

**IN THE INCOME TAX APPELLATE TRIBUNAL**

**“A” BENCH : BANGALORE**

**BEFORE SHRI INTURI RAMA RAO, ACCOUNTANT MEMBER**

**AND SHRI LALIET KUMAR, JUDICIAL MEMBER**

**Assessee’s Appeal**

IT(TP)A No. 79/Bang/2013
Assessment year : 2008-09

M/s. Sunquest Information Systems India Pvt. Ltd., I Floor, Eagle Ridge, EGL Business Park Off Intermediate Ring Road, Bengaluru-560071. <b>PAN:AAECS2754E</b>	Vs.	Joint Commissioner of Income Tax (OSD), Circle-12(3), Bengaluru.
APPELLANT		RESPONDENT

**Revenue’s Appeal**

IT(TP)A No. 112/Bang/2013
Assessment year : 2008-09

Assistant Commissioner of Income Tax, Circle-12(3), 14/3, 4 <sup>th</sup> Floor, Rastrothana Bhavan (Opp. RBI), Nrupathunga Road, Bengaluru-560 001.	Vs.	M/s. Sunquest Information Systmes India Pvt. Ltd., Bengaluru-560071. <b>PAN:AAECS2754E</b>
APPELLANT		RESPONDENT

Assessee by	:	Shri. T. Suryanarayana, Advocate
Revenue by	:	Shri. Kamaladhar, Sd. Counsel

Date of hearing	:	28.12.2016
Date of Pronouncement	:	17 .03.2017

**ORDER**

*Per Inturi Rama Rao, Accountant Member*

These are the appeals filed by the assessee company as well as the revenue directed against the order of learned CIT(A)-IV, Bengaluru dated 20.11.2012 for the assessment year 2008-09.

2. Briefly the facts of the case are that the assessee company is a wholly owned subsidiary of Sunquest Information Systems Inc., USA, and is engaged in the business of providing software services to its Associate Enterprises (AE). The assessee company filed its return of income for the assessment year 2008-09 on 30.09.2008 declaring total income of Rs.2,25,47,548/- under the provisions of MAT and Rs.1,43,060/- under the normal provisions of the Act. The said return of income was taken up for scrutiny assessment after the issue of requisite notice under section 143(2) of the Act, during the course of the assessment proceedings, the AO noticed that the assessee company reported the following international transactions:

<b>Sl. No.</b>	<b>Type of transaction</b>	<b>Amount Paid (Rs.)</b>	<b>Amount received (Rs.)</b>
1	Software Development Services		34,96,83,925/-
2	Reimbursement of expenses	68,83,883/-	23,98,255/-

3. The assessee company sought to justify the consideration received for the international transactions entered with its AE to be at Arm's Length Pricing. The assessee company had also submitted transfer pricing study report adopting operating profit to total cost (OP/TC) as a profit level indicator for the Transfer Pricing study Report. The assessee company applied TNMM which was considered to be the most appropriate method for the purpose of bench marking the international transactions. The assessee company's profit was computed at 13.6% and the assessee company claimed that the same was comparable with other companies rendering software development services. For the purpose of transfer pricing study, the assessee company had chosen 23 comparables and the arithmetic average profit margin of the said comparables was computed at 14.84%. According to the assessee company, its PLI was within  $\pm 5\%$  of arithmetic mean of comparable entity. Hence, it was claimed that the transaction with its AE are at arm's length. The assessee had chosen the following 23 entities:

<b>Company Name – Prowess, Capitaline &amp; Segmental</b>	<b>Mark-up on Total Costs</b>
Akshay Software Technologies Limited	6.60%
Aztecsoft Limited	18.16%
Goldstone Technologies Limited	11.50%
Helios & Matheson Information Technology Limited	38.40%

Indium Software (India) Limited	11.09%
Infosys Technologies Limited	39.96%
KPIT Cummins Infosystems Limited	13.20%
Lanco Global Systems Limited	13.28%
Larsen & Turbo Infotech Limited	11.35%
Maars Software International Limited	15.58%
Melstar Information Technologies Limited	3.46%
Mindtree Limited	16.98%
Persistent Systems Private Limited	24.34%
Quintegra Solutions Limited	15.18%
R S Software (India) Limited	14.11%
S I P Technologies and Exports Limited	18.37%
Sasken Communication Technologies Limited	17.88%
Satyam Computers Services Limited	29.43%
T V S Infotech Limited	-21.27%
V J I L Consulting Limited	5.85%
V M F Softech Limited	4.32%
Visualsoft Technologies Limited	16.76%
Zylog Systems Limited	16.87%
<b>Mean (Average)</b>	<b>14.84%</b>

4. The AO referred the matter to the TPO for the purpose of benchmarking the international transactions. The TPO by order dated 31.10.2011 passed under section 92CA(3) of the Act, computed the transfer pricing adjustment at Rs.3,24,55,435/- . The TPO accepted the TNMM adopted by the assessee company, but rejected the transfer pricing study report. Then the TPO proceeded to identify the different set of comparable studies for the purpose of determining the ALP of

the transactions with its AE. While doing so, the learned TPO had adopted the following filters:

<b>Step</b>	<b>Description</b>
1	Companies whose data is not available for FY 2007-08 – excluded
2	Companies whose software development service revenue <Rs.1 Cr – excluded
3	Companies whose software development service revenue is less than 75% of the total operating revenues – excluded
4	Companies who have more than 25% related party transactions of the operating revenues – excluded
5	Companies who have less than 25% of the revenues as export sales - excluded
6	Companies with onsite revenues greater than 75% of the export revenues from software are excluded
7	Companies whose employee cost to revenues is less than 25% of the revenues – excluded
8	Companies having different financial year ending – rejected
9	Companies who have diminishing revenues/persistent losses for the period under consideration – excluded
10	Companies that are having peculiar economic circumstances were excluded
11	Companies functionally different from the assessee - excluded

5. The TPO rejected 16 comparables selected by the assessee company and accepted 7 comparables and also introduced 13 new comparables and finally selected the following comparables:

Sl. No.	Name of the Company	Mark-up on Total Costs
1.	AvaniCimcon Technologies	25.62%
2.	Bodhtree Consulting Ltd.	18.72%
3.	Celestial Biolabs	87.94%
4.	e-zest Solutions Ltd.	29.81%
5.	Flextronics (Aricent)	7.86%
6.	iGate Global Solution Ltd.	13.99%
7.	Infosys	40.37%
8.	Kals Information Systems Ltd. (Seg)	41.94%
9.	LGS Global Ltd.	27.52%
10.	Mindtree Ltd. (Seg)	16.41%
11.	Persistent Systems Ltd.	20.31%
12.	Quintegra Solution Ltd.	21.74%
13.	R Systems (India) Ltd.	15.30%
14.	R S Software (India) Ltd.	7.41%
15.	Sasken Communication Technologies Ltd. (Seg)	7.58%
16.	Tata Elxsi (Seg)	18.97%
17.	Thirdware solution Ltd.	19.35%
18.	Wipro Ltd. (Seg)	28.45%
19.	Softsol India Ltd.	17.89%
20.	Lucid Software Ltd.	16.50%
	<b>Mean (Average)</b>	<b>23.65%</b>

6. The TPO computed the average profit margin finally selected at 23.65% after giving working capital adjustment of -0.50% (negative working capital adjustment), adjusted mean of the comparables at 24.15%. On the above said basis, the TPO computed the transfer pricing adjustment as follows:

Arm's Length Mean Margin on cost	23.65%
Less : Working Capital Adjustment (as per Annexure-C)	-0.50%
Adjusted mean margin of the comparables	24.15%
Operating Cost	Rs.30,78,04,559/-
Arm's Length Margin            124.15%    % of Operating Cost	
Arm's Length Price (ALP)    124.15%    % of Operating Cost	Rs.38,21,39,360/-
Price Received	Rs.34,96,83,925/-
<b>Short fall being adjustment u/s. 92CA</b>	<b>Rs.3,24,55,435/-</b>

7. The AO passed draft assessment order under the provisions of 144C of the Act, and served on the assessee company. The assessee company, after receipt of the draft assessment order conveyed to the AO that it would not prefer to file any objection before the Hon'ble DRP and therefore the AO passed the final assessment order dated 30.01.2012 under section 143 r.w.s. 144C(3) of the IT Act. After making the transfer pricing adjustment, as suggested by the learned TPO in his order under section 92CA of the Act and also adjusting the benefit under section 10A by reducing the foreign travel expenditure of Rs.42,07,544/- from the export turnover.

8. Being aggrieved, an appeal was preferred before the CIT(A). It was contended before the CIT(A) interalia that the TPO ought not have applied different year ending and applied turnover filter to reject the companies having turnover of less than 1 crore and having employee cost of less than 25% of revenue, etc. The learned CIT(A) directed the AO to apply the turnover filter both at the upper and lower ends and consequently directed the AO/TPO to exclude the following companies from the list of comparables:

1. Flextronics Ltd.,
2. IGate Global Solutions Ltd.,
3. Infosys Technologies Ltd.,
4. Mindtree Ltds.,
5. Persistent Systems Ltd.,
6. Sasken Communication Technologies Ltd.,
7. Tata Elxsi Limited
8. Wipro Limited (Seg.)

The CIT(A) also directed the AO/TPO to include 2 comparables which are rejected by the TPO viz., M/s. Helios & Matheson Information Technology Ltd., and M/s. Maars Software International Ltd. The CIT(A) has also upheld the application of onsite revenue filter and consequently directed the exclusion of Softsol India Ltd., as no breakup of revenue from onsite and offshore was available. The CIT(A) also accepted the contention of the assessee company that the companies Bodhtree Consulting Ltd., Celestial Biolabs, Lucid Software Ltd., should be excluded from the list of comparables on the ground of functionality. The CIT(A) also directed the AO/TPO to include Cat Technologies Ltd., VMF Soft Tech and Thinksoft Global Solutions P. Ltd., on the application of export earnings filter. Thus, consequent to the order of the CIT(A), the final comparables would remain as under:

Sl.No.	Name of the Company	Mark-up on Total Costs
1	Avani Cimcon Technologies Ltd.	21.40%
2	Cat Technologies Ltd.	14.86%
3	e-Zest Solutions Ltd.	29.81%
4	Helios & Matheson IT Ltd.	38.40%
5	KALS Information Systems Ltd.	30.92%
6	LGS Global Ltd.	27.52%
7	Maars Software International Ltd.	7.94%
8	Quintegra Solutions Ltd	21.74%
9	R Systems International Ltd.	15.30%
10	R S Software (India) Ltd.	7.41%
11	Think soft Global Solutions Pvt. Ltd.	16.94%
12	Third ware Solutions Ltd.	19.30%
13	VMF Sof Tech Ltd.	4.32%
<b>Arithmetical mean</b>		<b>19.68%</b>

9. While matter stood thus, the assessee company filed an application on 2.1.2013 before the CIT(A) praying that the CIT(A) erred in considering the multi year data in order to arrive at margin of entity VMF Softech Ltd., and also directed the inclusion of one entity viz., Helios & Matheson Information Technology Ltd., despite company failing the foreign exchange earning filter applied by the TPO himself. The CIT(A), vide his order dated 12.02.2013, allowed the said application, consequently the margin of VMF Soft Ltd., was computed to be 2.64% and the entity Helios & Matheson Information Technology Ltd., was excluded by the CIT(A) and the final list of comparables pursuant to the rectification order passed by CIT(A) is as under :

**C.6. Final list of comparables pursuant to the rectification order passed by the CIT(A):**

Sl.No.	Name of the Company	Mark-up on Total Costs (Before WC Adj.)
1	AvaniCimcon Technologies Ltd.	21.40%
2	Cat Technologies Ltd.	14.86%
3	e-Zest Solutions Ltd.	29.81%
4	KALS Information Systems Ltd.	30.92%
5	LGS Global Ltd.	27.52%
6	Maars Software International Ltd.	7.94%
7	Quintegra Solutions Ltd	21.74%
8	R Systems International Ltd.	15.30%
9	R S Software (India) Ltd.	7.41%
10	Thinksoft Global Solutions Pvt. Ltd.	16.94%
11	Thirdware Solutions Ltd.	19.35%
12	VMF Soft Tech Ltd.	2.51%
	<b>Arithmetical mean</b>	<b>17.98%</b>

**C.7. +/- 5% of the Assessee's Margin:**

Particulars	Margin
Net Margin of the Assessee	13.61%
Arithmetical mean margin of the comparables	17.98%
+5% of the margin of the assessee	19.29%
-5% of the margin of the assessee	7.92%

10. Thus it was submitted before us that consequent to the rectification order passed by the CIT(A), the arithmetic mean margin of comparable entities is only 17.98% which is below  $\pm 5\%$  margin of the assessee company which is computed at 13.61%. Therefore, it was prayed that the grounds of the appeal raised by the assessee company in its appeal do not survive for consideration and therefore prayed for dismissal of the appeal.

11. After considering the rival submission and perusal of the material on record, the appeal filed by the assessee is dismissed.

12. In the result, assessee's appeal in appeal IT(TP)A No. 79/Bang/2013 is dismissed.

### **Revenue's Appeal IT(TP)A No.112/Bang/2013**

13. Now we shall deal with the revenue's appeal. The revenue has raised the following grounds of appeal:

1. The order of the learned CIT(A) is opposed to law and facts of the case.
2. On the facts and in the circumstances of the case the learned CIT(A) failed to appreciate that the different year ending filter applied by the TPO is necessary to exclude companies which do not have the same or comparable financial cycle as the tested party.
3. On the facts and in the circumstances of the case the learned CIT(A) erred in holding that the size and turnover of the company are deciding factors for treating a company as a comparable, and accordingly erred in excluding M/s Flextronics Ltd., M/s iGate Global Solutions Ltd., M/s Infosys Technologies Ltd., M/s Mindtree Ltd., M/s Persistent Systems Ltd., M/s Sasken Communications Technologies Ltd., M/s Tata Elxsi Ltd. and M/s Wipro Ltd. as comparables.
4. On the facts and in the circumstances of the case the learned CIT(A) has erred in directing the TPO to include M/s Maars Software International Ltd. and M/s Helios & Matheson IT Ltd. in the final set of comparables which were rejected by the TPO on application of the Employee Cost filter.

5. On the facts and in the circumstances of the case the learned CIT(A) has erred in rejecting the diminishing revenue filter used by the TPO to exclude companies that do not reflect the normal industry trend.
6. On the facts and in the circumstances of the case the learned CIT(A) has erred in holding that M/s Bodhtree Consulting Ltd. being functionally different, cannot be taken as a comparable.
7. On the facts and in the circumstances of the case the learned CIT(A) has erred in excluding M/s Celestial Biolabs Ltd. from the final set of comparables.
8. On the facts and in the circumstances of the case the learned CIT(A) has erred in holding that M/s Lucid Software Ltd being functionally different cannot be taken as comparable.
9. On the facts and in the circumstances of the case the learned CIT(A) erred in directing the AO to reduce an amount of Rs. 42,07,544 being reimbursement of travel and other expenses incurred in foreign currency both from the export turnover and from the total turnover, for computation of deduction u/s 10A of the IT Act whereas such exclusion is permitted to arrive at the export turnover only as per the definitions given in section 10A of the IT Act and total turnover has not been defined in section 10A of the Act.
10. The CIT(A) ought to have appreciated that the decision of Hon'ble High Court of Karnataka in the case of M/s Tata Elxsi Ltd. on the issue of computing deduction u/s 10A by excluding the above expenses from export turnover and total turnover as well, has not reached finality in view of the pending Department's SLP before the Hon'ble Supreme Court.
11. For these and other grounds that may be urged at the time of hearing, it is prayed that the order of the CIT(A) in so far as it relates to the above grounds may be reversed and that of the Assessing Officer may be restored.
12. The appellant craves leave to add, alter, amend and / or delete any of the grounds mentioned above.

14. Ground Nos. 1, 2, 11 and 12 are general in nature, do not require any adjudication. Ground No. 3 challenges the direction of the CIT(A) to exclude the following companies on the ground of turnover exceeding 200 crores and less than 1 crore revenue:

1. Flextronics Ltd.,
2. IGate Global Solutions Ltd.,
3. Infosys Technologies Ltd.,
4. Mindtree Ltds.,
5. Persistent Systems Ltd.,
6. Sasken Communication Technologies Ltd.,
7. Tata Elxsi Limited
8. Wipro Limited (Seg.)

15. The above companies were excluded by the learned CIT(A) on the grounds that the turnover of the comparable entities does not fall at 1 to 200 crore category. However, this Tribunal has been holding that the turnover is not a relevant criteria. Hence these companies cannot be excluded on this score. However, the learned counsel for the assessee company argued that though the turnover criteria is not applied, the companies Infosys, Tata Elxsi and Wipro Technologies are functionally dissimilar to that of the assessee company and therefore cannot be held to be comparable and reliance in this regard was placed by him on the decision of the coordinate bench in the case of *GXS India Technology Centre P. Ltd., v. ITO in IT(TP)A No. 1444/Bang/2012* and *JCIT v. Support.com India Pvt. Ltd., in IT(TP)A No.293/Bang/2013*. We find from the perusal of the above order that the Tribunal has directed the exclusion of these companies on the ground that these companies possess high brand value and intangible assets.

Hence, we direct TPO/AO to exclude the entities Infosys Technologies, Tata Elxsi and Wipro Ltd., on the ground of functionality.

16. Ground No. 4 challenges the direction of CIT(A) to exclude the comparables Maars Software International Ltd., and Helios & Matheson Information Technology Ltd., in the final set of comparables which were rejected by the TPO on the application of employee cost filter. The learned counsel for the assessee submitted that the learned CIT(A) in the rectification proceeding excluded Helios & Matheson Information Technology Ltd., as comparables on the ground that the company does not pass through foreign exchange filter. Thus the ground relevant to Helios & Matheson Information Technology Ltd., becomes infructuous.

17. As regards to the company Maars Software International Ltd., is concerned, he submitted that this company satisfies the employee cost filter applied by the TPO and therefore it could not be excluded. In this connection he has drawn our attention to the schedule 12 of the annual report, according to which the employee cost of the revenue is 91.14%. The learned CIT(DR) had not brought any evidence controverting the above findings. Thus we hold that these companies should be included in the final set of comparables. The ground No. 5 was not pressed during the course of hearing and dismissed as such.

18. Ground No. 6 challenges the direction of CIT(A) to exclude the company Bodhtree Consulting Ltd., on the ground of functionality.

The learned counsel for the assessee submits that the CIT(A) after considering the information obtained in exercise of the power vested with him under section 133(6) of the Act, that it is engaged in the business of software development and information technology enabled services. Thus it was submitted that the company is more into the ITeS and therefore functionally not comparable and reliance in this regard was also placed on the following 3 decisions:

- *GXS India Technology Centre P. Ltd. v. ITO* [order dated 31.07.2015 in IT(TP)A No.1444/Bang/2012) for AY 2008-09 at para 8 at pages 14-15]
- *ITO v. Infinera India Ltd.* [order dated 20.01.2016 in IT(TP)A No.294/Bang/2013 for AY 2008-09 at paras 20-22 at pages 22-24]
- *Emptoris Technologies India Pvt. Ltd. v. DCIT* [order dated 29.02.2016 in IT(TP)A No.436/Pun/2013 for AY 2008-09 at paras 13-14 at pages 15-19]

19. After perusal of the material on record, the Bodhtree Consulting Ltd., is engaged both in ITeS and software development and no segmental details were available and therefore in the absence of segmental details, it cannot be held to be comparable with that of the assessee company which is engaged in purely software development. Thus the ground of appeal filed by the revenue is dismissed.

20. Ground No. 7 and 8 challenges the direction of the learned CIT(A) to exclude Celestial Biolabs and Lucid Software Ltd., from the

final list of comparables on the ground of functionally different. The coordinate bench in the case of *GXS India Technology Centre P. Ltd. v. ITO* has held that these companies are not comparables with that of pure software development company. Placing reliance on the decision of *3DPLM Software Solutions Ltd.*, held that this company is functionally different from that of software development company as it is engaged in clinical research and manufacture of other bio products. There was no basis for the TPO to conclude that it was engaged in the business of providing software development services. The learned DR has not brought any evidence on record contrary to the above findings of the Tribunal. Hence, respectively following the decision of the Tribunal, we hold that this company i.e., Celestial Biolabs cannot be compared with that of the assessee company.

21. Similarly, as regards to *Lucid Software Ltd.*, it was held by the coordinate bench in the case of *3DPLM Software Solutions Ltd.*, that it is engaged in the product development rather than services. Therefore this company cannot be held to be comparable to that of assessee company which is engaged in the pure software development services. Thus the ground Nos. 7 and 8 raised by the revenue are dismissed.

22. The ground Nos. 9 and 10 challenges direction of learned CIT(A) not to exclude the travelling expenditure from the export turnover for the purpose of calculation of benefit under 10A. As regards portion of the expenses incurred in foreign exchange towards insurance, travelling and communication is concerned, in the case of *CIT vs. Tata Elxsi (349 ITR 98)*, the Hon'ble Jurisdictional High Court

held that the same is required to be reduced from export turnover as well as total turnover. Respectfully following the ratio of the decision of the Hon'ble jurisdictional High Court we direct that expenses incurred in foreign exchange towards insurance, travelling and communication are to be reduced both from export turnover as well as total turnover. Therefore, the grounds of appeal filed by the Revenue in this regard is dismissed.

23. In the result, the appeal filed by the revenue is partly allowed for statistical purposes and the appeal filed by the assessee is dismissed.

*Pronounced in the open court on this 17<sup>th</sup> day of March, 2017.*

Sd/-  
**(LALIET KUMAR)**  
**Judicial Member**

Sd/-  
**(INTURI RAMA RAO)**  
**Accountant Member**

Bangalore.  
Dated: 17<sup>th</sup> March, 2017.  
/NS/

Copy to:

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

By order

Assistant Registrar,  
ITAT, Bangalore.