following the decision of the Tribunal referred to above, we direct the AO/TPO to compute the correct margin of Mega Soft Ltd., as directed by the Tribunal in the case of *First Advantage Offshore Services Pvt.Ltd. (supra)*.

21. As far as comparable companies listed at Sl.No.10, 24 & 26 of the final list of comparable companies chosen by the TPO viz., M/S.Infosys Technologies Limited, Tata Elxsi Ltd. (Seg.) & Wipro Limited are concerned, this Tribunal in the case of *M/S. Curam Software International Pvt.Ltd. Vs. ITO ITA No.1280/Bang/2012 for AY 08-09 order dated 31.7.2013* has held that the aforesaid companies are not comparable companies in the case of software development services provider. The following were the relevant observations in the case of *M/S.Curam Software International Pvt. Ltd.(supra)*:

“12. (4) Infosys Technologies Ltd.

12.1 This was a comparable selected by the TPO. Before the TPO, the assessee objected to the inclusion of the company in the set of comparables, on the grounds of turnover and brand attributable profit margin. The TPO, however, rejected these objections raised by the assessee on the grounds that turnover and brand aspects were not materially relevant in the software development segment.

12.2 Before us, the assessee contended that this company is not functionally comparable to the assessee and in this context has cited various portions of the Annual Report of this company to this effect which is as under :-

(i) The company has an Intellectual Property (IP) Cell to guide its employees to leverage the power of IP for their growth. In 2008, this company generated over 102 invention disclosures and filed an aggregate 10 patents in India and the USA. Till date this company has filed an aggregate of 119 patent applications (pending) in India and USA out of which 2 have been granted in the US.

(ii) This company has substantial revenues from software products and the break-up of the software product revenues is not available.

(iii) This company has incurred huge research and development expenditure to the tune of approximately Rs.200 Crores.

(iv) This company has a revenue sharing agreement towards acquisition of IPR in AUTOLAY, a commercial software product used in designing high performance structural systems.

(v) The assessee also placed reliance on the following judicial decisions :-

(a) ITAT, Delhi Bench decision in the case of Agnity India Technologies India Pvt. Ltd. (ITA No.3856/Del/2010) and

(b) Trilogy E-Business Software India Pvt. Ltd. (ITA No.1054/Bang/2011)

12.3 Per contra, opposing the contentions of the assessee, the learned Departmental Representative submitted that comparability cannot be decided merely on the basis of scale of operations and the operating margins of this company have not been extraordinary. In view of this, the learned Departmental Representative supported the decision of the TPO to include this company in the list of comparable companies.

12.4 We have heard the rival submissions and perused and carefully considered the material on record. We find that the assessee has brought on record sufficient evidence to establish that this company is functionally dis-similar and different from the assessee and hence is not comparable and the finding rendered in the case of Trilogy E-Business Software India Pvt. Ltd. (supra) for Assessment Year 2007-08 is applicable to this year also. The argument put forth by assessee's is that Infosys Technologies Ltd is not functionally comparable since it owns significant intangible and has huge revenues from software products. It is also seen that the break up of revenue from software services and software products is not available. In this view of the matter, we hold that this company ought to be omitted from the set of comparable companies. It is ordered accordingly.

13.0 (5) Wipro Limited

13.1 This company was selected as a comparable by the TPO. Before the TPO, the assessee had objected to the inclusion of this company in the list of comparables on several grounds like functional dis-similarity, brand value, size, etc. The TPO, however, brushed aside the objections of the assessee and included this company in the set of comparables.

13.2 Before us, the assessee contended that this company is functionally not comparable to the assessee for several reasons, which are as under :

(i) This company owns significant intangibles in the nature of customer related intangibles and technology related intangibles and quoted extracts from the Annual Report of this company in the submissions made.

(ii) The TPO had adopted the consolidated financial statements for comparability purposes and for computing the margins, which contradicts the TPO's own filter of rejecting companies with consolidated financial statements.

13.3. Per contra, the learned Departmental Representative supported the action of the TPO in including this company in the set of comparables.

13.4.1 We have heard both parties and carefully perused and considered the material on record. We find merit in the contentions of the assessee for exclusion of this company from the set of comparables. It is seen that this company is engaged both in software development and product development services. There is no information on the segmental bifurcation of revenue from sale of product and software services. The TPO appears to have adopted this company as a comparable without demonstrating how the company satisfies the software development sales 75% of the total revenue filter adopted by him. Another major flaw in the comparability analysis carried out by the TPO is that he adopted comparison of the consolidated financial statements of Wipro with the stand alone financials of the assessee; which is not an appropriate comparison.

13.4.2 We also find that this company owns intellectual property in the form of registered patents and several pending applications for grant of patents. In this regard, the co-ordinate bench of this Tribunal in the case of 24/7 Customer.Com Pvt. Ltd. (ITA No.227/Bang/2010) has held that a company owning intangibles cannot be compared to a low risk captive service provider who does not own any such intangible and hence does not have an additional advantage in the market. As the assessee in the case on hand does not own any intangibles, following the aforesaid decision of the co-ordinate bench of the Tribunal i.e. 24/7 Customer.Com Pvt. Ltd.

(supra), we hold that this company cannot be considered as a comparable to the assessee. We, therefore, direct the Assessing Officer/TPO to omit this company from the set of comparable companies in the case on hand for the year under consideration.

14.0 (6) Tata Elxsi Ltd.

14.1 This company was a comparable selected by the TPO. Before the TPO, the assessee had objected to the inclusion of this company in the set of comparables on several counts like, functional dis-similarity, significant R&D activity, brand value, size, etc. The TPO, however, rejected the contention put forth by the assessee and included this company in the set of comparables.

14.2 Before us, it was reiterated that this company is not functionally comparable to the assessee as it performs a variety of functions under the software development and services segment namely

- (a) Product design services
- (b) Innovation design engineering and
- (c) visual computing labs.

In the submissions made the assessee had quoted relevant portions from the Annual Report of the company to this effect. In view of this, the learned Authorised Representative pleaded that this company be excluded from the list of comparables.

14.3 Per contra, the learned Departmental Representative supported the stand o the TPO in including this company in the list of comparables.

14.4.1 We have heard both parties and carefully perused and considered the material on record. From the details on record, we find that this company is predominantly engaged in product designing services and not purely software development services. The details in the Annual Report show that the segment “software development services” relates to design services and are not similar to software development services performed by the assessee.

14.4.2 The Hon'ble Mumbai Tribunal in the case of Telecordia Technologies India Pvt. Ltd. V ACIT (ITA No.7821/Mum/2011) has held that Tata Elxsi Ltd. is not a software development service provider and therefore it is not functionally comparable. In this context the relevant portion of this order is extracted and reproduced below :-

“ Tata Elxsi is engaged in development of niche product and development services which is entirely different from the assessee company. We agree with the contention of the learned Authorised

Representative that the nature of product developed and services provided by this company are different from the assessee as have been narrated in para 6.6 above. Even the segmental details for revenue sales have not been provided by the TPO so as to consider it as a comparable party for comparing the profit ratio from product and services. Thus, on these facts, we are unable to treat this company as fit for comparability analysis for determining the arm's length price for the assessee, hence, should be excluded from the list of comparable portion.”

As can be seen from the extracts of the Annual Report of this company produced before us, the facts pertaining to Tata Elxsi have not changed from Assessment Year 2007-08 to Assessment Year 2008-09. We, therefore, hold that this company is not to be considered for inclusion in the set of comparables in the case on hand. It is ordered accordingly.”

22. Respectfully following the decision of the Tribunal referred to above, we direct the AO/TPO to exclude the aforesaid companies from the final list of comparable companies for the purpose of determining ALP.

23. As far as comparable companies at Sl.No.5, 18, 19 and 25 of the final list of comparable companies chosen by the TPO are concerned, viz., M/S. E-Zest Solutions Ltd., Persistent Systems Ltd., Quintegra Solutions Limited and Third ware Solutions Ltd., this Tribunal in the case of 3DPLM Software Solutions Ltd. I.T (T.P) A. No.1303/Bang/2012 (Assessment Year: 2008-09) order dated 28.11.2013 was pleased to hold that the aforesaid companies are not comparable with a company engaged in Software Development Services such as the Assessee. The following were the relevant observations of the Tribunal:

“14. E-Zest Solutions Ltd.

14.1 This company was selected by the TPO as a comparable. Before the TPO, the assessee had objected to the inclusion of this company as a comparable on the ground that it was functionally different from the assessee. The TPO had rejected the objections raised by the assessee on the

ground that as per the information received in response to notice under section 133(6) of the Act, this company is engaged in software development services and satisfies all the filters.

14.2 Before us, the learned Authorised Representative contended that this company ought to be excluded from the list of comparables on the ground that it is functionally different to the assessee. It is submitted by the learned Authorised Representative that this company is engaged in 'e-Business Consulting Services', consisting of Web Strategy Services, I T design services and in Technology Consulting Services including product development consulting services. These services, the learned Authorised Representative contends, are high end ITES normally categorised as knowledge process Outsourcing ('KPO') services. It is further submitted that this company has not provided segmental data in its Annual Report. The learned Authorised Representative submits that since the Annual Report of the company does not contain detailed descriptive information on the business of the company, the assessee places reliance on the details available on the company's website which should be considered while evaluating the company's functional profile. It is also submitted by the learned Authorised Representative that KPO services are not comparable to software development services and therefore companies rendering KPO services ought not to be considered as comparable to software development companies and relied on the decision of the co-ordinate bench in the case of Capital IQ Information Systems (India) (P) Ltd. in ITA No.1961(Hyd)/2011 dt.23.11.2012 and prayed that in view of the above reasons, this company i.e. e-Zest Solutions Ltd., ought to be omitted from the list of comparables.

14.3 Per contra, the learned Departmental Representative supported the inclusion of this company in the list of comparables by the TPO.

14.4 We have heard the rival submissions and perused and carefully considered the material on record. It is seen from the record that the TPO has included this company in the list of comparables only on the basis of the statement made by the company in its reply to the notice under section 133(6) of the Act. It appears that the TPO has not examined the services rendered by the company to give a finding whether the services performed by this company are similar to the software development services performed by the assessee. From the details on record, we find that while the assessee is into software development services, this company i.e. e-Zest Solutions Ltd., is rendering product development services and high end technical services which come under the category of KPO services. It has been held by the co-ordinate bench of this Tribunal in the case of Capital I-Q Information Systems (India) (P) Ltd. Supra) that KPO services are not comparable to software development services and are therefore not comparable. Following the aforesaid decision of the co-ordinate bench of the Hyderabad Tribunal in the aforesaid case, we hold that this company,

i.e. e-Zest Solutions Ltd. be omitted from the set of comparables for the period under consideration in the case on hand. The A.O. /TPO is accordingly directed.

15. Thirdware Solutions Ltd. (Segment)

15.1 This company was proposed for inclusion in the list of comparables by the TPO. Before the TPO, the assessee objected to the inclusion of this company in the list of comparables on the ground that its turnover was in excess of Rs.500 Crores. Before us, the assessee has objected to the inclusion of this company as a comparable for the reason that apart from software development services, it is in the business of product development and trading in software and giving licenses for use of software. In this regard, the learned Authorised Representative submitted that :-

(i) This company is engaged in product development and earns revenue from sale of licences and subscription. It has been pointed out from the Annual Report that the company has not provided any separate segmental profit and loss account for software development services and product development services.

(ii) In the case of E-Gain communications Pvt. Ltd. (2008-TII-04-ITAT-PUNE-TP), the Tribunal has directed that this company be omitted as a comparable for software service providers, as its income includes income from sale of licences which has increased the margins of the company.

The learned A.R. prayed that in the light of the above facts and in view of the afore cited decision of the Tribunal (supra), this company ought to be omitted from the list of comparables.

15.2 Per contra, the learned Departmental Representative supported the action of the TPO in including this company in the list of comparables.

15.3 We have heard the rival submissions and perused and carefully considered the material on record. It is seen from the material on record that the company is engaged in product development and earns revenue from sale of licenses and subscription. However, the segmental profit and loss accounts for software development services and product development are not given separately. Further, as pointed out by the learned Authorised Representative, the Pune Bench of the Tribunal in the case of E-Gain Communications Pvt. Ltd. (supra) has directed that since the income of this company includes income from sale of licenses, it ought to be rejected as a comparable for software development services.

In the case on hand, the assessee is rendering software development services. In this factual view of the matter and following the afore cited decision of the Pune Tribunal (supra), we direct that this company be

omitted from the list of comparables for the period under consideration in the case on hand.”

“17. Persistent Systems Ltd.

17.1.1 This company was selected by the TPO as a comparable. The assessee objected to the inclusion of this company as a comparable for the reasons that this company being engaged in software product designing and analytic services, it is functionally different and further that segmental results are not available. The TPO rejected the assessee's objections on the ground that as per the Annual Report for the company for Financial Year 2007-08, it is mainly a software development company and as per the details furnished in reply to the notice under section 133(6) of the Act, software development constitutes 96% of its revenues. In this view of the matter, the Assessing Officer included this company i.e. Persistent Systems Ltd., in the list of comparables as it qualified the functionality criterion.

17.1.2 Before us, the assessee objected to the inclusion of this company as a comparable submitting that this company is functionally different and also that there are several other factors on which this company cannot be taken as a comparable. In this regard, the learned Authorised Representative submitted that :

(i) This company is engaged in software designing services and analytic services and therefore it is not purely a software development service provider as is the assessee in the case on hand.

(ii) Page 60 of the Annual Report of the company for F.Y. 2007-08 indicates that this company, is predominantly engaged in ‘Outsourced Software Product Development Services’ for independent software vendors and enterprises.

(iii) Website extracts indicate that this company is in the business of product design services.

(iv) The ITAT, Mumbai Bench in the case of Telecordia Technologies India Pvt. Ltd.(supra) while discussing the comparability of another company, namely Lucid Software Ltd. had rendered a finding that in the absence of segmental information, a company be taken into account for comparability analysis. This principle is squarely applicable to the company presently under consideration, which is into product development and product design services and for which the segmental data is not available.

The learned Authorised Representative prays that in view of the above, this company i.e. Persistent Systems Ltd. be omitted from the list of comparables.

17.2 Per contra, the learned Departmental Representative support the action of the TPO in including this company in the list of comparables.

17.3 We have heard the rival submissions and perused and carefully considered the material on record. It is seen from the details on record that this company i.e. Persistent Systems Ltd., is engaged in product development and product design services while the assessee is a software development services provider. We find that, as submitted by the assessee, the segmental details are not given separately. Therefore, following the principle enunciated in the decision of the Mumbai Tribunal in the case of Telecordia Technologies India Pvt. Ltd. (supra) that in the absence of segmental details / information a company cannot be taken into account for comparability analysis, we hold that this company i.e. Persistent Systems Ltd. ought to be omitted from the set of comparables for the year under consideration. It is ordered accordingly.

18. Quintegra Solutions Ltd.

18.1 This case was selected by the TPO as a comparable. Before the TPO, the assessee objected to the inclusion of this company in the set of comparables on the ground that this company is functionally different and also that there were peculiar economic circumstances in the form of acquisitions made during the year. The TPO rejected the assessee's objections holding that this company qualifies all the filters applied by the TPO. On the issue of acquisitions, the TPO rejected the assessee's objections observing that the assessee has not adduced any evidence as to how this event had an any influence on the pricing or the margin earned.

18.1.2 Before us, the assessee objected to the inclusion of this company for the reason that it is functionally different and also that there are other factors for which this company cannot be considered as a comparable. It was submitted that,

(i) Quintegra solutions Ltd., the company under consideration, is engaged in product engineering services and not in purely software development services. The Annual Report of this company also states that it is engaged in preparatory software products and is therefore not similar to the assessee in the case on hand.

(ii) In its Annual Report, the services rendered by the company are described as under :

“ Leveraging its proven global model, Quintegra provides a full range of custom IT solutions (such as development, testing, maintenance, SAP, product engineering and infrastructure management services), proprietary software products and consultancy services in IT on various platforms and technologies.”

(iii) This company is also engaged in research and development activities which resulted in the creation of Intellectual Proprietary Rights (IPRs) as can be evidenced from the statements made in the Annual Report of the company for the period under consideration, which is as under :

“ Quintegra has taken various measures to preserve its intellectual property. Accordingly, some of the products developed by the company have been covered by the patent rights. The company has also applied for trade mark registration for one of its products, viz. Investor Protection Index Fund (IPIF). These measures will help the company enhance its products value and also mitigate risks.”

(iv) The TPO has applied the filter of excluding companies having peculiar economic circumstances. Quintegra fails the TPO's own filter since there have been acquisitions in this case, as is evidenced from the company's Annual Report for F.Y. 2007-08, the period under consideration.

The learned Authorised Representative prays that in view of the submissions made above, it is clear that inter alia, this company i.e. Quintegra Solutions Ltd. being functionally different and possessing its own intangibles / IPRs, it cannot be considered as a comparable to the assessee in the case on hand and therefore ought to be excluded from the list of comparables for the period under consideration.

18.2 Per contra, the learned Departmental Representative supported the action of the TPO in including this company in the set of comparables to the assessee for the period under consideration.

18.3.1 We have heard the rival submissions and perused and carefully considered the material on record. It is seen from the details brought on record that this company i.e. Quintegra Solutions Ltd. is engaged in product engineering services and is not purely a software development service provider as is the assessee in the case on hand. It is also seen that this company is also engaged in proprietary software products and has substantial R&D activity which has resulted in creation of its IPRs. Having applied for trade mark registration of its products, it evidences the fact that this company owns intangible assets. The co-ordinate bench of this Tribunal in the case of 24/7 Customer.Com Pvt. Ltd. (ITA No.227/Bang/2010 dt.9.11.2012) has held that if a company possesses or owns intangibles or IPRs, then it cannot be considered as a comparable company to one that does not own intangibles and requires to be omitted from the list of comparables, as in the case on hand.

18.3.2 We also find from the Annual Report of Quintegra Solutions Ltd. that there have been acquisitions made by it in the period under consideration. It is settled principle that where extraordinary events have

taken place, which has an effect on the performance of the company, then that company shall be removed from the list of comparables.

18.3.3 Respectfully following the decision of the co-ordinate bench of the Tribunal in the case of 24/7 Customer.Com Pvt. Ltd. (supra), we direct that this company i.e. Quintegra Solutions Ltd. be excluded from the list of comparables in the case on hand since it is engaged in proprietary software products and owns its own intangibles unlike the assessee in the case on hand who is a software service provider.”

24. Respectfully following the decision of the Tribunal referred to above, we direct the AO/TPO to exclude the aforesaid companies from the final list of comparable companies for the purpose of determining ALP.

25. As far as comparable chosen by the TPO at Sl.No.8 of the final list of comparable viz., M/S.Helios & Matheson Information Technology Ltd., we find that the said company has been held to be not comparable with a software service provider like the Assessee by the ITAT Pune Bench in the case of *PTC Software (India)Pvt.Ltd. ITA.No.1605/PN/2011 (Asstt. Year : 2007-08) order dated 30.4.2013.*

The following were the relevant observations of the Tribunal:

“16. The next point made out by the assessee is with regard to the inclusion of items at (9) and (11) namely Helios & Matheson Information Technology Ltd., and KALS Information Solutions Ltd. (Seg). The primary plea raised by the assessee to assail the inclusion of the aforesaid two companies from the list of comparables is to be effect that they are functionally incomparable and therefore, are liable to be excluded. In sum and substance, the plea set up by the assessee is that both the aforesaid concerns are engaged in development and sale of software products which is functionally different from the services undertaken by the assessee in its IT-services segment.

17. As per the discussion in para 6.3.2. of the order of the TPO, the reason advanced for including KALS Information Systems Ltd., is to the effect that the said concern’s application software segment is engaged in the development of software which can be considered as comparable to the assessee company. The said concern is engaged in two segments namely application software segment and Training. As per the TPO, the application

software segment is functionally comparable to the assessee as the said concern is engaged in software services. The stand of the assessee is that a perusal of the Annual Report of the said concern for F.Y. 2006-07 reveals that the application software segment is engaged in the business of sale of software products and software services. The assessee pointed out this to the TPO in its written submissions, copy of which is placed in the Paper book at page 420.3 to 420.4. The assessee further pointed out that there was no bifurcation available between the business of sale of software products and the business of software services, and therefore, it was not appropriate to adopt the application software segment of the said concern for the purposes of comparability with the assessee's IT-Services Segment. The TPO however, noticed that though the application software segment of the said concern may be engaged in selling of some of the software products which are developed by it, however, the said concern was not into trading of software products as there were no cost of purchases debited in the Profit & Loss Account. Though the TPO agreed that the quantum of revenue from sale of products was not available as per the financial statements of the said concern, but as the basic function of the said concern was software development, it was includible as it was functionally comparable to the assessee's segment of IT-Services.

18. Before us, apart from reiterating the points raised before the TPO and the DRP, the Ld. Counsel submitted that in the immediately preceding assessment year of 2006-07, the said concern was evaluated by the assessee and was found functionally incomparable. For the said purpose, our reference has been invited to pages 421 to 542 of the Paper book, which is the copy of the Transfer Pricing study undertaken by the assessee for the A.Y. 2006-07, and in particular, attention was invited to page 454 where the accept reject matrix undertaken by the assessee reflected KALS Information Solutions Ltd. (Seg) as functionally incomparable. The Ld. Counsel pointed out that the aforesaid position has been accepted by the TPO in the earlier A.Y. 2006-07 and therefore, there was no justification for the TPO to consider the said concern as functionally comparable in the instant assessment year.

19. In our considered opinion, the point raised by the assessee is potent in as much as it is quite evident that the said concern has not been found to be functionally comparable with the assessee in the immediately preceding assessment year and in the present year also, on the basis of the Annual Report, referred to in the written submissions addressed to the lower authorities, the assessee has correctly asserted out that the said concern was inter alia engaged in sale of software products, which was quite distinct from the activity undertaken by the assessee in the IT Services segment. At the time of hearing, neither is there any argument put forth by the Revenue and nor is there any discussion emerging from the orders of the lower authorities as to in what manner the functional profile of the said concern has undergone a change from that in the immediately preceding year.

Therefore, having regard to the factual aspects brought out by the assessee, it is correctly asserted that the application software segment of the said concern is not comparable to the assessee's segment of IT services.

20. With regard to the inclusion of Helios & Matheson Information Technology Ltd., the assessee has raised similar arguments as in the case of KALS Information Solutions Ltd. (Seg). We have perused the relevant para of the order of the TPO i.e., 6.3.21, in terms of which the said concern has been included as a comparable concern. The assessee pointed out that as in the case of KALS Information Solutions Ltd. (Seg), in the instant case also for A.Y. 2006-07 the said concern was found functionally incomparable by the assessee in its Transfer pricing study and the said position was not disturbed by the TPO. The relevant portion of the Transfer pricing study, placed at page 432 of the Paper book has been pointed out in support. Considered in the aforesaid light, on the basis of the discussion in relation to KALS Information Solutions Ltd. (Seg), in the instant case also we find that the said concern is liable to be excluded from the list of comparables.”

26. Respectfully following the decision of the Tribunal referred to above, we direct the AO/TPO to exclude the aforesaid company from the final list of comparable companies for the purpose of determining ALP.

27. The Id. counsel for the assessee brought to our notice that out of the 26 comparable companies chosen by the TPO, the following companies will have to be excluded as the turnover of these companies are more than Rs.200 crores and cannot be compared with the Assessee whose turnover is less than Rs.20 crores:

(1) Flextronics Software Systems Ltd.	848.66 crores
(2) iGate Global Solutions Ltd.	747.27 crores
(3) Mindtree Ltd.	590.39 crores
(4) Persistent Systems Ltd.	293.74 crores
(5) Sasken Communication Technologies Ltd.	343.57 crores
(6) Tata Elxsi Ltd.	262.58 crores
(7) Wipro Ltd.	9616.09 crores
(8) Infosys Technologies Ltd.	13149 crores

28. Our attention was drawn to the observations of the Tribunal in the case of *Trilogy E-Business Software India Pvt.Ltd. (supra) (ITA No.1338/Bang/2010)* for same assessment year on the application of turnover filter and it was submitted that the aforesaid comparable companies have to be excluded from the final list of comparables selected by the TPO.

29. We have considered the submission of the learned counsel for the Assessee and the learned DR. In the case of *Trilogy E-Business Software India (P) Ltd. (supra)*, this Tribunal on application of the turnover filter while selecting comparable companies for comparability analysis held as follows:

“(1) Turnover Filter

11. The ld. counsel for the assessee submitted that the TPO has applied a lower turnover filter of RS. 1 crore, but has not chosen to apply any upper turnover limit. In this regard, it was submitted by him that under rule 10B(3) to the Income-tax Rules, it was necessary for comparing an uncontrolled transaction with an international transaction that there should not be any difference between the transactions compared or the enterprises entering into such transaction, which are likely to materially affect the price or cost charged or paid or profit arising from such transaction in the open market. Further it is also necessary to see that wherever there are some differences such differences should be capable of reasonable accurate adjustment in monetary terms to eliminate the effect of such differences. It was his submission that size was an important facet of the comparability exercise. It was submitted that significant differences in size of the companies would impact comparability. In this regard our attention was drawn to the decision of the Special Bench of the ITAT Chandigarh Bench in the case of *DCIT v. Quark Systems Pvt. Ltd. 38 SOT 207*, wherein the Special Bench had laid down that it is improper to proceed on the basis of lower limit of 1 crore turnover with no higher limit on turnover, as the same was not reasonable classification. Several other decisions were referred to in this regard laying down identical proposition. We are not referring to those decisions as the decision of the Special Bench on this

aspect would hold the field. Reference was also made to the OECD TP Guidelines, 2010 wherein it has been observed as follows:-

“Size criteria in terms of Sales, Assets or Number of Employees: The size of the transaction in absolute value or in proportion to the activities of the parties might affect the relative competitive positions of the buyer and seller and therefore comparability.”

12. The ICAI TP Guidelines note on this aspect lay down in para 15.4 that a transaction entered into by a Rs. 1,000 crore company cannot be compared with the transaction entered into by a Rs. 10 crore company. The two most obvious reasons are the size of the two companies and the relative economies of scale under which they operate. The fact that they operate in the same market may not make them comparable enterprises. The relevant extract is as follows [on Rule 10B(3)]:

“Clause (i) lays down that if the differences are not material, the transactions would be comparable. These differences could either be with reference to the transaction or with reference to the enterprise. For instance, a transaction entered into by a Rs 1,000 crore company cannot be compared with the transaction entered into by a Rs 10 crore company. The two most obvious reasons are the size of the two companies and the relative economies of scale under which they operate.”

13. It was further submitted that the TPO’s range (Rs. 1 crore to infinity) has resulted in selection of companies like Infosys which is 277 times bigger than the Assessee (turnover of Rs. 13,149 crores as compared to Rs. 47.47 crores of Assessee). It was submitted that an appropriate turnover range should be applied in selecting comparable uncontrolled companies.

14. Reference was made to the decision of the ITAT Bangalore Bench in the case of *Genesis Integrating Systems (India) Pvt. Ltd. v. DCIT, ITA No.1231/Bang/2010*, wherein relying on Dun and Bradstreet’s analysis, the turnover of RS. 1 crore to RS. 200 crores was held to be proper. The following relevant observations were brought to our notice:-

“9. Having heard both the parties and having considered the rival contentions and also the judicial precedents on the issue, we find that the TPO himself has rejected the companies which .ire (sic) making losses as comparables. This shows that there is a limit for the lower end for identifying the comparables. In such a situation, we are unable to understand as to why there should not be an upper limit also. What should be upper limit is another factor to be considered. We agree with the contention of the learned counsel for the

assessee that the size matters in business. A big company would be in a position to bargain the price and also attract more customers. It would also have a broad base of skilled employees who are able to give better output. A small company may not have these benefits and therefore, the turnover also would come down reducing profit margin. Thus, as held by the various benches of the Tribunal, when companies which are loss making are excluded from comparables, then the super profit making companies should also be excluded. For the purpose of classification of companies on the basis of net sales or turnover, we find that a reasonable classification has to be made. Dun & Bradstreet & Bradstreet and NASSCOM have given different ranges. Taking the Indian scenario into consideration, we feel that the classification made by Dun & Bradstreet is more suitable and reasonable. In view of the same, we hold that the turnover filter is very important and the companies having a turnover of Rs.1.00 crore to 200 crores have to be taken as a particular range and the assessee being in that range having turnover of 8.15 crores, the companies which also have turnover of 1.00 to 200.00 crores only should be taken into consideration for the purpose of making TP study.”

15. It was brought to our notice that the above proposition has also been followed by the Honourable Bangalore ITAT in the following cases:

1. M/s Kodiak Networks (India) Private Limited Vs. ACIT (ITA No.1413/Bang/2010)
2. M/s Genesis Microchip (I) Private Limited Vs. DCIT (ITA No.1254/Bang/2010).
3. Electronic for Imaging India Private Limited (ITA No. 1171/Bang/2010).

It was finally submitted that companies having turnover more than Rs. 200 crores ought to be rejected as not comparable with the Assessee.

16. The Id. DR, on the other hand pointed out that even the assessee in its own TP study has taken companies having turnover of more than RS. 200 crores as comparables. In these circumstances, it was submitted by him that the assessee cannot have any grievance in this regard.

17. We have considered the rival submissions. The provisions of the Act and the Rules that are relevant for deciding the issue have to be first seen. Sec.92. of the Act provides that any income arising from an international transaction shall be computed having regard to the arm's length price. Sec.92-B provides that “international transaction” means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing

money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises. Sec.92-A defines what is an Associated Enterprise. In the present case there is no dispute that the transaction between the Assessee and its AE was an international transaction attracting the provisions of Sec.92 of the Act. Sec.92C provides the manner of computation of Arm's length price in an international transaction and it provides:-

(1) that the arm's length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely :—

- (a) comparable uncontrolled price method;
- (b) resale price method;
- (c) cost plus method;
- (d) profit split method;
- (e) transactional net margin method;
- (f) such other method as may be prescribed by the Board.

(2) The most appropriate method referred to in sub-section (1) shall be applied, for determination of arm's length price, in the manner as may be prescribed:

Provided that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices:

Provided further that if the variation between the arm's length price so determined and price at which the international transaction has actually been undertaken does not exceed five per cent of the latter, the price at which the international transaction has actually been undertaken shall be deemed to be the arm's length price.

(3) Where during the course of any proceeding for the assessment of income, the Assessing Officer is, on the basis of material or information or document in his possession, of the opinion that—

- (a) the price charged or paid in an international transaction has not been determined in accordance with sub-sections (1) and (2); or
- (b) any information and document relating to an international transaction have not been kept and maintained by the assessee in accordance with the provisions contained in sub-section (1) of section 92D and the rules made in this behalf; or
- (c) the information or data used in computation of the arm's length price is not reliable or correct; or
- (d) the assessee has failed to furnish, within the specified time, any information or document which he was required to furnish by a notice issued under sub-section (3) of section 92D,

the Assessing Officer may proceed to determine the arm's length price in relation to the said international transaction in accordance with sub-sections (1) and (2), on the basis of such material or information or document available with him.”

18. Rule 10B of the IT Rules, 1962 prescribes rules for Determination of arm's length price under section 92C:-

“10B. (1) For the purposes of sub-section (2) of section 92C, the arm's length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, in the following manner, namely :—

(a).....

to

(d).....

(e) transactional net margin method, by which,—

- (i) the net profit margin realised by the enterprise from an international transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;
- (ii) the net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;
- (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;

- (iv) the net profit margin realised by the enterprise and referred to in sub-clause (i) is established to be the same as the net profit margin referred to in sub-clause (iii);
- (v) the net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction.

(2) For the purposes of sub-rule (1), the comparability of an international transaction with an uncontrolled transaction shall be judged with reference to the following, namely:—

- (a) the specific characteristics of the property transferred or services provided in either transaction;
- (b) the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;
- (c) the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;
- (d) conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

(3) An uncontrolled transaction shall be comparable to an international transaction if—

- (i) none of the differences, if any, between the transactions being compared, or between the enterprises entering into such transactions are likely to materially affect the price or cost charged or paid in, or the profit arising from, such transactions in the open market; or

- (ii) reasonably accurate adjustments can be made to eliminate the material effects of such differences.

(4) The data to be used in analysing the comparability of an uncontrolled transaction with an international transaction shall be the data relating to the financial year in which the international transaction has been entered into :

Provided that data relating to a period not being more than two years prior to such financial year may also be considered if such data reveals facts which could have an influence on the determination of transfer prices in relation to the transactions being compared.”

19. A reading of the provisions of Rule 10B(2) of the Rules shows that uncontrolled transaction has to be compared with international transaction having regard to the factors set out therein. Before us there is no dispute that the TNMM is the most appropriate method for determining the ALP of the international transaction. The disputes are with regard to the comparability of the comparable relied upon by the TPO.

20. In this regard we find that the provisions of law pointed out by the Id. counsel for the assessee as well as the decisions referred to by the Id. counsel for the assessee clearly lay down the principle that the turnover filter is an important criteria in choosing the comparables. The assessee’s turnover is RS. 47,46,66,638. It would therefore fall within the category of companies in the range of turnover between 1 crore and 200 crores (as laid down in the case of *Genesis Integrating Systems (India) Pvt. Ltd. v. DCIT, ITA No.1231/Bang/2010*) . Thus, companies having turnover of more than 200 crores have to be eliminated from the list of comparables as laid down in several decisions referred to by the Id. counsel for the assessee. Applying those tests, the following companies will have to be excluded from the list of 26 comparables drawn by the TPO viz.,

	<u>Turnover Rs.</u>
(1) Flextronics Software Systems Ltd.	848.66 crores
(2) iGate Global Solutions Ltd.	747.27 crores
(3) Mindtree Ltd.	590.39 crores
(4) Persistent Systems Ltd.	293.74 crores
(5) Sasken Communication Technologies Ltd.	343.57 crores
(6) Tata Elxsi Ltd.	262.58 crores
(7) Wipro Ltd.	961.09 crores.
(8) Infosys Technologies Ltd.	13149 crores.”

30. Respectfully following the aforesaid decision of the Tribunal in the case of *Trilogy E-Business Software India Pvt.Ltd. (supra)*, we hold that the aforesaid companies should be excluded from the list of comparable companies. The AO is directed to compute the Arithmetic mean by excluding the aforesaid companies from the list of comparable.

31. The AO/TPO is directed to compute the arithmetic mean of the profit margins of the remaining comparable companies after excluding the companies from the final list of 26 comparable companies chosen by the TPO and compare the same with the profit margin of the Assessee in accordance with the provisions of Sec.92C of the Act.

32. No other arguments were raised on the other issues raised in the grounds of appeal (No.1 to 6) and therefore the issue with regard to determination of ALP of the international transaction of providing software development services to the AE by the Assessee is decided as set out in the earlier paragraphs.

33. Ground No.7 raised by the Assessee was not pressed due to insignificant tax effect and hence the same is dismissed as not pressed.

34. Ground No.8 raised by the Assessee project the grievance of the Assessee regarding the action of the learned Assessing Officer and Honorable Dispute Resolution Panel in excluding while computing deduction u/s.10A of the Act telecommunication expenses of Rs.55,51,700 and expenditure incurred in foreign currency amounting to Rs.1,81,04,482 are to be excluded from export turnover on the ground that these expenses (except telecommunication charges) are not incurred in rendering technical services rendered to clients outside India or were not incurred in connection with export of software out of India. It is the plea of the

Assessee that at all times during the relevant previous year, it was engaged in development of computer software and not in rendering any technical services. Without prejudice to its contention that the aforesaid sums should not be excluded from the export turnover while computing deduction u/s.10A of the Act, the Assessee has also made an alternate prayer (in ground No.8(c)) that expenses that are reduced from the export turnover should also be reduced from the total turnover and in this regard has placed reliance on the decision of the Hon'ble Karnataka High Court in the case of *CIT v. Tata Elxsi Ltd [2012] 349 ITR 98 (Karn)*.

35. We have heard the Id. counsel for the assessee and the Id. DR on the issues raised in concise ground No.8. Taking into consideration the decision rendered by the Hon'ble High Court of Karnataka in the case of *CIT v. Tata Elxsi Ltd [2012] 349 ITR 98 (Karn)*, we are of the view that it would be just and appropriate to direct the Assessing Officer to exclude telecommunication charges, consultancy charges, repairs and maintenance and certain other expenses incurred by the Assessee (including expenses incurred in foreign currency), both from export turnover and total turnover, as has been prayed for by the assessee in ground No.8(c) . In view of the acceptance of the alternative prayer in ground No.8 (c), we are of the view that no adjudication is required on ground No.8 (a) & (b).

36. The other grounds of appeal raised by the Assessee are purely consequential (ground No.9) regarding charging of interest u/s.234B of the Act and the AO is directed to give consequential relief. Ground No.10 regarding initiation of penalty u/s.271(1)(c) of the Act, is not appealable and hence dismissed. No arguments were advanced on Ground No.11 and hence dismissed. Ground No.12 is general ground calling for no specific adjudication.

37. In the result, the appeal of the Assessee is partly allowed.

Pronounced in the open court on this 23rd day of September, 2015.

Sd/-

(ABRAHAM P. GEORGE)
Accountant Member

Sd/-

(N.V. VASUDEVAN)
Judicial Member

Bangalore,
Dated, the 23rd September, 2015.

/D S/

Copy to:

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

By order

Assistant Registrar /
Senior Private Secretary
ITAT, Bangalore.