

IN THE INCOME TAX APPELLATE TRIBUNAL
BANGALORE BENCH 'B', BANGALORE

BEFORE SMT. ASHA VIJAYARAGHAVAN, JUDICIAL MEMBER

AND

SHRI. ABRAHAM P. GEORGE, ACCOUNTANT MEMBER

I.T(TP).A No.1107/Bang/2011
(Assessment Year : 2005-06)

Deputy Commissioner of Income-tax,
Circle – 12 (3), Bangalore

..Appellant

v.

Synopsis India P. Ltd,
RMZ Infinity Tower 'A', 4th & 5th floor,
No.3, Old Madras Road, Benniganahalli,
Bangalore 560016
PAN : AABCS8847D

..Respondent

I.T(TP).A No.1093/Bang/2011
(Assessment Year : 2005-06)
(By the Assessee)

Assessee by : Shri. Dhanesh Bafna, CA
Revenue by : Shri. Farhat Hussain Qureshi, CIT -DR

Heard on : 08.09.2015

Pronounced on : 08.10.2015

ORDER

PER ABRAHAM P. GEORGE, ACCOUNTANT MEMBER :

These are appeals filed by the assessee and Revenue respectively directed against an order dt.13.09.2011, of the CIT (A)-IV, Bengaluru, for the assessment year 2005-06.

02. Appeal of the Revenue is taken up first for disposal. Revenue has raised altogether seven grounds of which grounds 1, 6 and 7 are general needing no specific adjudication.

03. Grievance raised by the Revenue in its ground.2 is that CIT (A) directed exclusion of telecommunication expenditure of Rs.2,74,80,645/- and foreign currency expenditure of Rs.3,73,26,570/- from total turnover while computing the deduction available u/s.10A of the Income-tax Act, 1961 ('the Act' in short).

04. We find that the direction given by the CIT (A) is in consonance with the judgment of Hon'ble jurisdictional High Court in the case of CIT v. Tata Elxsi Ltd (349 ITR 98). Their Lordships held that parity has to be there between export turnover and total turnover while excluding items from the export turnover. Filing SLP before the Hon'ble Apex Court, would not be a sufficient reason not to follow the jurisdictional High Court judgment. Accordingly ground 2 of the Revenue is dismissed.

05. In its ground 3, grievance raised by Revenue is that the CIT (A) directed exclusion of all comparables that were having any related party transactions (RPT) from the list of comparables considered for bench marking the pricing of international transactions of the assessee.

06. Ld. DR submitted that 0% of the RPT directed by the CIT (A) went against various decisions of the Tribunal. Specific reliance was placed on the

decision of Bangalore Bench of the Tribunal in the case of 24/7 customer.com Pvt Ltd vs DCIT (2013) 140 ITD 344.

07. Per contra, Ld. AR submitted that though he was not having any objection for adopting the 15% RPT filter, as held in the case of 24/7 Customer.Com P. Ltd (supra), the RPT worked out for Geometric software Ltd, by the lower authorities at 11.49% was incorrect. According to him, Geometric Software Solutions Co., had RPT of 24.1%. He placed reliance on the coordinate bench in the case of ACIT v. Symbol Technologies India P. Ltd [ITA No.391/Bang/2012, dt.27.03.2015]. Further according to him, though Infosys Technologies Ltd, Satyam Computers Ltd, Thirdware Solutions Ltd, Tata Elxsi Ltd and Flextronics Software Systems Ltd, would come back into the list of comparables on adopting an RPT filter of 15%, these companies had to be excluded for reasons like functional differences, non-availability of segmental results and non-availability of reliable financial data.

08. We have perused the orders and heard the rival contentions. This Tribunal in the case of 24/7 customer.com Pvt Ltd (supra) had held as under :

“In respect of the ground raised at S.No.1 regarding acceptance of comparable companies having related party transactions as proposed by the TPO, the learned counsel for the assessee argued that the transfer pricing regulations do not stipulate any minimum limit of related party transactions which form the threshold for exclusion as a comparable. In this regard, the learned counsel for the assessee objected to the TPO’s setting a limit of 25 percent on related party transactions. He objected to the inclusion of comparables being related party transactions in excess of 15 percent of sales / revenue. In support of this proposition, the learned counsel for the assessee placed reliance on the decision of

the Hon'ble Bench of the ITAT, Delhi in the case of Sony India (P) Ltd. reported in 2008-TIOL-439-ITAT-Delhi dt.23.12.2008. The learned counsel for the assessee drew our attention to para 115.3 of the order wherein the Tribunal has held that -

"We are further of the view that an entity can be taken as uncontrolled if its related party transactions do not exceed 10 to 15 percent of total revenue. Within the above limit, transactions cannot be held to be significant to influence the profitability of the comparables. For the purpose of comparison what is to be judged is the impact of the related party transactions vis-à-vis sales and not profit since profit of an enterprise is influenced by large number of other factors"

Respectfully following the decision of the Tribunal in the case of Sony India (P) Ltd (supra), the Assessing Officer / TPO are directed to exclude after due verification those comparables from the list with related party transactions or controlled transactions in excess of 15 percent of total revenues for the financial year 2003-04."

09. Accordingly we are of the opinion that CIT (A) fell in error in directing exclusion of comparables which were having any RPTs. RPT ratio has to be considered at 15% in accordance with the above decision. Vis-a-vis argument of the Ld. AR that a few of the companies which come back to the list of comparables, still had to be excluded, for other reasons, we are of the opinion that the submission warrants consideration. These companies will be considered by us when we take up the appeal of the assessee, while adjudicating on the grounds taken by the assessee seeking exclusion of certain comparable companies. Ground 3 of the Revenue is treated as partly allowed.

10. Vide its ground 4, grievance raised by Revenue is that companies having abnormal profits were directed to be excluded.

11. Ld. DR submitted that CIT (A) had not given any reason as to how the functions discharged, assets deployed and risks assumed by such companies were different from that of the assessee.

12. Per contra, Ld. AR submitted that assessee had sought exclusion of comparables based on non-availability of segmental details, non-availability of reliable financial results and on different functionalities and not for abnormal profits. According to him, in one of the comparables considered namely, Exensys Software Solutions Ltd, there was an extra-ordinary and such extra-ordinary event was due to amalgamation with one Holool India Ltd, during the relevant previous year and not because of any abnormal profits. As pr Ld. AR in the case of M/s. Thirdware Solutions P. Ltd, it was also into software product development and segmented results were not available.

13. We have heard the rival contentions. Though Ld. DR has not been able to point out any company which were excluded by CIT (A) citing abnormal profits, it seems one of the reasons why Exensys Software Solutions Ltd and M/s. Thirdware Solutions P. Ltd, were directed for exclusion was that they had abnormal profits. As per the Ld. AR, there are other reasons why these companies had to be excluded from the list of comparables. These will be discussed by us while adjudicating the grounds raised by the assessee. Comparability of both Exensys Software Solutions Ltd and Thirdware Solutions P. Ltd, are dealt with in later part of this order. In line with this ground 4 of Revenue is treated as partly allowed for statistical purposes.

14. In its ground 5 grievance raised by Revenue is that CIT(A) held the assessee eligible for 5% deduction while making the ALP analysis relying on proviso to Section 92C(2) of the Act. The impugned assessment year being 2005-06, the proviso to Section 92C(2) as it stood prior to substitution brought in by Finance (No.2) Act, 2009, w.e.f. 1.10.2009 applied. The question whether + / - 5% disallowance could be allowed as a standard deduction, had come up before this Tribunal in the case of Sap Labs India P. Ltd v. ACIT [(2011) 44 SOT 0156]. CIT (A) had followed the Coordinate Bench decision in Sap Labs India P. Ltd (supra), wherein it was held that prior to the substitution, the second limb of the old proviso could be construed as a standard deduction available to the assessee. We do not find any reason to deviate from the view taken by the CIT (A) since it was in consonance with the Special Bench decision. Ground 5 of the Revenue is dismissed.

15. Now we take up the appeal of assessee. Ld. Counsel for the Assessee at the outset submitted that he was confining his arguments to exclusion of certain companies from the list of comparables, as it remained after giving effect to the CIT (A) decision and after applying the 15% RPT filter. According to him, other grounds relating to TP issue could be dealt with at an appropriate time, if required.

16. As per the Ld. AR assessee was a subsidiary of Synopsis Inc, USA, providing captive service in the nature of software development to its AE abroad. According to him, assessee had adopted TNMM as the most

appropriate one for analysing the pricing of its international transactions with AE. Assessee had considered itself to be a software development service provider and selected 15 comparable companies from the prowess and capitaline data base. As per the Ld. AR, arithmetic mean of the operating margin over cost of the said 15 companies came to 9.78% against assessee's own PLI of 10.35%. As per the Ld. AR, TPO had worked out the PLI of the assessee at 10.47% and pursuant to the CIT (A)'s direction such PLI had gone further down to 10.10%. Nevertheless, according to him, these were well within the +/- 5% of average PLI of 9.78% of comparables and therefore there was no requirement of any ALP adjustment. Further as per the Ld. AR, TPO had rejected 11 comparables out of the 15 selected by the assessee leaving four comparables namely Geometric Software Solutions Company, R S Software (India) Ltd, Sasken Communication Technology Ltd and Visualsoft Technologies Ltd. Ld. AR pointed out that during the course of TP proceedings assessee had offered three more companies as good comparables. Of these, only iGate Global Solutions Ltd (seg) was accepted by the TPO. Thus, according to him, TPO had accepted five comparables out of the total 18 companies suggested by the assessee. There after TPO made his own analysis of the prowess and capitaline data bases and selected seventeen comparable companies including the five from assessee's list. As per the Ld. AR, TPO worked out the arithmetic mean of the PLI of these 17 companies, after making a negative working capital adjustment of 0.02%, at 26.59% and thereafter recommended an adjustment of Rs.7,64,99,675/- u/s.92C of the Act.

17. Ld. AR submitted that assessee had moved in appeal before the CIT (A) against companies having different functionalities, having RPTs, having abnormal profits and not having segmental results being included by the TPO in the list of comparables. As per the Ld. AR, CIT (A) had directed removal of 12 comparables from the list of seventeen applying 0% RPT filter. In addition, CIT (A) had also excluded Exensys Software Solutions Ltd and Thirdware Solutions Ltd, for a reason that they had super normal profits. Latter was also found by CIT (A) to have RPT. CIT (A) also found that Infosys Technologies Ltd was not functionally comparable with the assessee due to its size and economics of scale. Ld. AR submitted that CIT (A) directed exclusion of Satyam Infotech Ltd, for a reason that financial result of the company were not reliable. According to him, if CIT (A)'s directions were to be given effect, only four companies would be left namely Bodhtree Consulting Ltd, Lanco Global Systems Ltd, Sankhya Infotech Ltd and Visualsoft Technologies Ltd, and these had an average PLI of 20.53%. As per the Ld. AR, CIT (A) had accordingly reduced the TP adjustment to Rs.2,09,31,455/-.

18. Continuing his arguments, Ld AR submitted that once RPT filter of 15% were adopted, Flextronics Software Systems Ltd, Geometric Software Ltd, iGate Global Solutions Ltd, Infosys Technologies Ltd, L & T Infotech Ltd, R S Software (India) Ltd, Sasken Communications Ltd, Sasken Networks Ltd, Satyam Computers Ltd, Tata Elxsi Ltd, and Thirdware Solutions Ltd, would come back to the list of comparables. According to him, assessee had no

objections in iGate Global Solutions Ltd, L & T Infotech Ltd, R S Software (India) Ltd, Sasken Communications Ltd and Sasken Networks Ltd, coming back to the list of comparables. However according to him, in the case of Infosys Technologies Ltd, CIT (A) himself had rejected it on the basis of functionality and Department had not appealed against such finding of the CIT (A). Vis-a-vis Satyam Computers Ltd, CIT (A), had rejected such comparable for a reason that its financial results were not reliable. As per the Ld. DR Department had not raised any grievance in this regard.

19. Coming to the issue of comparability of M/s. Exensys Software Solutions Ltd, Ld. AR submitted that it was not due to extra-ordinary profits, but due to extra-ordinary events that happened during the relevant previous year that exclusion was sought. Reliance was placed on the coordinate bench in the case of ACIT v. Symbol Technologies India P. Ltd [supra].

20. Vis-a-vis Thirdware Solutions Ltd, argument of the Ld. AR was that segmental details were not available and this was specifically brought to the notice of TPO. According to him, Thirdware Solutions Ltd was into software product development and had no functional similarity to that of the assessee. Reliance was once again placed on the coordinate bench decision of Symbol Technologies India P. Ltd, (supra). Vis-a-vis, Tata Elxsi, argument of the Ld. AR was that the said company was functionally different from a software development services company, as held by the coordinate bench in the case of Symbol Technologies India P. Ltd (supra). Similar arguments were raised for

Sankhya Infotech Ltd, and Flextronics Software Systems Ltd. Vis-a-vis, Four Soft Ltd, Ld. AR submitted that lower authorities have themselves found their RPT to be 19.89%. Ld. AR submitted that he was not pressing for exclusion of Bodhtree Consulting Ltd. However, vis-a-vis Geometric Software Solutions Ltd, it was argued that their RPT was incorrectly worked out at 11.49%. According to him, RPT of Geometric Software Ltd was 26.64% and this was clearly brought out in the decision of Symbol Technologies India P. Ltd (supra). As per the Ld. AR once these companies were excluded, and after effecting the working capital adjustment, PLI of the remaining comparables would be 13.19% and the assessee would be within the + / - 5% range. Thus according to him the transactions of the assessee were at arm's length.

21. Per contra, Ld. DR submitted that there were various judgments of High Courts holding that abnormal profits were not a criteria for exclusion of comparables. According to him, assessee had consciously not applied the turnover filter since many of the comparables convenient to it would go out of the list of selected comparables. As per the Ld. DR, logic of application of RPT filter of 15% was not clear. Even if comparables were having related party transactions of less than 15%, still it required exclusion. Assessee was attempting selective application of filters according to its choice. As per the Ld. DR this type of approach should not be allowed.

22. We have perused the orders and heard the rival contentions. In relation to appeal of the Revenue, we have already held that 15% RPT filter is a proper threshold for selecting comparables for the purpose of ALP study. That assessee was engaged in software development service, is clear from the profile of the assessee reproduced by the TPO at para 2.2 of its order :

"2.5 Synopsys India entered into an agreement with Synopsys USA and Synopsys Ireland to provide R&D services in respect of development of EDA tools and software.

2.6 EDA software comprises software programs that are used by engineers as tools in designing ICs. IC's are distinguished by the speed at which they run, their area, the amount of power they consume and the cost of production Synopsys products in the form of EDA software/tools offers its customers the opportunity to design ICs that are optimized or speed. area, power consumption and production cost while reducing overall design time."

As per the details provided in the TP report, the tax payer company is engaged in provision of software research and development services to Synopsys UK and Synopsys Ireland. The tax payer's nature of international transactions and functions has been described as under at Page 5 as under:-

23. List of the comparables selected by the TPO for analysing the pricing of international transactions undertaken by the assessee as it appear at page 157 of the TP order is reproduced here under :

Sl. No.	Company Name	Sales (Rs.cr.)	OP to Total Cost%	Product sales (Rs. / % of sales)	RPT(Rs .cr.)	% of RPT over Sales	E (I C)
1	Bodhtree consulting ltd **	3.87	24.85	Nil	0	0	
2	Lanco Global Systems ltd **	6.11	13.65	Nil	0	0	
3	Exensys Software Solutions ltd	7.3	70.68	Nil	0	0	
4	Sankhya Infotech ltd	12.99	27.39	Nil	0	0	
5	Sasken Network Systems ltd **	14.44	16.64	Nil	1.1	7.62	
6	Four soft ltd	15.94	22.98	2.57(16%)	3.17	19.89	
7	Thirdware Solution limited	29.11	66.09	2.7(9%)	2.58	8.86	
8	R S Software (India) Ltd* **	81.69	8.07	Nil	6	7.34	
9	Geometric Software Solutions Co.ltd* **	95.44	20.34	17.56(18 %)	10.97	11.49	
10	Tata Elxsi Limited (seg) **	146.46	24.35	Nil	8.63	5.89	
11	Visual soft Technologies ltd (seg)* **	185.43	23.52	Nil	0	0	
12	Sasken communicaton Technologies ltd(seg)* **	189.05	14.42	Nil	0.44	0.23	
13	Igate(seg.)* **	406	4.32	Nil	28.83	7.10	
14	Flextronics (seg)	457.45	32.19	70(15%)	24.91	5.45	
15	L&T Infotech **	562.45	10.33	Nil	46.8	8.32	
16	Satyam	3464.2	29.44	Nil	67.1	1.94	
17	Infosys	6859.7	42.83	212(3%)	254.07	3.7	
	avg.		26.59%	3.59%		5.17 %	

* taxpayer's comparables

** comparables accepted / not objected during the TP proceedings

24. In the above list Geometric Software Solutions Co. Ltd, R. S. Software India Ltd, Sasken Communications Ltd (seg), Visualsoft Technologies Ltd, (seg) and iGate Global Solutions Ltd (seg), were in the list provided by the assessee itself. One among the above, namely M/s. Geometric Software Solutions Co. Ltd, is sought by the assessee for removal from the list of comparables due to application of RPT filter of 15%. For this, reliance has been placed by the assessee on the decision of coordinate bench in the case of Symbol Technologies India P. Ltd (supra). Relevant part is reproduced here under :

30. The learned counsel for the Assessee submitted that Geometric Software Solutions Ltd., should be excluded as it has RPT of 22%. In this regard our attention was drawn to the decision of the ITAT Bangalore in the case of EMC Data Storage Systems (India) Pvt. Ltd. IT(TP)A.No.1274/Bang/2010 for AY 06-07. It is seen that the aforesaid decision relates to AY 06-07 and we do not know the details of the RPT in AY 05-06. We therefore deem it fit and proper to remand the question of excluding this company as a comparable to the TPO. If the RPT is more than 15% of the total revenues than this company should be excluded from the list of comparable companies. We hold and direct accordingly.

25. The decision in the case of Symbol Technologies India P. Ltd (supra) was also for the very same assessment year, viz., A. Y. 2005-06 and the said company was also considered to be a software development service provider. Since in Revenue's appeal we have already held that 15% is the RPT filter that is to be applied, we are of the opinion that the question whether Geometric Software Solutions Co. Ltd had RPT in excess of 15% can be looked into by the AO / TPO. If it is having RPT of more than 15% of total revenues, no doubt it has to be excluded.

26. Vis-a-vis Infosys Technologies Ltd and Satyam Computers Ltd, CIT (A) had held in favour of assessee and directed their exclusion based on functionality for the former and unreliable financial results for the latter. Revenue has not moved in appeal against such directions. Vis-a-vis Exensys Software Solutions Ltd, what we find is that its comparability was an issue that came up before this Tribunal in the case of Symbol Technologies India P. Ltd. This Tribunal had held at para 14 of the order, as under :

14. The Ground raised by the Revenue with regard to the action of the CIT(A) in excluding companies with abnormal profits is misconceived and the issue does not arise out of the order of the CIT(A). As we have already seen the CIT(A) rejected some of the comparable companies chosen by the TPO by applying related party transaction filter. The filter of companies dealing in software products and abnormal profits owing to amalgamation of the companies during the relevant period thereby showing abnormal profits was applied to exclude Exensys Software solutions Ltd., was excluded for reasons of high turnover and high risk profile. Satyam Computer Services Ltd., has to be excluded from the comparable companies for non-reliability of financial data as it was involved in financial scam. In doing so, the CIT(A) followed the decision of this Hon'ble Tribunal in Agnity India Technologies v. ITO (ITA 3856/DeI/2010) and SAP India Pvt. Ltd v. ITO [ITA No. 398/8/2008]. Therefore the grievance as projected by the Revenue in ground No.5 is misconceived. On the facts of the present case, we are of the view that the CIT(A) rightly excluded Exensys Software Solutions Ltd., and Satyam Computers Ltd., from the list of comparable companies.

27. Main reason why Exensys Software Solutions Ltd, was directed to be excluded was on account of amalgamation of certain other companies with it resulting in the abnormal profits. Assessee had before the TPO raised the issue of amalgamation of such company with Holool India Ltd, as under :

Exensys' functional profile is even otherwise not comparable: In this regard we submit as follows:

During the year ending on March 2005, Exenys under a scheme of amalgamation, amalgamated with a company Holool India Limited ('Holool'), with effect from April 01, 2004.

Export turnover achieved by Exensys during FY 2004-05 is primarily on account of the amalgamation with Holool. This is substantiated by the following statement of the Directors of Exensys as given in the Directors' Report for FY 2004-05 under performance review on page 16 (attached herewith as Annexure 15.2):

"During the year under review, your company had earned Income of Rs. 73 7. 79 Lacs which consists of an Export turnover of Rs. 691.76 Lacs, this was possible with the Amalgamation of Holool India. Limited with Exensys."

28. Though abnormal profits as such may not be a reason for exclusion of a company from the list of comparables, if such abnormal profits were caused due to amalgamation then unless contribution of the amalgamating company to the profits are brought out, in our opinion, comparability gets eroded. We are therefore of the opinion that Exensys Software Solutions Ltd, has to be excluded from the list of comparables.

29. Coming to Thirdware Solutions Ltd, argument of the Ld. AR is that the said company was also into software product segment and segmental results were not available. Reliance has once again been placed on coordinate bench decision in the case of Symbol Technologies India P. Ltd (supra), wherein this Tribunal had held as under, quoting from a decision of Hyderabad Bench of this Tribunal in the case of Invensys Development Centre India P. Ltd v. ACIT [ITA.1251/Hyd/2010, dt.29.02.2014] :

26. As far as Thirdware Software Solution Limited is concerned, we find from the information furnished by the said company that though the said company is also into product development, there are no software products that the company invoiced during the relevant financial year and the financial results are in respect of services only. Thus, it is clear that there is no sale of software products during the year but the said company might have incurred expenditure towards the development of the software products.

30. Though this Tribunal had directed exclusion of Thirdware Solutions Ltd, what we find is that Hyderabad bench decision of the Tribunal in the case of Invensys Development Centre I. P. Ltd (supra), was admittedly against

exclusion of Thirdware Solutions Ltd. Argument of the assessee before us is that segmental results of Thirdware Solutions Ltd were not available and Thirdware Solutions were into software product development and software development services. No doubt in the submissions made before the CIT (A) by the assessee, it has been stated that annual report of Thirdware Solutions Ltd for F. Y. 2004-05 did not provide segmental information. Annual report of Thirdware Solutions Ltd for the relevant previous year shows its revenue stream as under :

15.3.1.10 Thirdware Solutions Ltd:-

The annual report of the company shows sales as under for the FY 2004-05:

	Amount in Rs.	% of total sale
Sale of license	27202087	9.342328037
Software Services(domestic)	80602781	27.68234734
Software services(export)	147425780	50.63214443
Rev.from subscription	35939678	12.34318019
Total sales	291170326	

27. Notes to its accounts for the said year mentioned as under :

QUANTITAVE DETAILS:-

The company is engaged in trading and development of software. The production and sale of developed and traded software cannot be expressed in any generic unit. Hence it is not possible to give quantitative details of sales and certain information required under paragraphs 3, 4C, 4D of part II of schedule VI of the Companies Act 1956,

31. The above note, in our opinion, would not be sufficient to come to a conclusion that Thirdware Solutions Ltd was into software product development and not in software development services. Its revenue stream does show some

licence income, but there was substantial software services income also. We are therefore of the opinion that the issue whether Thirdware Solutions Ltd can be considered as a good comparable requires a fresh look by the AO / TPO, after getting requisite information from the concerned company. Hence, comparability of Thirdware Solutions Ltd is remitted back to the file of AO / TPO.

32. Vis-a-vis, Tata Elxsi Ltd, and Sankhya Infotech Ltd, assessee had taken a plea before the CIT (A) that these companies were functionally different. Functional comparability of these companies was an issue which came up before this Tribunal in the case of Symbol Technologies India P. Ltd (supra), which was also for the very same assessment year. Relevant paras of this decision is reproduced hereunder :

“15.7. TATA ELXSI LIMITED : The objection of the assessee is that TATA Elxsi operating two segments –system communication services and software development services. The TPO accepted the software development services segment in his T.P. analysis and assessee’s objection is that the software development services segment itself comprises of three sub-services namely (a) product design services (b) design engineering services and (c) visual computing labs. It was submitted that these services are not akin to assessee software services and segmental information of only product design services could have been accepted by the TPO as a comparable but not the entire software development service. Since company’s operations are functionally different as such, the same is not comparable. Further, assessee is also objecting on the basis of intangible scale of operations. The coordinate bench in the case of Intoto (supra) considered the issue as under in para 22.

"22 Tata Elxsi Limited : As regards this company, the learned Counsel appearing on behalf of the assessee, filed before us the reply of Tata Elxsi Limited to the Addl. CIT (Transfer Pricing), Hyderabad, wherein the concerned

Officer has been informed that Tata Elxsi Limited is specialised Embedded Software Development Service Provider and that it cannot be compared with any other software development company. It was submitted that because of the specialisation and also because of diverse nature of its business, it is very difficult to scale-up the operations of Tata Elxsi Limited. In view of this, Tata Elxsi Limited has informed that it is not fair to use its financial numbers to compare it with any other company. The communication dated 25th August, 2009 to the TPO is placed before us. As this communication was not before the TPO at the time of transfer pricing adjustment we deem it fit and proper to remand this issue also to the file of the TPO to reconsider adopting this company as the comparable in the light of observations of this company to the TPO in the case of another assessee. In the result, the Assessing Officer/TPO is directed to reconsider the issue in accordance with law, after affording a reasonable opportunity of being heard to the assessee.”

Keeping the assessee’s objections and the decisions of the Coordinate Bench, prima facie, we are of the view that TATA Elxsi Limited is functionally different and has incomparable size to that of the assessee. Further, we are unable to verify whether the segmental profits adopted by the TPO pertain to entire software development services or pertain to limited service akin to assessee services. Since, these aspects are not clear from the data furnished before us, we direct the TPO to examine and in case, the segmental profits of a particular service is not available, then, to exclude the TATA Elxsi Limited from the list of comparables. Accordingly, this issue is restored to the file of TPO for examination and to decide in accordance with law and facts, after affording reasonable opportunity of being heard to assessee.”

23. Though the issue has been set aside to the AO in the aforesaid decision, the ITAT Hyderabad in the case of NTT Data India Enterprise Application Services Pvt.Ltd., ITA No.1612/Hyd/2010 order dated 23.10.2013 and in a subsequent ruling in the case of Invensys Development Centre (India) Pvt.Ltd., ITA No.1256/Hyd/2010 order dated 28.2.2014, held that TATA Elxsi is not functionally comparable with that of a software development service provider such as the Assessee.

24. In view of the aforesaid decision rendered on identical facts and circumstances, we are of the view that TATA Elxsi Ltd., should be excluded from the list of comparable companies.

Sankhya Infotech Limited ('Sankhya')

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

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

- SILICONTM LMS (Training Management Information

- SILICONTM QT (Online Assessment System)

- SILICONTM LCMS (Learning Content Management System)

- IRMAQTM : This is an integrated resource planning, management tracking system exclusively developed for Airline operations. It is an end-to-end solution for all Flight Operations.

- Sakai CLE : This is a widely used and popular open source LMS used in many leading educational institutions and corporate. The relevant extract from the Annual report substantiating that the company also engages in different activities is reproduced below:

“2. Activities

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

19. The Delhi Tribunal in ITO v. Colt Technology Services India Pvt. Ltd. (judgment dated 23.10.2012 in ITA No. 609I/Del/2011 for the assessment year 2005-06) has held that the said company is not a

comparable to the assessee therein which was also in the business of software development.

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

Accordingly we direct exclusion of Tata Elxsi Ltd and Sankhya Infotech Ltd from the list of comparables.

33. Comparability of M/s. Flextronics Software Systems Ltd, with that of a software development services company, was an issue which came up before the Hyderabad Bench of this Tribunal in the case of Intoto Software India P. Ltd v. ACIT [ITA No.1196/Hyd/2010, dt.24.05.2013]. Intoto Software India P. Ltd was also into software development services segment and the decision was also for very same assessment year. Hyderabad bench had held as under at para 27 of its order :

Flextronics Software Systems Ltd:

27. As far as Flextronics Software Limited is concerned, we find that at page 90 of his Order, the TPO has also observed that the said company has incurred expenditure for selling of products and has incurred R & D expenditure for development of the products. The above facts clearly demonstrate that there is functional dissimilarity between the assessee and these companies and without making adjustment for the dissimilarities brought out by the TPO himself, these companies cannot be taken as comparable companies.

It can be clearly seen from the case relied on by the assessee that exclusion of Flextronics Software Systems Ltd, was directed due to failure on the part of the TPO to make adjustments for the dissimilarities. At this point it is essential to see the objections raised by the assessee before the TPO and his reply to it :

“15.3.1.8 Flextronics Software Systems Ltd :

(Tax payer’s objections)

The taxpayer had rejected this company in the TP study based on company’s turnover. In any case, turnover in NASSCOM categorisation has been rejected by the taxpayer. The turnover filter is not an appropriate filter for selection of comparables as has been discussed above. As the company satisfies all the filters applied by the TPO, the same was proposed to be considered as a comparable vide this office letter dated 29.05.2007. The taxpayer has objected to the comparable company vide reply filed on 16.07.07 which is as under :

"For the reasons mentioned in the ensuing paras Flextronics cannot be considered as comparable company, for the purposes of application of TNMM in the subject proceedings. The relevant extracts from the Annual Report of Flextronics Ltd. (Flextronics) for FY 2004-05 are reproduced below and are attached as Annexures (as mentioned for each of the paras below) for your goodselfs ready reference.

At the outset the company submits the business review of Flextronics from the Director's Report for FY 2004-05 which states as follows.....

Income from products:

Flextronics has income from products and this is evident from the data available in the Annual Report for FY 2004-05.

Some of the products introduced by Flextronics during the year 2004-05 are: OSA Application

Server, IMS client Framework, IP Phone Toolkit, nexGen SS7 platform, GSNLite Solution.

(Source: Page 11 of the Annual Report attached herewith as Annexure 8.1)

As per notes to accounts: "revenue from sale of software user license / products is recognized on delivery of software and when the customer has an unrestricted right to use."

(Source: Page 36 of the Annual Report attached herewith as Annexure 8.2)

The fact that Flextronics focuses on software products is clear from the following extract from Management Discussion and Analysis

'The products business recorded growth by 19.6% during the fiscal year 2005 on account of high license sales and royalties'

Segment data not available:

The revenue mix of Flextronics comprises 15% from sale of products and related services, 81 % from software services and 4% from SPO services. In its segmental data disclosure, Flextronics has disclosed data for 'products and services' as a composite segment and therefore no bifurcation is available between the two activities of the Company

(Source: Page 11 and page 42 of the Annual Report attached herewith as Annexure 8.3)

Research and Development:

The Company focuses on R & D activities and has significant R & D expenses during the year FY 2004-05.

Creation of IPRs

'The Company has created a number of reusable IPRs and also filed patents during the year'

Future Focus:

"Further the company's focus on R&D will continue for the future to develop new products and IPRs."

(Source: Page 15 of the Annual Report attached herewith as Annexure 8.4)

In conclusion, Flextronics ought to be rejected by applying the filter established by your goodself as above, on the grounds of functionally not comparable based on the review of the Annual Report-including the Directors'-Report for FY 2004-05."

(TPO's comments to above objections)

"Any reference to the product business of the company is of no help to the taxpayer because the total product sales constitute only 16% of the turnover. Companies, which receive more than 75% of their operating income from software development services, have been considered.

The company derives its income from the following segments as per the annual report for the year 2004-05:

15. Segment Reporting

The Company develops software products and provides software consulting services for use in the telecommunications industry and also provides services on business process outsourcing. These services are distinguishable and are not subject to the same risks and returns. As the Company also exports its products and services, the secondary segment for the Company is based on the location of its customers.

Information on the primary business segment is as follows:

Reportable Segments	Products & Services Rs.	Business Process Outsourcing Rs.	Total 31.03.2005 Rs.	Products & Services Rs.	Business Process Outsourcing Rs.	Total 31.03.2004 Rs.
Revenue						
Sales	4,574,533,350	186,194,553	4,760,727,903	3,417,033,297	166,213,210	3,583,246,507
Other Income			93,675,642			79,216,087
Total Revenue	4,574,533,350	186,194,553	4,854,403,545	3,417,033,297	166,213,210	3,662,462,594
Result						
Segment Result	1,113,988,952	(20,902,044)	1,093,086,908	824,257,808	(41,122,992)	783,134,816
Operating Profit			1,093,086,908			783,134,816
Other Income			93,675,642			79,216,087
Prior Period Adjustments			(2,186,000)			
Provision for Taxation			(115,779,353)			(89,236,917)
Prior Period Tax Adjustments			12,895,842			659,188
Net Profit After Tax			1,081,693,039			773,773,174

The product and services segment has been considered for comparability. The mix of product (Rs.71.41 Cr.,) and service sales (Rs.385.60cr.,-SW) is as under as per the annual report:

Revenue Mix

Particulars	Year ended March 31, 2005
Services	81%
Products	16%
BPO	4%

The taxpayer has objected to the inclusion of product revenue. The same can be taken out and exclusive margins of the service segment can be worked out as the expenditure incurred for the products is identifiable from the P&L account. The service segment margins are worked out as under:

Seg. Income (product and services except BPO)					
	Ser.& Prod. segment	Services	Product		Source
Income	457.45	386.65	70.8	as per P&L	
Seg. result	111.4	94.351	26.3	R&D cost as per item 4 of pg.15 of AR and also as per item 9 of notes to accounts	Current year exp.
Seg. exp.	346.05	292.299	10.72	amortised product dev. Cost as per P&L account	Amortised exp.
			16.731	other exp. prorata for selling of product	selling & oth. exp. -pro rata
Op. exp.		292.299	53.751	Total cost	

		94.351	17.049	Op. profit	
Op./exp.		32.27893	31.71848		

As predominant part of the company revenue (81%) comes from software services the company is treated as functionally similar and retained as a comparable. The overall profit margin of 32.18% has been taken as worked out in the Annexure-B which include the product sale as the company qualifies the filter of >75% SW development service income.”

Assessee had in a letter written to TPO mentioned that said company was providing product development services, citing the annual report of the said company for F. Y. 2004-05 which inter alia mentioned three streams of its business as software services, sale of product and related services and business of project outsourcing services. TPO had noted that 81% of the revenue of the said company were from billings done on man-hours spent on services and its fixed price revenue was only about 15% of the total service income. In our opinion, TPO has been able to demonstrate that Flextronics Software Systems Ltd was predominantly into software development service. Just because an insignificant portion of revenue was generated from sale of products and related services or business process outsourcing, a conclusion cannot be drawn that it was not into software development services. We are therefore of the opinion that Flextronics Software Systems Ltd was properly considered as a good comparable.

34. Coming to Foursoft Ltd, admittedly RPT was in excess of 15%. In accordance with our decision in 24/7 Customer.com P. Ltd (supra), the said company is directed to be excluded.

35. As mentioned by us exclusion of Bodhtree Consulting Ltd, though mentioned in the chart furnished by the assessee, was not pressed by the Ld. AR during the argument.

36. Vis-a-Vis Geometric Software Solutions Co, we have already held that as directed in Symbol Technologies India Ltd (supra), it requires a fresh look by the AO so as to verify whether RPT exceeded 15%. Accordingly we direct exclusion of Infosys Infotech Ltd, Satyam Computers Ltd, Exensys Software Solutions Ltd, Tata Elxsi Ltd, Sankhya Infotech Ltd and Foursoft Ltd, from the list of 17 comparables selected by the TPO. Comparability of Thirdware Solutions Ltd and Geometric Software Solutions Co, are remitted back to the AO / TPO for consideration in accordance with our directions given in para 29 to 31 and para 25 above. Other companies mentioned in the list of 17 companies shall remain.

37. AO / TPO shall rework the average mean PLI of the comparables after giving effect to the above directions and also consider the working capital adjustment that is necessary, and thereafter proceed as per law to verify the pricing of the international transactions undertaken by the assessee in the software development services segment. Ordered accordingly.

38. To summarise the result, both appeals of the assessee as well as that of the Revenue are partly allowed for statistical purpose.

Order pronounced in the open court on 8th day of September, 2015.

Sd/-

(SMT. ASHA VIJAYARAGHAVAN)
JUDICIAL MEMBER

Sd/-

(ABRAHAM P GEORGE)
ACCOUNTANT MEMBER

MCN*

Copy to:

1. The assessee
2. The Assessing Officer
3. The Commissioner of Income-tax
4. Commissioner of Income-tax(A)
5. DR
6. GF, ITAT, Bangalore

By Order

Assistant Registrar