

IN THE INCOME TAX APPELLATE TRIBUNAL
BENGALURU BENCH 'A', BENGALURU

BEFORE SMT. ASHA VIJAYARAGHAVAN, JUDICIAL MEMBER
AND

SHRI. S. JAYARAMAN, ACCOUNTANT MEMBER

I.T(TP).A No.497/Bang/2012
(Assessment Year : 2005-06)

M/s. Telsima Communications P. Ltd,
1st floor, Salarpuria Touch Stone, Marthahalli,
Kadubeesanahalli, Bengaluru 560 013 .. Appellant
PAN : AABCT9826D

v.

Deputy Commissioner of Income-tax,
Circle 12(4), Bengaluru .. Respondent

I.T(TP).A No.518/Bang/2012
(Assessment Year : 2005-06)
(By the Revenue)

Assessee by : Shri. K. R. Vasudevan, Advocate
Revenue by : Dr. P. K. Srihari, Addl. CIT, DR

Heard on : 27.07.2016
Pronounced on : 30.09.2016

ORDER

PER S. JAYARAMAN, ACCOUNTANT MEMBER :

These are cross appeals filed by the assessee and the Revenue respectively, against the order of DCIT, Circle -12(4), Bengaluru, dt.12.12.2008, for the A. Y. 2005-06.

02. The effective grounds taken up by the assessee before us are extracted herebelow, issue wise and dealt with therein :

1. Non-TP issues :**Issue no.1 Disallowance of diminution in value of assets amounting to Rs.59,29,812/- :**

1.1 *Depreciation on actual cost of asset amounting to Rs. 83,87,286*

- The learned Commissioner of Income-tax (Appeals) ["CIT(A)"] erred in not granting depreciation on the actual cost of asset put to use i.e., on Rs. 83,87,286.
- The learned CIT(A) erred in granting depreciation on Rs. 33,57,474 which is post revaluation. The learned CIT(A) ought to have observed that the definition of actual cost does not include any increase or reduction on account of revaluation.
- The learned CIT(A) ought to have observed that the appellant has put the asset to use on 5th July, 2004 and hence, eligible for depreciation on the actual cost of asset amounting to Rs. 83,87,286.
- The learned CIT(A) erred in observing that the advance money forfeited should be reduced from the actual cost of assets as the said advance was for sale and not for bringing the asset into existence.

02. In this regard, the relevant portion of the assessment order is extracted as under :

"8. Diminution in the Value of Assets

8.1. The Assessee Company has reflected an amount of Rs.50,29,812/- as Diminution in the Value of Asset. On Verification of Records, it was found that the Assessee Company has bought Communication Equipment for an amount of Rs.83,87,286/- from M/s Mistral Solutions Pvt Ltd over a period of time from 24th September, 2002 to 18th April 2003 on which the allowable depreciation is Rs.50,32,372/-.

8.2. The above equipment were leased to M/s Tayana Software Solutions Pvt Ltd on which an Income of Rs.35,00,00/- has been received and offered to Tax for AY 2005-06. However, the Assessee Company claims that the above Transaction is 'Sale on Approval' basis to M/s Tayana Software Solutions FM Ltd and not Leasing of Equipment. The Assessee Company further claims that M/s Tayana Software Solutions Pvt Ltd has subsequently returned the equipment.

8.3. The Assessee Company Revalued the above equipment at Rs.35,57,474/- (Actual Value Rs.83,87,286/-) through a Chartered Engineer, Mr. C E Bhaskar, dated 6th July 2005 and claimed a further Depreciation of Rs.20,14,484/- on the Revalued amount of Rs.35,57,474/-.

8.4. From the above Transactions it can be Proved beyond Reasonable Doubts that the Assessee Company has Revalued the Communication Equipments with an Actual Value Rs.83,87,286/- to Rs.35,57,4741- thereby writing off a amount of Rs.50,29,812/- and additionally an excess Depreciation of Rs 20,14,484/- on the same.

8.5. When the above issue was brought to the notice of the Authorised Representative, the Authorised Representative could not substantiate the reason for the same.

8.6. Therefore, the Assessee Company's claim of Depreciation is limited to Rs 50,32,372/- which is allowed in accordance to Income Tax Act, 1961 and the additional Depreciation of Rs.20,14,484/claimed by revaluing the Asset (on which Depreciation has already been claimed) at Rs.35,57,4741- is disallowed and added back to the total income of the Assessee company

Thus, the Addition under this head is **Rs.20,14,484/-"**

03. On an appeal, the CIT (A) held as under :

"2.2.2 During the appellate proceedings the appellant submitted that the appellant sold a telecommunication equipment to M/s. Tayana Software Solutions Private Limited during FY 2002-03 for a total sum Of Rs 99,00,000/-. This was on sale on approval basis. Against this transaction, the customer had paid a sum of Rs 35,00,000/- .which was shown as advance from customers. The customer used this equipment for a while and finally rejected the equipment and returned the same to the appellant. The advance of Rs 35,00,000/- collected earlier from this customer was shown as OTHER INCOME. Consequent to the return of this equipment, the appellant decided to use this equipment as capital goods for their business purpose and got a valuation of this equipment done at Rs 33,57,474/- (but it was wrongly mentioned as Rs35,57,474/- in the assessment order). Thus, as per the Accounting Standard, the appellant capitalized this asset at Rs 33,57,474/- and claimed depreciation @60.00%. The learned assessing officer has however come to the conclusion that depreciation on this equipment is allowable on the original cost of the asset and he has not disturbed the forfeiture of advance of Rs.35 lakhs accounted as other income. It is submitted that the learned AO ought to have reduced the advance forfeited from the cost of the asset and allowed the depreciation on such reduced value. Thus, he ought to have reduced the income by Rs.35 lakhs on account of inclusion of this amount in the other income and thereafter, he

ought to have reduced the original cost of the asset by this amount and allowed the depreciation. This is in line with even provisions of section 51 of the Income Tax Act where any advance forfeited can only be reduced from the cost of the asset. Even u/s 43 of the IT Act, the definition of 'actual asset' excludes any cost met by anybody else and therefore, the sum forfeited has to be excluded from the actual cost of the asset. There are several case laws holding that in the case of fixed assets, depreciation can be claimed only on the value of the asset after reducing the amount, if any, which is received towards the same. Thus, the learned AO ought to have proceeded as under:

- a. He ought to have excluded a sum of Rs.35 lakhs being the amount forfeited and credited to OTHER INCOME by the appellant;*
- b. Thereafter, he ought to have reduced this amount from the original cost of the asset of Rs. 83,87,286 and thus, allowed the depreciation on such reduced amount.*

2.2.3 Having heard the contention of the appellant, the undersigned obtained the Profit & Loss A/c and the statement of the total income from the Assessing Officer for the Assessment Year in respect of Hyderabad Unit, it is noticed from the Profit & Loss A/c that the appellant has shown the income under the head "other income" of Rs. 35 Lakhs from the customer and also the 'other income' which is interest received of Rs. 10,495/- against which the assessee debited an amount of Rs.50,29,812/- on diminishing value of the asset and also an amount of Rs. 22,72,741/- as loss on disposal of the fixed asset. As the above loss pertains to the Capital Asset, hence not allowable as deduction either under section 37(1) or under Section 57(3) of the Income Tax Act. However, the appellant even though added loss on sale of asset of Rs. 22,72,741/- but did not add Rs. 50,29,812/- to the total income and therefore, a notice u/s.251(2) of the Income Tax Act was issued to the appellant on 11.1.2012 in which the assessee was asked to explain as to why the income should not be enhanced by Rs. 50,29,812/-, in response to which the appellant admitted that the amount of Rs. 50,29,812/- on account of revaluation difference has been charged to the Profit & Loss A/c. further, it is evident from the record that the asset was put to use for the purpose of the business of the appellant from which the income of Rs.35 lakhs has been shown as 'other incomes. Once, Rs. 35,00,000/- is offered as income, the same has to be assessed by the Assessing Officer. Further, the appellant has claimed the depreciation as per the Provisions of the IT Act at Rs. 22,81,244/- in the computation of income according to the Audit Report filed in Form 3 CD on the above asset. Hence the question of allowance of any further depreciation does not arise. Accordingly, the addition made by the Assessing Officer at Rs.20,14,484/- is enhanced to Rs. 50,29,812/-. The Assessing Officer is accordingly directed to give effect to the enhancement of the income."

04. We heard the rival submissions. From the above, it is clear that the assessee used the communication equipment in its business from 24.09.2002 to 18.04.2003. Thereafter, it gave to M/s. Tayana Software Solutions P. Ltd, received back and then claimed to have used for its business. There is no clear finding as to whether the equipment was sold or leased to M/s. Tayana Software Solutions P. Ltd and its related financial aspects. Further the depreciation claim apparently falls within the scope of Section 43 of the Act. However, its scope has not been examined. In view of that, this issue is remitted back to the AO. The AO shall examine the above issues and after furnishing adequate opportunity to the assessee, pass appropriate order in accordance with law.

Issue no.2 : Set off of current year loss of non-STP unit from income of STP unit eligible before computation of deduction u/s.10A :

2. Set off of current year loss of non-STP unit from income of STP unit eligible before computation of deduction under section 10A
 - The learned Assessing Officer (“AO”) ought to have observed that the appellant operates through two units – STP unit at Bangalore and non-STP unit at Hyderabad.
 - The learned AO has erred in setting off returned loss of non-STP unit amounting to Rs.66,82,806 against the returned profit of STP unit amounting to Rs.53,01,127 for the purpose of computing the profits eligible for deduction under section 10A of the Act.
 - The learned AO has erred in not granting deduction under Section 10A of the Act on the returned profit of the STP unit amounting to Rs.53,01,127.

This issue is neither dealt with by the ACIT, Circle -12(4), Bengaluru, in his order dt.12.12.2008 nor by the CIT (A)-IV, Bengaluru, in his order dt.13.12.2012. In view of the same, it is not deliberated upon by us.

Transfer Pricing Issues :

5. The assessee, Telsima Communications P. Ltd, is a subsidiary of Telsima Corporation, USA, which was incorporated on 17.5.2000. Assessee is a provider of software development services only to its AE – Telsima-US. During the transfer pricing assessment proceedings, the TPO rejected the TP documentation of the assessee and applied TNMM as the most appropriate method while determining arm's length price. Accordingly the TPO determined the arm's length adjusted margin at 22.98% and hence proposed the transfer pricing adjustment of Rs.70,82,720/-.

5.1. Aggrieved by the order of TPO, assessee filed an appeal before the CIT (A). The CIT (A) granted the following relief to the assessee :

- i) Turnover filter of Rs.1crore to Rs.200 crore was upheld*
- ii) Related party transaction filter of 0% was upheld and*
- iii) Directed that Exensys Software Solutions Ltd, should be rejected as a comparable on the ground that it has extraordinary profit of 70.67% during the F. Y. 2004-05.*

5.2. The gist of reasons given by the CIT (A) for rejection of comparable is extracted as under :

Sl No	Company Name	Reason for rejection/Acceptance
1	Bodhtree Consulting Ltd	Accept
2	Lanco Global Systems Ltd	Accept
3	Exensys Software Solutions Ltd	Reject - Presence of Extraordinary event

4	Sankhya Infotech Ltd	Accept
5	Sasken Networks Systems Ltd	Reject - RPT >0%
6	Four Soft Ltd	Reject - RPT >0%
7	Thirdware Solutions Ltd	Reject - RPT >0%
8	R S Software (India) Ltd	Accept
9	Geometric Software Solutions Ltd	Reject - RPT >0%
10	Tata Elxsi Ltd (seg)	Reject - RPT >0%
11	Visualsoft Technologies Ltd (seg)	Accept
12	Sasken Communications Ltd (seg)	Reject - RPT >0%
13	iGate Global Solutions Ltd (seg)	Reject - RPT >0% Turnover >200 crores
14	Flextronics Software Systems Ltd (seg)	Reject - RPT >0% Turnover >200 crores
15	Larsin & Toubro Infotech Ltd	Reject - RPT >0% Turnover >200 crores
16	Satyam Computer Services Ltd	Reject - RPT >0% Turnover >200 crores
17	Infosys Technologies Ltd	Reject - RPT >0% Turnover >200 crores

5.3. Based on the above reasons, the final list of comparable companies accepted by the CIT (A) are as under :

Sl No	Name of the company	Margin on cost (2006)
1	Bodhtree Consulting Ltd	24.86%
2	Lanco Global Systems Ltd	13.65%
3	Sankhya Infotech Ltd	27.39%
4	Visualsoft Technologies Ltd (seg)	23.52%
	Arithmetic Mean	22.35%
	Less : Working Capital Adjustment	4.95%
	Adjusted Arithmetic Mean	17.41%

06. Assessee's effective grounds of appeal are extracted as under :

1. The Honourable CIT (A) and the learned AO grossly erred in law and facts of the case in determining the arm's length price ('ALP') of the international transaction of the Appellant and thereby making an adjustment of Rs.70,82,720 under section 92CA of the Act with respect to the software services rendered by the appellant.

07. Assessee has also raised the following additional grounds numbered 9 to 11:

Transfer Pricing-Additional Ground of Appeal

It is most humbly prayed to the Hon'ble Tribunal to permit the Appellant to raise the following additional ground of appeal in continuation of the existing grounds of appeal and be read as Ground no. 9, 10 & 11 under Transfer Pricing grounds.

Transfer pricing Grounds

Ground 9: Bodhtree Consulting Limited ("Bodhtree") should be rejected as a comparable company

The Appellant submits that the Ld. Commissioner of Income-tax (Appeals) ("CIT(A)") has erred in including Bodhtree as a comparable company to the Appellant, while doing the comparability analysis.

Reason for filing Additional Ground of Appeal

In determining the arm's length price, the comparable company should be functionally comparable and should not have significant controlled transaction. It has now come to light that this company is not a good comparable because of the following reasons:-

- i) The Appellant submits that Bodhtree provides e-paper solutions, data cleansing software, website development and other customized software and that the e-paper solutions and data cleansing services would come under category of IT enabled Services making it functionally not comparable to the Appellant which is involved in the software development services. Further, it has also been held by the Hon'ble Tribunal in various decisions that Bodhtree is a product development company.

- ii) Further, subsequent to the filing of the appeal, it has come to the notice of the Appellant that it has been held by the Hon'ble Tribunal in various decisions that Bodhtree has significant related party transaction of export sales to Perigon LIC, USA of INR 133.90 lakhs, being 34.68% of the total turnover and cannot be considered as comparable.

Therefore, based on the above reasons, the Appellant humbly requests the Hon'ble Bench members that Bodhtree should be excluded from the list of comparable companies.

Ground 10: Sankhya Infotech Limited ("Sankhya Infotech") should be rejected as a comparable company

The Appellant submits that the Ld. CIT(A) has erred in including Sankhya Infotech as a comparable company to the Appellant, while doing the comparability analysis.

Reason for filing Additional Ground of Appeal

In the absence of any specific details in the public domain, the Appellant was not in a position to controvert the stand of either Ld. Transfer pricing officer ("TPO") or the Ld. CIT(A) at the time of respective proceedings. Therefore, the inclusion of this company as a comparable was not specifically contested. However, it has now come to light that this company is not a good comparable because of the following reasons:-

- i) The Appellant submits that Sankhya Infotech is engaged in the business of development of software products and training. As per annual report, this company has been focusing on development of niche products for the transport and aviation industry making it functionally not comparable to the Appellant. Further, it has also been held by the Hon'ble Tribunal in various decisions that Sankhya Infotech is a product development company.
- ii) Further, the Appellant submits that Sankhya Infotech is engaged in research and development activity and owns intangible assets to the extent of 52% of the revenue of the company and hence it is not functionally comparable to the Appellant engaged in software development services.
- iii) The Appellant also submits that Sankhya Infotech has also incurred selling and marketing expenditure to the extent of 16.65% of the revenue of the

Appellant, thereby, showing that this company is exposed to market risk and hence not comparable to the Appellant. .

- iv) Further, subsequent to the filing of the appeal, it has also come to the notice of the Appellant that it has been held by the Hon'ble Tribunal in various decisions that Sankhya Infotech's employee cost to the total turnover ratio is 23.03% which is less than the threshold limit and thus cannot be considered as comparable to the Appellant.

Therefore, on this basis, the Appellant humbly requests the Hon'ble Bench Members to exclude Sankhya Infotech from the list of comparable companies.

Ground No 11: Without prejudice to the contention that 0% Related party transaction filter should be applied, the appellant submits that following companies should also be rejected on grounds of functional dissimilarity

The Appellant submits that the Ld. CIT(A), while excluding the following companies on the ground of Related Party Transactions (RPT) filter, has failed to adjudicate on the functional dissimilarity:

1. Flextronics Software Systems Limited;
2. Larsen & Toubro Infotech Limited;
3. Igate Global Solutions Limited;
4. Sasken Communications Limited;
5. Sasken Networks Systems Limited;
6. Four Soft Limited;
7. Thirdware Solutions Limited;
8. Geometric Software Solutions Limited;
9. Tata Elxsi Limited;
10. Satyam Computer Services Limited; and
11. Infosys Technologies Limited;

Reason for filing Additional Ground of Appeal

The Appellant wishes to submit that since the above-mentioned comparables were rejected by the Ld. CIT(A) on RPT filter, the same was not raised in Form 36.

Therefore, the Appellant humbly requests the Hon'ble Bench members to reject the above mentioned companies as they are functionally not comparable to the Appellant.

In view of the above, the Appellant craves permission to file this additional ground seeking exclusion of this company from the set of comparables and make submissions in this regard.

08. The gist of Ld. AR's submissions is extracted as under :

Sl No	Company Name	Adjusted OP/TC (2005)	Gist of AR's plea	Reliance placed on
1	Bodhtree Consulting Ltd	21.56%	i)Functionally not comparable	Hyderabad ITAT order in Cordys Software India P. Ltd (ITA.1451/Hyd/2010)
			ii) Fails RPT filter	
2	Lanco Global Systems Ltd	8.48%	Accepted by both assessee and TPO	--
3	Exensys Software Solutions Ltd	62.84%	Rejected by CIT (A)	--
4	Sankhya Infotech Ltd	20.32%	i) Functionally different - development of software products	Directors Report for F. Y. 2004-05 p.13 and Bengaluru ITAT order in M/s. McAfee Software (India) P. Ltd[IT(TP)A No.04/Bang/2012
			ii) R & D activities	Annual Report for FY 2004-05 p.32
			iii) Fails employee cost to sales filter - employee cost to sales less than 25%	Annual Report

			iv) Selling and marketing activities	Annual Report for F. Y. 2004-05 & Bengaluru Tribunal order in DCIT v. Toshiba Embedded Software (I) P.Ltd [IT(TP)A.1/Bang/2012]
5	Sasken Networks Systems Ltd	13.07%	Functionally different - substantial selling and marketing expenses	Annual report for FY 2004-05
6	R S Software (India) Ltd	5.70%	Fails Turnover filter	--
7	Four Soft Ltd	20.54%	i) Functionally different - development of software products	Directors' report for FY.2004-05 p.12 to 14 & Management decision for FY 2004-05 p.25, 30 etc.,
			ii) Fails related party transactions to sales filter - RPT to sales greater than 15%	Bengaluru Tribunal order in DCIT v. Toshiba Embedded Software (I) P.Ltd [IT(TP)A.1/Bang/2012]
8	Thirdware Solutions Ltd	63.99%	Functionally different - purchase and sale of licenses	Schedule 13 of Annual Report for FY 2004-05
9	Geometric Software Solutions Ltd	16.87%	i) Functionally different - product development and engineering services	Directors' Report for FY 2004-05 p.4
			ii) Fails RPT to sales filter - RPT to sales greater than 15%	--
10	Tata Elxsi Ltd (seg)	21.98%	i) Functionally different - product engineering and design	Annual report for F. Y. 2004-05 - p.2 and 18.

			services	
			ii) Fails Turnover filter	--
11	Visualsoft Technologies Ltd (seg)	19.27%	Accepted by both assessee and the TPO	--
12	Sasken Communications Ltd (seg)	12.27%	i) Fails turnover filter	Annual report for F Y 2004-05 p.12,38 & 79
			ii) Functionally different - development of software products	--
			iii) Owns intangibles in form of patents	--
13	Flextronics Software Systems Ltd (seg)	28.77%	i) Fails turnover filter	Annual Report for F. Y. 2004-05 p.42
			ii) Functionally different - software product (hardware and software solutions) for telecom industry	--
14	Larsen & Toubro Infotech Ltd	7.50%	i) Fails turnover filter	Annual Report for A. Y. 2004-05 p.18
			ii) Leverages on the brand name of Larsen & Toubro group	--
			iii) Functionally different	--
15	Satyam Computer Services Ltd	26.24%	i) Fails turnover filter	Annual report for A. Y. 2004-05 p.16, 24,29,54 etc
			ii) Unreliable financial statements	--
			iii) Owns brand	--

16	Infosys Technologies Ltd	40.53%	i) Fails turnover filter	--
			ii) Owns brand (Rs.14,153 crores)	--
17	Igate Global Solutions Ltd (seg)	0.71%	i) Fails turnover filter	Annual report for F Y 2004-05 p.40, 70 etc.,
			ii) Functionally different	

09. Thus, the Ld. AR submitted in his summary of arguments in 36 pages that the Ld. CIT (A), while excluding the eleven companies mentioned in para 5.3 (supra), on the ground of related party transactions filter, has failed to adjudicate on the functional dissimilarity and hence based on this Tribunal's decisions reported in IT(TA)A No.1/Bang/2012 & IT(TP)A No.04/Bang/2012 etc., pleaded to reject them as they are functionally not comparable.

10. We find merit in the submissions of the Ld. AR. Since the Ld. CIT (A) has not considered the above issue, we remit the matter back to the TPO for examining them in the light of the material furnished by the Ld. AR and on the decisions relied upon by the Ld. AR and then decide the issue in accordance with law. Relying on the Special Bench decision of the ITAT Chandigarh Bench in DCIT v. Quark Systems P. Ltd., [(2010) 42 DTR 414], the additional grounds are also set aside to the TPO for adjudication.

IT(TP)A No.518/Bang/2012 – Departmental appeal :

11. The grounds of appeal raised by the Department are extracted as under :

1. The order of the Ld. 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) erred in holding that the TPO ought to have excluded comparables having any related party transactions, not only those with more than 25% related party transactions on sales.
3. The learned CIT(A) erred in holding that the size, turnover and brand of the company are deciding factors for treating a company as a comparable, and accordingly erred in excluding M/s Flextronics Software Systems Ltd., M/s Infosys Technology Ltd., M/s Larsen & Toubro Infotech Ltd., M/s Satyam Computer Services Ltd., and M/s iGate Global Solutions Ltd., as comparables.
4. The learned CIT(A) erred in holding that the assessee is eligible for a standard deduction of 5% from the Arm's Length Price(ALP) under the proviso to section 92C(2) of the Income Tax Act.
5. 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.
6. The appellant craves leave to add, alter, amend and / or delete any of the grounds mentioned above.

12. We heard the rival submissions. Since the issue is remitted back to the TPO / AO in the assessee's appeal in IT(TP)A.497/Bang/2012, (supra), here also we hold accordingly.

13. In respect of ground no.4, we uphold that the decision of the CIT (A) in holding that the assessee is eligible for standard deduction of 5% from the ALP, under the proviso to Section 92C(2) of the Act.

14. In the result the both the appeals are treated as allowed for statistical purpose.

Order pronounced in the open court on 30th day of September, 2016.

Sd/-

Sd/-

(SMT. ASHA VIJAYARAGHAVAN)
JUDICIAL MEMBER

(S. JAYARAMAN)
ACCOUNTANT MEMBER

MCN*

Copy to:

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

By Order

Assistant Registrar