

आयकर अपीलीय अधिकरण, 'डी' न्यायपीठ, चेन्नई।
**IN THE INCOME TAX APPELLATE TRIBUNAL
'D' BENCH: CHENNAI**

श्री एन.आर.एस. गणेशन, न्यायिक सदस्य एवं
श्री डि.एस. सुन्दर सिंह, लेखा सदस्य के समक्ष

**BEFORE SHRI N.R.S. GANESAN, JUDICIAL MEMBER AND
SHRI D.S.SUNDER SINGH, ACCOUNTANT MEMBER**

आयकर अपील सं./ITA No.2052/Mds/2011
निर्धारण वर्ष /Assessment Year: 2007-08

M/s.Sella Synergy India Pvt. Ltd.,
1st Floor, "Elnet Software City",
TS-140, Rajiv Gandhi Salai,
Taramani, Chennai,
Tamil Nadu-600 113.

Vs. The Asst. Commissioner of
Income Tax,
Circle-VI(2),
Chennai,
Tamil Nadu-600 034.

[PAN: AACCS9750 N]

(अपीलार्थी/Appellant)

(प्रत्यर्थी/Respondent)

अपीलार्थी की ओर से/ Appellant by

: Mr.N.V.Balaji, Adv.

प्रत्यर्थी की ओर से /Respondent by

: Mr.Pathlavath Peerya, CIT

सुनवाई की तारीख/Date of Hearing

: 04.01.2017

घोषणा की तारीख /Date of Pronouncement

: 17.03.2017

आदेश / O R D E R

PER D.S.SUNDER SINGH, ACCOUNTANT MEMBER:

This is an appeal filed by the assessee against the Order dated 17/10/2011 of Assistant Commissioner of Income Tax,(Co), Circle-VI(2), Chennai-34, U/s 143(3) r.w.s.144C(13) for the Assessment Year 2007-08 and raised the following grounds:

Grounds of Appeal:

1. The assessment Order dated October 17, 2011, passed by the learned Assessing Officer ("AO") under section 143(3) read with section 92CA(4) and 144C(13) of the Income-Tax Act, 1961 (Act") is not in accordance with the law and is contrary to the facts and circumstances of the present case and in any case in violation of principles of equity and natural justice.

Adjustment under section 92CA of the Act in respect of software development services

2. The Honourable DRP and the Ld.AO/TPO have erred in law and on facts in rejecting Transfer Pricing documentation carried out by the Appellant containing detailed computation of ALP and erred in conducting a fresh search for comparables.
3. The learned AO/ Honourable DRP have erred in law in rejecting the use of previous years' financial data of comparables for determining ALP without appreciating the fact that impact or influence of past data on the current year profits is inherent in the software development or service industry.
4. The Honourable DRP has erred in upholding the use of information obtained under section 133(6) of the Act by the TPO at the time of assessment proceedings, as it is not in accordance with law and in violation of the principles of equity and natural justice.
5. The Honorable DRP and Ld.AO have erred in law and on facts in applying additional filters without appreciating that the Appellant had itself applied adequate and relevant filters in its benchmarking study.
6. The Honourable DRP and the Ld.AO have erred in law by rejecting the objections raised by the Appellant in relation to inclusion of additional companies as comparables by the Ld.TPO, without considering factors such as functional differences, high turnover, abnormal profit margins, exceptional year, failing the filters applied by the TPO himself and other relevant factors.
7. The learned AO/Honourable DRP has erred in upholding the rejection by the TPO of the comparables selected by the Appellant in its Transfer Pricing study.
8. The learned AO/Honourable DRP has erred in upholding the excessive margins computed by the TPO for the comparable companies, which in some cases was also erroneously computed on an entity wide basis without considering that that company had other operations, which were not functionally comparable.
9. The learned AO/Honourable DRP have erred in not appreciating that the appellant, being a captive service provider operated at lower risk levels as compared to comparable companies, which carry higher risks and accordingly erred in not granting appropriate adjustments to the margins of the comparables.
10. Without prejudice to the other grounds, learned AO/Honourable DRP have erred in making the adjustment under section 92 of the Act when the appellant income is not taxable as provided vide paragraph 55.5 of Circular No.14/200 of the CBDT and the principles of the Bangalore Tribunal in the case of Philips Software Centre Private Limited (26 SOT 226).

Adjustment under section 92CA of the Act in respect of management fees paid

11. The learned AO/Honourable DRP has erred in upholding the TPO's action of determining the ALP of management fee paid at zero without considering the benefits derived, relevant facts and submissions provided by the appellant.
12. The learned AO/Honourable DRP has erred in determining that the arm's length price of the management fees to be Nil without referring to any method prescribed under the Act and without referring to any comparable and merely on the assumption that the services did not result in any benefit to the appellant and that the services were duplicative in nature.

13. The learned AO/Honourable DRP has erred in concluding without any basis that most of the services received by the appellant from its AEs are in the nature of shareholder services or stewardship services.

Grounds of Objection against Error in Computation of Income

14. The learned AO/Honourable DRP has erred in taking the total income at Rs.2,33,86,490/- by further adding income-tax and fringe benefit taxes to the profit and not considering the fact that the total income of the assessee was only Rs.1,63,10,363/- which is the profit before income-tax and fringe benefit tax.
15. The learned AO/Honourable DRP failed to rectify the mistake apparent from the record in the intimation under section 143(1) of the Act as well as in response to the assessee's application for the rectification of the same.
16. The learned AO/Honourable DRP failed to take into account the revised computation of total income submitted by the assessee, whereby the total income was reduced to Rs.1,77,15,551/-.

2.0 M/s.Sella Synergy India Pvt. Ltd., is a subsidiary of M/s.Sella Holding N.V. and part of Gruppo Banca Sella (GBS) based in northern Italy. M/s.Sella Synergy India Pvt. Ltd., is a part of Information Technology arm of the Gruppo Banca Sell catering to the software needs there for.

2.1 During the previous year 2005-06, the company has entered into the following international transaction with its AE:

Name of the AE	Nature of transactions	Value	Method
Banca Sella S.p.A, Italia, Italy	Software development	140783711	CUP
	Reimbursement of expenses	16844488	
Banca Sella – Miami	Software development	99691	
Gestnord Fondi SGR S.p.A, Milano	Software development	2315766	
Total		160043656	

2.2 AO having noticed the international transaction referred the issue to the TPO for determining the ALP. The TPO noticed from Form-3CEB Report that the assessee has reported to have adopted the Comparable Uncontrolled Price (in short 'CUP') method but the AO observed that the

arms length price of the international transactions relating to software Development services provided to the Associated Enterprise (AE), by applying Transaction Net Margin Method (in short 'TNMM') as most appropriate method in the facts and circumstances. The PLI adopted is the Operating Profit to Total Cost (OPTC). The assessee has selected the following 28 comparables with average arithmetic mean of 14.53%:

Margin Analysis		
Unadjusted margins of comparable companies		
Sl. No.	Name of the company	Weighted average margins (%)
1	Akshay Software Technologies Limited	7.64%
2	Aztecsoft Limited (formerly known as Aztec Software & Technology Services Limited)	18.42%
3	Four Soft Limited	22.27%
4	Gebbs Infotech Limited	16.52%
5	Genesys International Corpn. Limited	-11.24%
6	Goldstone Technologies Limited	3.79%
7	Hellos & Matheson Information Technology Limited	35.17%
8	Infosys Technologies Limited	41.04%
9	K P I T Cummins Infosystems Limited	13.30%
10	Lanco Global Systems Limited	6.73%
11	Larsen & Toubro Infotech Limited	11.03%
12	Maars Software International Limited	17.12%
13	Melstar Information Technologies Limited	1.30%
14	MindTree Consulting Limited	16.60%
15	Orient Information Technology Limited	2.68%
16	Quintegra Solutions Limited	11.93%
17	R S Software (India) Limited	12.19%
18	S I P Technologies and Exports Limited	25.25%
19	Sasken Communication Technologies Limited	17.71%
20	Sasken Network Systems Limited	16.19%
21	Satyam Computers Services Limited	29.27%
22	T V S Infotech Limited	-4.81%
23	Transworld Infotech Limited	26.34%
24	Tyche Industries Limited	10.62%
25	V J I L Consulting Limited	6.26%
26	V M F Softech Limited	18.39%
27	Visualsoft Technologies Limited	18.73%
28	Zylog Systems Limited	16.32%
	Arithmetic mean	14.53%
	Lower Range (-5%)	8.80%
	Upper Range (+5%)	20.25%

2.3 The assessee's company's margin was 11.3% since the difference in margin is less than (+/- 5%), the assessee held the international transactions are at arm's length price. The AO observed from the transfer pricing document that the assessee has arrived the average PLI of comparables at 11.45% by considering weighted average margin of 3 years data for the FY 2004-05, 2005-06 & 2006-07. Since the assessee stated in the transfer pricing document that the CUP method has been adopted but applied TNMM method and considered three years weighted average to arrive at the average margin, the AO rejected the TP study of the assessee and conducted separate study, made FAR analysis and selected following additional filters for selection of suitable comparables functionally similar to that of the tested party:

- *Companies whose data is not available for the FY 2006-07 were excluded.*
- *Companies whose software development service Income <Rs.1 Cr. were excluded.*
- *Companies whose Software Development Service is less than 75% of the total operating revenues were excluded.*
- *Companies who have more than 25% related party transactions (sales as well as expenditure combined) of the sales were excluded.*
- *Companies who have export sales less than 25% of the sales were excluded.*
- *Companies who have diminishing revenues/persistent losses for the last three years up to and including FY 2006-07 were excluded.*
- *Companies having different financial year ending (i.e. not March 31, 2007) or data of the company does not fall within 12 month period i.e. 01-04-2006 to 31-03-2007, were rejected.*

The AO also collected information u/s.136(6) and identified 28 comparables and arrived at the average margin of 27.96% as under:

Sl. No.	Company Name	Sales (Rs.Cr.)	OP to Total Cost%	Data base
1	Accel Transmatic Ltd. (Seg.)	9.68	21.11%	P (Seg.)
2	Avani Cimcon Technologies Ltd.	3.55	52.59%	P
3	Bodhtree Consulting Ltd. (Seg.)	7.40	109.79%	P
4	Celestial Labs Ltd.	14.13	58.35%	P
5	Datamatics Ltd.	54.51	7.27%	P
6	E-Zest Solutions Ltd.	6.26	36.12%	P (Seg.)
7	Flextronics Software Systems Ltd. (Seg.)	848.66	25.31%	-
8	Geometric Ltd. (Seg.)	158.38	10.71%	P
9	Hellos & Matheson Information Technology Ltd.	183.51	40.35%	P
10	IGate Global Solutions Ltd.	747.27	7.49%	P
11	Infosys Technologies Ltd.	13149	40.30%	P
12	Ishir Infotech Ltd.	7.42	30.12%	C
13	KALS Information Systems Ltd. (Seg.)	2.00	30.55%	P
14	LGS Global Ltd. (Lanco Global Solutions Ltd.)	45.39	15.75%	P
15	Lucid Software Ltd.	1.70	54.85%	P
16	Mediasoft Solutions Ltd.	1.85	3.66%	P
17	Megasoft Ltd. (Seg.)	63.71	23.11%	P
18	Mindtree Ltd.	590.35	16.90%	P
19	Persistent Systems Ltd.	293.75	24.52%	P
20	Quintegra Solutions Ltd.	62.72	12.56%	P
21	R S Software (India) Ltd.	101.04	13.47%	P
22	R Systems International Ltd. (Seg.)	112.01	15.07%	P
23	Sasken Communication Technologies Ltd. (Seg.)	343.57	22.16%	P
24	SIP Technologies & Exports Ltd.	3.80	13.90%	P
25	Tata Elxsi Ltd. (Seg.)	262.58	26.51%	P
26	Thirdware Solutions Ltd.	36.08	25.12%	C
27	TVS Infotech Ltd.	7.24	11.61%	P
28	Wipro Ltd. (Seg.)	9616.09	33.65%	P
			27.96%	

2.4 The TPO issued show cause notice to call for explanation of the assessee as to why the fresh set of comparables should not be adopted to determine ALP of sales made to AE. The assessee raised objections which was considered by the TPO and rejected the assessee's submissions. The TPO added extra filters to determine the comparables as discussed above. The assessee has made the payment of Rs.31,18,602/- as payment of management fee to AE. The TPO verified the reasons for the payment of services rendered by the AE to the assessee company and noticed that no management fee was paid in the earlier years and of the view that payment of management fee was not justified. Therefore, determined the

ALP of management fee at zero and worked out the PLI of the company @13.61%.

2.5 The assessee has adopted multiple year data of three years weighted average for computing the comparable margin. The assessee could not establish that the earlier year margins have influenced the current year margins and as per Sec.92C and Rule 10B requires to apply contemporaneous data, hence the TPO rejected the multiple year data adopted by the assessee as per Rule 10B(4) and considered the current year data.

2.6 The TPO rejected the assessee's claim for standard deduction benefit of (+/-)5% and determined the ALP considering the arithmetic mean of PLI of comparables @22.94% after giving working capital adjustment of 2.5% and determined the ALP of sale to AE at Rs.15,49,61,504/- and suggested for upward adjustment in AE at sale price of Rs.1,17,62,336/- as under:

Determination of ALP

Determination of Arms Length Price

Profit Level Indicator (PLI) adopted: % of Operating Profit / Operating cost

Operating Sales of the assessee company (A) :	Rs.14,31,99,168/-
Operating Cost of the assessee company (B) :	
1. Employee cast:	Rs.8,90,78,639/-
2. Administration expense excluding Bank charges, interest expense & Loss on exchange fluctuation & Mgt fee	Rs.2,61,12,681/-
3. Maintenance cost	Rs.72,20,748/-
4. Depreciation	Rs.36,34,381/-
	Rs.12,60,46,449/-
Operating Profit (C=A-B) :	Rs.1,71,52,719/-
PLI of the assessee company	13.61%
PLI of the Comparables	22.94
Expected Arms length profit@ 22.94% on operating cost (D) :	Rs.2,89,15,055/-
Arms Length sale price (B+D) :	Rs.15,49,61,504/-
Less: Actual AE sale price of the assessee company	Rs.14,31,99,168/-
Difference to be adjusted	Rs.1,17,62,336/-

3.0 The AO on receipt of order from the TPO issued draft the Assessment Order proposing the adjustments suggested by the TPO. Against the draft Assessment Order, the assessee filed objections before the DRP. The DRP rejected the assessee's objections regarding the comparables and the Management fee. The AO passed the Assessment Order u/s.143(3) r/w Sec.144C as per the directions issued by the DRP against which the assessee filed the appeal before this Tribunal.

4.0 Assailing the orders of AO/DRP the assessee raised 16 grounds in this appeal.

5.0 Ground No.1 is general in nature which does not require specific adjudication.

6.0 Ground Nos.2 to 5 & 7 to 10 are not pressed by the Ld.AR of the assessee and no arguments are made assailing these grounds. Therefore, Ground Nos.2 to 5 & 7 to 10 are dismissed as not pressed.

7.0 Ground No.6 is related to the selection of comparables.

8.0 Appearing for the assessee, the Ld.Counsel of the assessee Mr.N.V.Balaji argued that out of the 28 comparable companies selected by the TPO, following comparables considered by the TPO are functionally dissimilar and required to be excluded from the list of comparables:

Sl. No.	Company Name	OP to Total Cost%	Reasons for exclusion
1	Accel Transmatic Ltd. (Seg.)	21.11%	Functionally different – Diversified operations – 2D/3D animation (media), manufacture of Kiosks and queue management systems. Software segment services revenues is 967 lacs. Related party services is 387 lacs or 40% of software segment revenues [Page 977&979 of PB-III]
2	Avani Cimcon Technologies Ltd.	52.59%	Functionally Different -Developed a product called 'Dxchange' - revenue break-up from product sales not available. [Page 373 &378 of PB-III]
3	Bodhtree Consulting Ltd. (Seg.)	109.79%	Functionally Different -Further, for AY 2007-08 the company has undergone business re-structuring and expenses have been transferred to associate company.[Page 282-3 of PB-II].
4	Celestial Labs Ltd.	58.35%	Functionally Different- Biotech company which has in-house R&D centre; developed a drug design tool 'celsuite', filed for IPRs relating to drug discovery. Also Fails Employee cost filter of TPO which is less than 25% revenues [Page 326, 339-40 of PB-II]
5	E-Zest Solutions Ltd.	36.12%	Functionally different - as it is engaged in high end product design services similar to a KPO[Page 630 of PB-III]
6	Flextronics Software Systems Ltd. (Seg.)	25.31%	Functionally different with revenue mix comprising of communication products and services rendered [Also Nine month financial year data only available.] [Page 663,679 of PB-III].
7	Ishir Infotech Ltd.	30.12%	Functionally different - engaged in outsourcing model of business operations [Page 764,767 of PB-III]
8	KALS Information Systems Ltd. (Seg.)	30.55%	Functionally different - Revenues comprise mix of product sales and services rendered[Page 757-58 of PB-III]
9	Lucid Software Ltd.	54.85%	Functionally different - Revenues comprise mix of software product and services rendered[Page 372 of PB-II]
10	Persistent Systems Ltd.	24.52%	Functionally different - Revenues comprise mix of software product and services rendered [Page 775-780, 796,805 of PB-III]
11	Tata Elxsi Ltd. (Seg.)	26.51%	Functionally different - software segment includes design engineering, visual computing, and industrial engineering services. Enjoys significant brand value[Page 918 & 936 of PB-III]
12	Thirdware Solutions Ltd.	25.12%	Functionally different - Revenue mix comprises of product sales, subscription sales. Also engaged in hi-end application development and implementation services[Page 939& 948 of PB-III]
13	Wipro Ltd. (Seg.)	33.65%	Functionally different - Commands significant brand value and revenue mix comprises of software product and sales [Page 698,703,711 of PB-III]

8.1 The assessee relied on the decision of the Bangalore Bench in the case of M/s.SAP Labs India Pvt. Ltd., reported in IT(TP)A No.1006/Bang/2011 dated 30.06.2016. The coordinate bench of Bangalore considered the above comparables (except M/s Bodhtree) and directed to exclude them from the list of comparables due to functional dissimilarity as under:

13. TPO himself has given a finding that assessee was providing software services to SAP group of companies abroad. Now coming to the decision of SAP Labs, relied on by the Ld. AR this Tribunal at Para 3 has clearly observed that the said company was providing software development services to its AE abroad. The said decision was relied by this Tribunal in the case of M/s. Hewlett-Packard (India) Globalsoft P. Ltd (supra), where also the profile of the concerned assessee was similar to the assessee here. At Para 8 of the Tribunal order in the case of M/s. Hewlett-Packard (India) Globalsoft P. Ltd (supra), profile of the said assessee has been reproduced and such profile clearly shows that the said company was also rendering software development services to them. This decision relied was also for the very same assessment year. Hence, we are of the opinion that these decisions could be considered as a good precedence for adjudicating the exclusions sought by the assessee. What has been held by the coordinate bench at Para 23 of its order dt.23.09.2015, in the case of M/s.Hewlett-Packard (India) Globalsoft P. Ltd (supra) is reproduced hereunder:

23. We have perused the orders and heard the rival contentions. In so far as Accel Transmatic Ltd (seg), Avani Cimcon Technologies Ltd, Celestial Labs Ltd, E-Zest Solutions Ltd,, Helios & Matheson Information Technology Ltd, Infosys Technologies Ltd, Ishir Infotech Ltd, Kals Information Systems Ltd (seg), Lucid Software Ltd, Persistent Systems Ltd, Quintegra Solutions Ltd, Tata Elxsi Ltd (seg), Thirdware Solutions Ltd (seg) and Wipro Ltd (seg) are concerned, the issue of comparability of these companies had come up before this Tribunal in the case of NXP Semiconductors India P. Ltd (supra). Analysis done in the said decision was also for software development services segment and the TPO in the said case had also selected the very same set of 26 companies. Said decision being for the very same assessment year 2007-08, we are of the opinion that it can be taken as a good precedence for deciding the issue of comparability raised by the assessee herein, in so far as these companies are concerned. This Tribunal had observed as under:

i) 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

(iv) Accel Animation Studios 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.”

20. Respectfully following the decision of the Tribunal in similar set of facts, these companies are directed to be excluded from the list of comparables.”

ii) 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	FY 05-06	FY 06-07	FY 07-08	FY 08-09
Operating Revenue	21761611	35477523	29342809	28039851
Operating Expns.	6417661	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.

iii) 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:-

- 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."
- 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.1,16,92,020/- 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 though 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.

iv) 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 Authorized 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 Authorized 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 Authorized Representative contends, are high end ITES normally categorized as knowledge process Outsourcing ('KPO') services. It is further submitted that this company has not provided segmental data in its Annual Report. The learned Authorized 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 Authorized 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 coordinate 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.

v) Helios & Matheson Information Technology Ltd & Kals Information Systems Ltd (seg):

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.

vii) & viii) M/S.Ishir Infotech Ltd. And Lucid Software Ltd :

20. 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.

21. 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.

x) 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 Authorized 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 Authorized Representative prays that in view of the

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.

(xii) 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 dissimilarity, 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 Authorized Representative pleaded that this company be excluded from the list of comparables.

14.3 Per contra, the learned Departmental Representative supported the stand of 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 Authorized 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."

25. 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.

xiii) 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 Authorized Representative submitted that

(i) This company is engaged in product development and earns revenue from sale of licenses 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 licenses 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 Authorized 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."

xiv) 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

(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.

3.4.1 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.

3.4.2 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 coordinate 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 coordinate 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. In so far as Flextronics Software Systems Ltd (seg) is concerned, comparability of this company was considered by the Tribunal at para 26 to 28 of its order in the case of M/s. Hewlett- Packard (India) Globalsoft P. Ltd (supra). These paras are reproduced hereunder:

26. Now taking up the question of exclusion of Flextronics Software Systems Ltd (seg), it is true that the decision of Motorola Solutions (India) P. Ltd (supra) also was for the very same year and also on software development services sector. This Tribunal held as under:

"97.2 For a company to be included in the list of comparables, it is necessary that credible information is available about the company. Unless this basic requirement is fulfilled, the company cannot be taken as a comparable. It is true that Id. TPO is entitled to obtain information u/s 133(6), the object of which is primarily only to supplement the information already available on record, but not, as rightly submitted by Id. Counsel for the assessee, to replace the information. If there is a complete contradiction between the information obtained u/s 133(6) and annual report then the said information cannot be substituted for the information contained in annual report. We, therefore, are in ITA No. 5637/D/2011 149 agreement with Id. counsel for the assessee that this company cannot be included as a comparable in the set of comparables selected by Id. TPO on account of clear contradiction between contents of annual report and information obtained u/s 133(6).

27. Rule 10D(3) specifies the information and documents that are to be maintained by a person who is entering into international transactions. These are official publications, published accounts or those which are in public domain except for agreements and contracts to which assessee is privy. Once the annual report of a company is for a year

different from the financial year ending 31st March, then without doubt, it will cease to be a good comparable, unless the information received in pursuance to a notice u/s.133(6) of the Act from such company, is reconciled with the figures available in such annual report.

28. In the case of Flextronics Software Systems Ltd (seg), no doubt the annual report was for the year ending 31.03.2007. However it was only for a nine months period. No reconciliation was attempted by the lower authorities between the figures given in such annual report with the figures which were made available by the said company to the TPO pursuant to notice issued to them u/s.133(6) of the Act. No doubt at page 123 of TP order, TPO has stated that the software development service revenues were more than 75% based on the following figures. But how this segmentation was done by the TPO and the reconciliation of the said segmentation with the annual report of the assessee was never attempted or done. In such a situation we are of the opinion that Flextronics Software Solutions Ltd (seg) could not be considered as a proper comparable. We direct exclusion thereof. We are therefore of the opinion that Flextronics Software Systems Ltd (seg) has to be excluded from the list of comparables.

9.0 The assessee's AR submitted that the comparable selected by the TPO listed above were functionally dissimilar and required to be excluded. The Ld.AR further submitted that the assessee company is low end software provider and its case is covered by the above decision of Co-ordinate Bench on facts. On the other hand the Ld.DR supported the inclusion of the above comparables. However the DR did not controvert the facts and did not place any other higher court's judgment to controvert the submissions made by the A.R. Therefore respectfully following the coordinate bench decision cited we direct the AO to exclude all the above comparables.

10.0 Similarly the assessee relied on the decision of M/s.Kumaran Systems Pvt. Ltd., for the AY 2009-10 for exclusion of M/s.Bodhtree Consulting Ltd from the list of comparables. The Co-ordinate Bench in the case of M/s.Kumaran Systems Pvt. Ltd., v. DCIT in ITA No.906/Mds/2015 dated 06.01.2016 in Para No.8 excluded the comparables as under:

8. We have heard both the parties and perused the material on record. Similar issue was considered by the Tribunal, Bangalore Bench in the case of M/s. CISCO Systems (India) Pvt. Ltd. in IT(TP)A No. 271/Bang/14 dated 14.8.2014 wherein Bodhtree is not 4 ITA 906/15 considered as a comparable one and the Tribunal held in paragraph 26.1 as follows:

26.1 Bodhtree Consulting Ltd.: - As far as this company is concerned, it is not in dispute that in the list of comparables chosen by the assessee, this company was also included by the assessee. The assessee, however, submits before us that later on it came to the assessee's notice that this company is not being considered as a comparable company in the case of companies rendering software development services. In this regard, the Ld.counsel for the assessee has brought to our notice the decision of the Mumbai Bench of the Tribunal in the case of Nethawk Networks Pvt. Ltd. v. ITO, No. 7633/Mum/2012, order dated 6.11.2013. In this case, the Tribunal followed the decision rendered by the Mumbai Bench of the Tribunal in the case of Wills Processing Services (I) P. Ltd., ITA No.4547/Mum/2012. In the aforesaid decisions, the Tribunal has taken the view that Bodhtree Consulting Ltd. is in the business of software products and was engaged in providing open & end to end web solutions software consultancy and design & development of software using latest technology. The decision rendered by the Mumbai Bench of the Tribunal in the case of Nethawk Networks Pvt. Ltd. (supra) is in relation to A.Y. 2008-09. It was affirmed by the learned counsel for the Assessee that the facts and circumstances in the present year also remains identical to the facts and circumstances as it prevailed in AY 08-09 as far as this comparable company is concerned. Following the aforesaid decision of the Mumbai Bench of the Tribunal, we hold that Bodhtree Consulting Ltd. cannot be regarded as a comparable. In this regards, the fact that the assessee had itself proposed this company as comparable, in our opinion, should not be the basis on which the said company should be retained as a comparable, when factually it is shown that the said company is a software product company and not a software development services company."

9. The same view was taken by the Tribunal, Delhi Bench in the case of Ciena India Pvt. Ltd. in ITA No.1453/Del./14 dated 24.4.2015, wherein it was held as under:

"9.6. Coming back to the facts of the instant case, we find from Schedule 12 that there is a mention of Significant accounting policy at Sl. no.3, which provides that : "Revenue from software development is recognized based on software development and billed to clients." If some software development project is incomplete at the end of the year, this Note may entail two situations , viz., the first, in which the expenses incurred in respect of such software development may be capitalized, which appears to be a more rational manner of depicting the true and fair view of the profitability of the enterprise; and the second, in which such expenses may be straightway taken as revenue cost for the year of its incurring itself, which may not reflect a true and fair view of the profits on year to year basis. The contention of the Id. AR is that whereas Bodhtree fell into the second situation, the assessee was in the first situation. Though this contention about Bodhtree accounting for expenses in the year of incurring but considering income only on the conclusion of the project in the subsequent year sounded a little awkward, we attempted to find out the amount of capitalized expenses in respect of incomplete projects at the end of the year. Apparently, we could not find out any such capitalized value of work-in-progress in the balance sheet of the company on standalone basis. We directed the Id. DR to examine the Annual report of this company and point out the amount of expenses capitalized in respect of incomplete work at the end of the year. On the next date of hearing, the Id. DR failed to specifically point out any amount of such capitalized expenses with the opening or closing balance. This prima facie shows that the expenses incurred in respect of incomplete projects of software development at the end of the year, but billed in the subsequent year, were, in fact, treated as expenses for the current year alone. In the same manner, expenses incurred in the preceding year for the contracts of software development remaining incomplete at the end of the year, also must have been included in the expenses of the last 6 ITA 906/15 year alone, but, the income getting recognized on the raising of bills in the current year. This albeit, patently deforms the correct profitability on year to year basis, yet, but we cannot help the situation. When the position of accounts of Bodhtree is such that it does not properly match expenses with revenue, it loses its credibility for making a logical comparison with a company that accounts for expenses matching with the revenue. Once it is held that the profits of Bodhtree Consulting Ltd. do

not represent fair profitability on year to year basis, this company loses its tag of an effective comparable

In view of the above position, we are inclined to hold that Bodhtree is not considered as comparable to the assessee's case to determine the ALP by TPO. This ground is allowed.

Respectfully following the decision of Co-ordinate Bench, we direct the AO to exclude M/s.Bodhtree Consulting Ltd., from the list of comparables. We direct the DRP/AO to exclude the above comparables from the list of comparables selected by the AO/DRP/TPO and re-work the margin for determining the ALP and accordingly set-aside the issue to the file of the AO to re-work the ALP. *Ground No.6 of the assessee is allowed for statistical purposes.*

11.0 Ground Nos.11 to 13 are related to the payment of management fee to the AE:

The assessee made payment of Rs.31,18,602/- towards outsourcing fee, management fee in respect of various services rendered by group concerns. The TPO has determined the ALP at Rs.NIL and the DRP has rejected the assessee's arguments and the AO made the addition. During the TP proceedings, the TPO has called for the services rendered to M/s.Sella Synergy India Pvt. Ltd., and the benefit derived by the assessee company. The assessee could not explain the services rendered by the assessee and the benefit derived by the assessee. The TPO observed that the management fee is paid from FY 2006-07 and due to payment of management fee, operating profit has reduced drastically. The assessee did not explain the services and the benefit derived by it. Therefore, the

TPO held that payment of management fee is not justified and accordingly determined the ALP of Rs.NIL.

11.1 Before the DRP, the assessee explained that the company has received the following services of M/s.Sella Synergy India Pvt. Ltd.,

10.1 In this regard, we wish to submit that during the FY 2006-07, the assessee company paid an amount of Rs.31,18,602/- towards various services received by Sella Holdings as set Out in the agreement entered by SSIL with Sella Holdings, being the parent company. The services in respect of which the fee is paid are listed below:

- **Supplier accounting services:** Under this Sella Holdings provides processing of payment by bank remittance of invoices/utility bills/rent and common premises maintenance expenses etc.;
- **IT outsourcing:** Connection to the internet network through a seamless availability of autonomous system of Sella Holdings for navigation by the employees of client, E-mail service, E-mail archival, updating antivirus software;
- **IT security:** Periodical checks carried out on the systems as regards upgrades and updation of versions, providing new systems of checking for the prevention of software virus attacks, management of incident response in case of software virus attacks etc.
- **Payroll processing and Personnel management procedures:** Calculation of National Institute of Social Security ("NISS") contributions, Declaration made by the tax withholding agent, Arranging for F24 forms for the payment of TDS, VAT etc;
- Utilizing the information systems of the Group (Oracle Business Suite) for managing the accounting operations;
- Providing THE ASSESSEE COMPANY with functions of specific protection against the various risk profiles, establishment of internal company processes, offering support to all the compliances connected with and consequent to obligations arising from norms and regulations. This includes providing support in respect of the following:
 - strategic planning and financial analysis;
 - legal and fiscal affairs;
 - internal auditing to ensure adherence to rules;
 - compliance with reference to norms or best practices or models of conduct;
 - providing specialized resources in case of emergency or crisis situations;
 - organizational support to keep up the efficiency and effectiveness of the operations;
 - Activity control for the purpose of information security and safeguarding of assets;
 - General accounting in compliance with legislative, regulatory and internal rules relating to accounting; and
 - Company secretarial services

10.2 Thus, the Company has benefited from the services provided by Sella Holdings. These services were also inherent to the carrying on of SSIL's business. The payment of fees has also been established to be at arm's length, as the profit margins derived by SSIL after meeting the cost of these services has been established to be at arm's length as per the Company's transfer pricing study.

11.2 The DRP has considered the submissions made by the assessee and rejected the assessee's claim for payment of management fee as under:

11. FINDINGS OF THE DRP:

11.1 Management fee transaction being a separate transaction, it was required to be analyzed separately. Onus was on the taxpayer to apply appropriate method for the intra group service payments and to show that the payment made was at ALP. The same cannot be aggregated and analyzed by applying TNMM at the enterprise level, just by applying TNMM at the enterprise level, it does not follow that all the international transactions are at arm's length.

11.2 As the intra group service payments are not in the nature of routine business expenses and also these payments are not inter linked with other international transactions like rendering software services etc, the aggregation under TNMM is not justified and thus the TPO is justified in analyzing these intra group transactions separately by applying CUP as the most appropriate method.

11.3 In respect of intra-group sharing arrangements, the taxpayer has to prove the following in order to establish that payments are made at arm's length –

- i. The AE might be in a position to provide number of services but it has to be shown that such services were required by the taxpayer.*
- ii. Whether the Associated Enterprise rendered these services actually.*
- iii. Whether such services are required for the taxpayer's business and also whether the taxpayer is also capable of getting these services locally or on its own.*
- iv. Even if the services are rendered by the AE and required by the taxpayer, whether any cost benefit analysis was carried out by the taxpayer before making such payment.*
- v. How the payment was determined and how the same was at arm's length.*
- vi. The actual cost incurred by the AE in rendering such services to the taxpayer.*
- vii. Even when the services are actually rendered, what is the arms length price that would be paid for similar transactions between two independent parties?*
- viii. Whether the services are duplicate in nature i.e. whether the capable of rendering such services on its own.*

11.4 The manner in which the above principles are examined is as under.

- i. The first step is to determine if a charge for a particular service is justified, and then the amount to be charged should be determined. Deciding whether a charge is justified requires determining whether the taxpayer would have paid a third party for the service (in other words, does the activity confer benefits of value). Once a service is justified, the amount of the charge must be determined based on arm's length principles. This requires a detailed assessment of the services, benefits and costs. This cost benefit analysis is not done by the taxpayer. An independent entity in an identical situation sees whether it can get such services from third party or can do it on its own. It also sees alternatives for service providers and selects one service provider and pays to it in accordance with the economic benefit derived by it from such service. Not only the mark up but also the quantification of service itself is subject to transfer pricing.*
- ii. To conform with the arm's length principle, the costs of intra-group services can only be charged for where the recipient of the services expected, at the time the relevant activities were undertaken, to derive a benefit from those activities. The expected benefit must be sufficiently direct and substantial so that an independent recipient, in similar circumstances, would be prepared to*

pay for it. If no benefit has been provided (or was expected to be provided), then the service cannot be charged for. In the case of taxpayer, it failed to prove the benefit that is derived from paying above fees.

- iii. The taxpayer must first determine whether a specific activity performed by a member of the group for another member is a service for which a charge is justified. An arm's length entity would be willing to pay for an activity only to the extent that the activity confers on it a benefit of economic or commercial value.

11.5 It can be seen from the description of services given above, most of these services are either shareholder services or stewardship activities/ duplicative activities or activities where the benefit to the AE is remote and indirect. Thus, at arm's length these services are not required to be charged by the AE.

11.6 Further, based on the response filed the taxpayer, the following points emerge.

- i. That the taxpayer emphasized the need for centralized IT services rather than furnishing the documents evidencing the expenditure incurred by the AE for rendering such services to the taxpayer.
- ii. The taxpayer was not able to file any copies of its account in the books of AE as regards these services.
- iii. The taxpayer did not submit the details and evidence on the actual expenditure incurred (with unrelated parties) in connection with rendering such services to the taxpayer by the AE.
- iv. The taxpayer did not submit any primary evidence (with third parties) other than secondary evidence (invoices, agreement with the AE and cost allocation made by the AE).

11.7 The documents filed by the taxpayer are nothing but secondary evidence and also the correspondence/agreement between related parties. But, it did not show whether the services rendered are actually rendered in connection with the business of the taxpayer in India. Even if these services are rendered, whether an independent party would like to pay such amount as charged by the AE because independent party would be willing to pay for such services after evaluating alternative vendors. As the taxpayer did not submit the quantification of services in terms of actual incurred by the AE in connection with rendering services to the taxpayer on the basis of third party invoices, the arm's length price for such payments is to be treated as Rs.Nil.

11.8 Thus, it is the considered opinion of the DRP that, in the absence of any evidence being furnished before the TPO, he was justified at treating the arm's length price for services as Rs.Nil.

11.9 It was stated before the DRP that the TPO made adjustment on account of management fee and also at the entity level by applying TNMM. This is factually incorrect. At Para 10 of the Order of TPO, she stated that "Having determined the ALP management fee as zero, the same is not considered as part of the operating expense. Therefore, the PLI of the company is determined at 13.61%." Thus, the TPO first made ALP of management fee as Rs.Nil and recomputed the PLI at 13.61%, before applying TNMM at the entity level at Para-9. Thus, the argument of the assessee that the TPO made double adjustment is incorrect and is rejected.

11.3 The Ld.AR argued that the DRP/TPO has fixed ALP of management fee at Rs.NIL which is unjustified. The assessee enclosed service

agreement entered into with the AE. No such payment was paid in the earlier years and the AO has re-worked the PLI after reducing the management fee claimed by the assessee. Though, the assessee has furnished the agreements, the assessee has not justified the reasons for making payment of management fee in the year under consideration the assessee has also not applied any method for payment of management fee to the AE and arrived at the ALP. The DRP also held that the assessee did not show whether any services rendered by the AE actually in connection with the business of the tax payers in India. It was also stated that the tax-payer did not submit quantification of services in terms of actually incurred by the AE in connection with the services rendered to the tax payer. The Ld.DRP analyzed the complete facts and rejected the claim made by the assessee in a reasoned Order and we are not inclined to interfere with the directions given by the DRP on the elaborate and detailed reasoning given and this ground of appeal is dismissed.

12.0 Ground Nos.14 to 15 are related to the error in computation of income:

The assessee argued that there were clerical errors crept in computation of income. The assessee submitted that amounts relating to income tax and fringe benefit tax were added twice to the income. The assessee submitted that the taxable income was Rs.1,60,10,363/- after taking the sum of income tax and fringe benefits which was added back to the profits again by mistake. Similarly, the assessee also failed to

consider the interest income in the computation of income. The Ld.DRP rejected the assessee's claim placing reliance on the Hon'ble Supreme Court Judgment in the case of Goetz India Ltd. v. CIT. 284 ITR 323 (SC) wherein the Hon'ble Apex Court held that no claim of deduction is permissible before the AO otherwise by Revised Return.

12.1 The Ld.AR of the assessee submitted that it was a genuine mistake which requires rectification and the rectification is pending before the AO. On the other hand, the Ld.DR supported the lower authorities' orders and stated that as per the Hon'ble Supreme Court judgment (cited supra), the AO is not permitted to entertain any fresh claim other than by way of filing Revised Return by the assessee during the assessment proceedings.

12.2 We heard the rival submissions and perused the lower authority's orders. Though fresh claim is not permissible to be made through statement of computation of income during the assessment proceedings, Appellate Authorities are entitled to entertain the fresh claim made by the assessee during the appeal proceedings in the interest of justice. The Hon'ble Supreme Court decision relied upon by the AO is limited to the power of AO but not Appellate Authorities. The mistake appears to be genuine and needs to be rectified. Therefore, we direct the AO to entertain the claim made by the assessee and rectify the computation of income after making necessary verification. This ground is allowed for statistical purposes.

13.0 In the result, the appeal of the assessee is partly allowed for statistical purposes.

Order pronounced in the Open Court on 17th March, 2017, at Chennai.

Sd/-
(एन.आर.एस. गणेशन)
(N.R.S. GANESAN)
न्यायिक सदस्य/**JUDICIAL MEMBER**

Sd/-
(डि.एस. सुन्दर सिंह)
(D.S.SUNDER SINGH)
लेखा सदस्य/**ACCOUNTANT MEMBER**

चेन्नई/Chennai,

दिनांक/Dated: 17th March, 2017.

TLN

आदेश की प्रतिलिपि अग्रेषित/**Copy to:**

1. अपीलार्थी/Appellant
2. प्रत्यर्थी/Respondent
3. आयकर आयुक्त (अपील)/CIT(A)
4. आयकर आयुक्त/CIT
5. विभागीय प्रतिनिधि/DR
6. गार्ड फाईल/GF