

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

BEFORE SHRI. ABRAHAM P. GEORGE, ACCOUNTANT MEMBER

AND

SHRI. VIJAY PAL RAO, JUDICIAL MEMBER

I.T(TP).A No.1304/Bang/2011  
(Assessment Year : 2006-07)

M/s. Hewlett Packard (India) Software Operation P. Ltd,  
29, Cunningham Road, Bangalore .. Appellant  
PAN : AAACH7164B

v.

Deputy Commissioner of Income-tax,  
Circle -11(4), Bangalore .. Respondent

Assessee by : Shri. Ajit Kumar Jain, CA  
Revenue by : Shri. G. R. Reddy, Addl.CIT

Heard on : 16.02.2016  
Pronounced on : 09.03.2016

**ORDER**

**PER ABRAHAM P. GEORGE, ACCOUNTANT MEMBER :**

In this appeal filed by assessee directed against an order dt.30.09.2011 of AO, passed in pursuance to directions of DRP u/s.144C of the Income-tax Act, 1961 ('the Act' in short), it has filed concise grounds as well as a set of additional grounds.

02. Concise grounds consist of seven grounds, out of which grounds 1 and 7 are general in nature, needing no specific adjudication. Ground 2 is regarding adjustments made on the value of the international transactions by the AO / TPO to the extent confirmed by the DRP.

03. Ld. Counsel for the assessee submitted that out of ground 2 relating to transfer pricing, he was pressing only sub-grounds 2.4, 2.6 and 2.7. Accordingly all other sub-grounds relating to TP issues are dismissed as not pressed.

04. Facts apropos are that assessee engaged in R & D services in the field of e-commerce, e-solutions, internet security and management, filed its return of income for the impugned assessment year declaring income of Rs.54,94,29,613/-. Since value of the international transactions undertaken by the assessee during the relevant previous year exceeded the stipulated limit, reference was made to the TPO for analysing the ALP of such transactions with its AE. Assessee is a part of HP group and its

ultimate holding company is Hewlett Packard Company, USA. It had operating revenue of Rs.628,74,04,881/- against operating cost of Rs.580,40,71,166/- resulting in a profit of Rs.48,33,33,715/-, with a ratio of 8.33% as operating profit to operating cost. International transactions undertaken by the assessee during the relevant previous year as reported in its audit report were as under :

**International Transactions (as mentioned in the 92 CE report)**

Software Development Services	Rs. 585,47,55,957/-
Purchase of fixed assets	Rs. 34,79,50,015/-
Purchase of components	Rs. 4,37,66,553/-

05. Recommendations of the TPO which were adverse the assessee was confined to software development services and therefore issues arising in this appeal are also of the same segment. For justifying its pricing of the international transactions with its AE, assessee had selected 46 comparables and the average PLI of the 46 comparables came to 12.52%. As per the assessee, this was within + / - 5% margin of its own PLI and therefore there was no requirement of any adjustment for the pricing of the transactions with its AE. Assessee had adopted TNMM method as the most appropriate one. TPO while agreeing with TNMM, was of the

opinion that many of the comparables selected by the assessee were not appropriate for various reasons mentioned in the TP order. He rejected all, but 38 comparables for functional dissimilarity, unreliable data, lack of complete information, difference in economic circumstances and existence of related party transactions. Comparables which were accepted by the TPO were Accel Transmatic Ltd, LGS Global Ltd, Mind Tree Ltd, Quintegra Solutions Ltd, R S Software (India) Ltd, R Systems International (Seg), Sasken Communication Technologies Ltd (seg) and Tata Elxsi Ltd. Relying on the very same data base, namely, capitaline plus and Prowess, TPO in addition to the eight companies mentioned above zeroed in on another eighteen comparable companies which according to him fitted perfectly with that of the assessee's profile as software development services provider. Final list considered by TPO for the ALP analysis and their average PLI read as under :

Sl. No.	Company Name	Sales (Rs.cr.)	OP to Total Cost%	Product sales (Rs. / % of sales)	RPT (Rs.cr.)	% of RPT over Sales
1	Accel Transmatic Ltd (Seg.)	9.68	21.11%	0	0.6	6.20%
2	Avani Cimcon Technologies Ltd	3.55	52.59%	0	0.07	1.97%
3	Celestial Labs Ltd	14.13	58.35%	0.51 / 3.61%	0	0.00%
4	Datamatics Ltd	54.51	1.38%	0	7.16	13.14%
5	E-Zest Solutions Ltd	6.26	36.12%	0	0	0.00%
6	Flextronics Software Systems Ltd (Seg.)	848.66	25.31%	9.21 / 1.08%	44.21	5.21%
7	Geometric Ltd (Seg.)	158.38	10.71%	0	31.64	19.98%
8	Helios & Matheson Information Technology Ltd	178.63	36.63%	0	5.24	2.93%
9	IGate Global Solutions Ltd	747.27	7.49%	0	39.64	5.30%
10	Infosys Technologies Ltd	13149	40.30%	538 / 4.1%	664	5.05%
11	Ishir Infotech Ltd	7.42	30.12%	0	1.63	21.97%
12	KALS Information Systems Ltd (Seg.)	2.00	30.55%	106 / 3%	0	0.00%
13	LGS Global Ltd (Lanco Global Solutions Ltd)	45.39	15.75%	0	1.22	2.69%
14	Lucid Software Ltd	1.70	19.37%	0	0	0.00%
15	Mediasoft Solutions Ltd	1.85	3.66%	0	0	0.00%
16	Megasoft Ltd	139.33	60.23%	26.47 / 19%	10.21	7.33%
17	Mindtree Ltd	590.35	16.90%	0	0	0.00%
18	Persistent Systems Ltd	293.75	24.52%	2.16 / 0.73%	28.55	9.72%
19	Quintegra Solutions Ltd	62.72	12.56%	0	0	0.00%
20	R S Software (India) Ltd	101.04	13.47%	0	0.85	0.84%
21	R Systems International Ltd (Seg.)	112.01	15.07%	2.68 / 2.39%	12.77	11.40%
22	Sasken Communication Technologies Ltd (Seg.)	343.57	22.16%	0	3.94	1.15%

23	SIP Technologies & Exports Ltd	3.80	13.90%	0	0	0.00%
<del>24</del>	Tata Elxsi Ltd (Seg.)	262.58	26.51%	0	3.34	1.27%
25	Thirdware Solutions Ltd	36.08	25.12%	0	3.60	9.90%
26	Wipro Ltd (Seg.)	9616.09	33.65%	0	58.26	0.61%
			25.14%			

06. On the average ALP of 25.14% as worked out above, TPO allowed negative working capital adjustment of 2.16%. Final ALP of the comparables considered by the TPO was 22.98%. He therefore

recommended an adjustment of Rs.85,04,41,829/-, worked out as hereunder:

Operating Cost	Rs. 580,40,71,166/-
Arm's Length Margin	22.98% of the Operating Cost
Arm's Length Price (ALP) @ 122.98% of operating cost (a)	Rs. 713,78,46,720/-
Price received (b)	Rs. 628,74,04,881/-
Price charged in international transactions (c)	Rs. 585,47,55,957/-
Price charged in unrelated party transactions (d) = (b)-(c)	Rs. 43,26,48,924/-
Arm's length price of international transactions (e) = (a) -(d)	Rs. 670,51,97,796/-
Shortfall being adjustment u/s 92CA (f) = (e) - (c)	Rs. 85,04,41,839/-

07. When a proposal on the above lines was put before the assessee, it chose to move the DRP. Though assessee asserted a number of grounds before the DRP for excluding comparables which as per the assessee were functionally different, DRP was not impressed. Thereafter final assessment order was passed by making an addition of Rs.85,04,41,839/- as ALP adjustment.

08. Now before us, Ld. AR submitted that he was seeking for exclusion of Avani Cimcon Technologies Ltd, Celestial Labs Ltd, E- Zest Solutions Ltd, Flextronics Software Systems Ltd (seg), Helios & Matheson Information Technology Ltd, Infosys Technologies Ltd, Ishir Infotech Ltd,

Kals Information Systems Ltd, Lucid Software Ltd, Persistent Systems Ltd, Tata Elxsi Ltd (seg) and Wipro Ltd (seg), from the list of comparables considered by the TPO. Further according to him, M/s. Megasoft Ltd, could be considered as comparable only after segmentising its results. For seeking the above exclusions, Ld. AR placed reliance on a coordinate bench order in the case of Hewlett Packard Global Soft P. Ltd v. DCIT [IT(TP)A.1031/Bang/2011, dt.23.09.2015]. Ld. AR submitted that the assessee in the said case was also into software development services and the segment considered for comparison was very same. As per the Ld AR, profile in so far as software development services of Hewlett Packard Global Soft P. Ltd, compared favourably with that of the assessee. According to him, this Tribunal had directed exclusion of 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, Lucid Software Ltd, Persistent Systems Ltd, Tata Elxsi Ltd (seg) and Wipro Ltd (seg), as not comparable being functionally different vide para 24 of the order mentioned supra.

09. Continuing his submissions, Ld. AR asserted that comparability of Megasoft Ltd, was also considered by this Tribunal in the above decision

and the Tribunal had remitted this issue back to the AO / TPO for proper segmentation of its results. Further according to him, M/s. Flextronics Software Systems Ltd (seg) also had to be excluded by virtue of the finding appearing at para 28 of the decision in the case of Hewlett Packard Global Soft P. Ltd (supra).

10. Per contra, Ld. DR submitted that assessee could not show how it was functionally similar to the software development segment of Hewlett Packard Globalsoft P. Ltd (supra).

11. We have perused the orders and heard the rival contentions. Out of the 26 comparables selected by the TPO, assessee is seeking exclusion of twelve companies and is also pleading for segmentation of result of one company before comparing. As per the assessee these companies were functionally different and it was so held by this Tribunal in the case of Hewlett Packard Global Soft P. Ltd (supra). What we find is that M/s. Hewlett Packard Global Soft P. Ltd (supra) also fell in the same group of

companies as that of the assessee. Comparison done in the said case was also with regard to the software development services and this is clear from functional profile of the said company which has been reproduced at para eight of that order. Profile of the assessee in the case before us is reproduced here under :

HPISO was established in Bangalore in 1988. HPISO is engaged in the provision of Research & development services in the fields of e-commerce, e-solutions, internet security and management etc. During the FY 2006-07, HP ISO has undertaken software research and development services for various Hewlett Packard entities.

Thus we are inclined to accept the contention of the Ld. AR that the companies which were excluded from list of comparables considered in software development services segment in the case of Hewlett Packard Global Soft P. Ltd (supra) have to be excluded here also. This Tribunal following the decision of another coordinate bench in the case of NXP Semiconductors (India) P. Ltd, v. ACIT [IT(TP)A.1174/Bang/2011, dt.14.11.2014], has held as under in paras 23 and 24 of its order in the case of M/s. Hewlett Packard Global Soft P. Ltd (supra) :

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

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

imaging technologies, outsourced product development

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

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

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

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

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

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

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

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

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. 11,692,020/- has been debited to the Profit and Loss Account as "Deferred Revenue Expenditure" (page 30 of PB-II). This amounts to nearly **8.28 percent** of the sales of this company.

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

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

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

‘The Company has developed a *de novo* drug design tool “CELSUITE” to drug discovery in, finding the lead molecules for drug discovery and protected the IPR by

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

**According to the learned D.R. celestial labs is also in the field of research in pharmaceutical products and should be considered as comparable. As rightly submitted by the learned counsel for the Assessee, the discovery is in relation to a software discovery of new drugs. Moreover the company also is owner of the IPR. There is however a reference to development of a molecule to treat cancer using bio-informatics tools for which patenting process was also being pursued.** As explained earlier it is a diversified company and therefore cannot be considered as comparable functionally with that of the Assessee. There has been no attempt made to identify and eliminate and make adjustment of the profit margins so that the difference in

functional comparability can be eliminated. By not resorting to such a process of making adjustment, the TPO has rendered this company as not qualifying for comparability. We therefore accept the plea of the Assessee in this regard.’ ”

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

45. From the material available on record, it transpires that the TPO has accepted that up to AY 06-07 this company was classified as a Research and Development company. According to the TPO in AY 07-08 this company has been classified as software development service provider in the Capitaline/Prowess database as well as in the annual report of this company. The TPO has relied on the response from this company to a notice u/s.133(6) of the Act in which it has said that it is in the business of providing software development services. The Assessee in reply to the proposal of the AO to treat this as a comparable has pointed out that this company provides software products/services as well as bioinformatics services and that the segmental data for each activity is not available and therefore this company should not be treated as comparable. Besides the above, the Assessee has point out to several references in the annual report for 31.3.2007 highlighting the fact that this company was develops biotechnology products and provides related software development services. The TPO called for segmental data at the entity level from this company. The TPO also called for

description of software development process. In response to the request of the TPO this company in its reply dated 29.3.2010 has given details of employees working in software development but it is not clear as to whether any segmental data was given or not. Besides the above there is no other detail in the TPO's order as to the nature of software development services performed by the Assessee. Celestial labs had come out with a public issue of shares and in that connection issued Draft Red Herring Prospectus (DRHP) in which the business of this company was explained as to clinical research. The TPO wanted to know as to whether the primary business of this company is software development services as indicated in the annual report for FY 06-07 or clinical research and manufacture of bio products and other products as stated in the DRHP. There is no reference to any reply by Celestial labs to the above clarification of the TPO. The TPO without any basis has however concluded that the business mentioned in the DRHP are the services or businesses that would be started by utilizing the funds garnered through the Initial Public Offer (IPO) and thus in no way connected with business operations of the company during FY 06-07. We are of the view that in the light of the submissions made by the Assessee and the fact that this company was basically/admittedly in clinical research and manufacture of bio products and other products, there is no clear basis on which the TPO concluded that this company was mainly in the business of providing software development services. We therefore accept the plea of the Assessee that this company ought not to have been considered as comparable.

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

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

14.4 We have heard the rival submissions and perused and carefully considered the material on record. It is seen from the record that the TPO has included this company in the list of comparables only on the basis of the statement made by the company in its reply to the notice under section 133(6) of the Act.

It appears that the TPO has not examined the services rendered by the company to give a finding whether the services performed by this company are similar to the software development services performed by the assessee. From the details on record, we find that while the assessee is into software development services, this company i.e. e-Zest Solutions Ltd., is rendering product development services and high end technical services which come under the category of KPO services. It has been held by the coordinate bench of this Tribunal in the case of Capital I-Q InformationSystems (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 :

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

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

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

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

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

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

vi) Infosys Technologies Ltd.

12.1 This was a comparable selected by the TPO. Before the TPO, the assessee objected to the inclusion of the company in the set of comparables, on the grounds of turnover and brand attributable profit margin. The TPO, however, rejected

these objections raised by the assessee on the grounds that turnover and brand aspects were not materially relevant in the software development segment.

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

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

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

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

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

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

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

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

12.3 Per contra, opposing the contentions of the assessee, the learned Departmental Representative submitted that

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

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

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.

ix) KALS Information Systems Ltd.

46. As far as this company is concerned, the contention of the assessee is that the aforesaid company has revenues from both software development and software products. Besides the above, it was also pointed out that this company is engaged in providing training. It was also submitted that as per the annual report, the salary cost debited under the software development expenditure was Q 45,93,351. The same was less than 25% of the software services revenue and therefore the salary cost filter test fails in this case. Reference was made to the Pune Bench Tribunal's decision of the ITAT in the case of *Bindview India Private Limited Vs. DCI*, ITA No. ITA No 1386/PN/10 wherein KALS as comparable was rejected for AY 2006-07 on account of it being functionally different from software companies. The relevant extract are as follows:

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

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

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

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

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 Authorised Representative submitted that :

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

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

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

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

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

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

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

## xi) Quintegra Solutions Ltd.

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

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

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

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

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

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

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

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

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

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

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

considered as a comparable company to one that does not own intangibles and requires to be omitted from the list of comparables, as in the case on hand.

18.3.2 We also find from the Annual Report of Quintegra Solutions Ltd. that there have been acquisitions made by it in the period under consideration. It is settled principle that where extraordinary events have taken place, which has an effect on the performance of the company, then that company shall be removed from the list of comparables.

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

27. 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.

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 dis-similarity, significant R&D activity, brand value, size, etc. The TPO, however, rejected the contention put forth by the assessee and included this company in the set of comparables.

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

(a) Product design services

(b) Innovation design engineering and

(c) visual computing labs.

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

14.3 Per contra, the learned Departmental Representative supported the stand 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 Authorised Representative that the nature of product developed and services provided by this company are different from the assessee as have been narrated in para 6.6 above. Even the segmental details for revenue sales have not been provided by the TPO so as to consider it as a comparable party for comparing the*

*profit ratio from product and services. Thus, on these facts, we are unable to treat this company as fit for comparability analysis for determining the arm's length price for the assessee, hence, should be excluded from the list of comparable portion.”*

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

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 Authorised Representative submitted that :-

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

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

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

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

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

In the case on hand, the assessee is rendering software development services. In this factual view of the matter and following the afore cited decision of the Pune Tribunal (supra), we direct that this company be omitted from the list of comparables for the period under consideration in the case on hand.”

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 or several grounds like functional dis-similarity, brand value, size, etc. The TPO, however, brushed aside the objections of the assessee and included this company in the set of comparables.

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

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

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

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

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

13.4.2 We also find that this company owns intellectual property in the form of registered patents and

several pending applications for grant of patents. In this regard, the co-ordinate bench of this Tribunal in the case of 24/7 Customer.Com Pvt. Ltd. (ITA No.227/Bang/2010) has held that a company owning intangibles cannot be compared to a low risk captive service provider who does not own any such intangible and hence does not have an additional advantage in the market. As the assessee in the case on hand does not own any intangibles, following the aforesaid decision of the co-ordinate bench of the Tribunal i.e. 24/7 Customer.Com Pvt. Ltd. (supra), we hold that this company cannot be considered as a comparable to the assessee. We, therefore, direct the Assessing Officer/TPO to omit this company from the set of comparable companies in the case on hand for the year under consideration.

24. No doubt if we follow the above decision M/s. 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) have to be excluded from the list of comparables. However out of these, M/s. Accel Transmatics Ltd (seg), Quintegra Solutions Ltd and Tata Elxsi Ltd (seg) were a part of assessee's own TP study. Hon'ble Punjab & Haryana High Court in CIT v. Quark Systems India (P) Ltd (supra), upheld the Special Bench decision in DCIT v. Quark Systems (P) Ltd [(2010) 42 DTR 414], noting that latter had only remitted the issue of comparability of comparables considered in assessee's own TP study, back to TPO. Hence we are of the opinion that the issue of comparability of these three companies have to go back to AO / TPO for consideration afresh. However M/s. Avani Cimcon Technologies Ltd, Celestial Lab 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, Thirdware Solution Ltd (seg) and Wipro Ltd (seg) have to

be excluded by virtue of coordinate bench decision in the case of NXP Semiconductors India Ltd (supra). Comparability of M/s. Accel Transmatics Ltd (seg), M/s. Quintegra Solutions Ltd and M/s. Tata Elxsi Ltd (seg) is remitted back to the AO / TPO for consideration afresh as per law. Ordered accordingly.

Accordingly we direct exclusion of 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, Lucid Software Ltd, Persistent Systems Ltd, and Wipro Ltd (seg), from the list of comparables. Comparability of M/s. Tata Elxsi Ltd (seg) is remitted back to the TPO / AO for consideration afresh in line with the directions given in the case of M/s. Hewlett Packard Global Soft P. Ltd (supra),

12. As for the argument of the assessee that M/s. Flextronics Software Systems Ltd (seg) was also functionally different and not comparable to it, para 28 of the order of the Tribunal in the case of M/s. Hewlett Packard Global Soft P. Ltd (supra), is reproduced hereunder :

*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 :*

Revenue mix: Customer – activity-wise distribution:

Particulars	2007 (Rs. million)	%	2006 (Rs. Million)	%
Services-related parties	198	2.3	72	1.17
Services – others	7,363	85.51	4,853	78.22
Products-related parties	10	0.12	10	0.17
Products – others	896	10.4	970	15.74
BPO	129	1.5	211	3.47
Goods and others	15	0.17	45	0.73
Total Sales	8,616	100	6,165	100

*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.*

Accordingly we direct that Flextronics Software Systems Ltd (seg) also be excluded from the list of comparables.

13. In so far as Megasoft Ltd, is concerned, direction of the Tribunal in para 25 of its order in the case of M/s. Hewlett Packard Global Soft P. Ltd (supra), is reproduced hereunder :

25. *Vis-a-vis Megasoft Ltd, we find that coordinate bench of this Tribunal in the very case case of NXP Semi conductors India Ltd (supra) relying on its own earlier decision in Trilogy E-Business Software India Pvt.Ltd. Vs. DCIT [ITA No.1064/Bang/2011 for AY 07-08 order dated 23.11.2012] held it to be a good comparable, but had directed segmentation of its results. This Tribunal had directed that only the Blue Ally segment of the said company could be considered for comparison. Relevant findings of the Tribunal as it appears in the decision of NXP Semiconductors India Ltd (supra) is reproduced hereunder:*

Megasoft Ltd. :

24. This company was chosen as a comparable by the TPO. The objection of the assessee is that there are two segments in this company viz., (i) software development segment, and (ii) software product segment. The Assessee is a pure software services provider and not a software product developer. According to the Assessee there is no break up of revenue between software products and software services business on a standalone basis of this comparable. The TPO relied on information which was given by this company in which this company had explained that it has two divisions viz., BLUEALLY DIVISION and XIUS-BCGI DIVISION. Xius-BCGI Division does the business of product software. This company develops packaged products for the wireless and convergent telecom industry. These products are sold as packaged products to customers. While implementing these standardized products, customers may request the company to customize products or reconfigure products to fit into their business environment. Thereupon the company takes up the job of customizing the packaged software. The company also explained that 30 to 40% of the product software would constitute packaged product and around 50% to 60% would constitute customized capabilities and expenses related to travelling, boarding and lodging expense. Based on the above reply, the TPO proceeded to hold that the comparable company was mainly into customization of software products developed (which was akin to product software) internally and that the portion of the revenue from development of software sold and used for customization was less than 25% of the overall revenues. The TPO therefore held that less than 25% of the revenues of the comparable are from software products and therefore the comparable satisfied TPO's filter of more than 75% of revenues from software development services. The basis on which the TPO arrived at the PLI of 60.23% is given at page-115 and 116 of the order of the TPO. It is clear from the perusal of the same that the TPO has proceeded to determine the PLI at the entity level and not on the basis of segmental data.

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

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

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

27. *It was further submitted that the learned TPO in case of other comparable, similarly placed, had adopted the margins of only the software service segment for comparability purposes. Consistent with such stand, it was submitted that the margins of the software segment only should be adopted in the case of Megasoft also, in contrast to the entity level margins.*

28. *Computation of the net margin for Mega Soft Ltd. Is therefore remitted to the file of the TPO to compute the correct*

*margin by following the direction of the Tribunal in the case of Trilogy E-Business Software India Pvt.Ltd.”*

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

Accordingly, we direct that Megasoft Ltd, could be considered as a comparable only after proper segmentation in line with above directions.

14. To summarise we direct exclusion of Avani Cimcon Technologies Ltd, Celestial Labs Ltd, E- Zest Solutions Ltd, Flextronics Software Systems Ltd (seg), Helios & Matheson Information Technology Ltd, Infosys Technologies Ltd, Ishir Infotech Ltd, Kals Information Systems Ltd, Lucid Software Ltd, Persistent Systems Ltd, and Wipro Ltd (seg), from the list of comparables. Comparability of M/s. Tata Elxsi Ltd (seg), is remitted back to the TPO / AO for consideration afresh as per law. We also direct that Megasoft Ltd, shall be considered for inclusion only after segmentation of its results. Needless to say working capital adjustment shall be reworked by the AO / TPO confining to the comparables that are left after exclusions. Concise grounds 2.4, 2.6 and 2.7 are treated as partly allowed.

15. Ld. AR did not press ground 3. Hence it is dismissed as not pressed.

16. Vide grounds 4 and 5, assessee states that foreign currency expenditure on telecommunication expenditure ought not be excluded from the export turnover and in the alternative it should be reduced from total turnover also while computing the relief u/s.10A of the Act.

17. We find that submission of the assessee that what has been reduced from export turnover should also be deducted from the total turnover while working out the deduction u/s.10A of the Act, needs to be accepted in view of the judgment of Hon'ble jurisdictional High Court in the case of CIT v. Tata Elxsi Ltd (349 ITR 98). Accordingly, grounds 4 and 5 are treated as partly allowed.

18. Vide ground 6 grievance raised by the assessee is that software expenditure was not allowed as a revenue outgo but was considered as capital expenditure.

19. Facts apropos are that assessee had claimed Rs.1,86,58,327/- as software expenditure by debiting it to its profit and loss account. As per the assessee, expenditure was for the purpose of acquiring application software and for meeting annual maintenance charges. However AO was

of the opinion that these expenditure gave an enduring benefit to the assessee. He therefore held it as a capital outgo. Nevertheless he allowed a depreciation of 60%.

20. Now before us, Ld. AR strongly assailing the order of lower authorities submitted that the expenditure was on application software which did not give rise to any enduring benefit to the assessee. According to him, such claim ought not have been disallowed.

21. Per contra, Ld. DR supported the orders of lower authorities.

22. We have perused the orders and heard the rival contentions. What we find is that the nature of software expenditure was not analysed by the lower authorities. AO had simply considered it as a capital outgo without verifying whether the expenditure was relatable to application software or system software, which gave enduring benefit to the assessee. It is true that some application software can have enduring quality. A close analysis of the expenditure is required for coming to a reasoned conclusion. We are of the opinion that the matter requires a fresh look by the AO. We remit the issue back to the file of the AO for consideration in accordance with law.

23. In the result, appeal of the assessee is allowed protanto.

Order pronounced in open court on 9<sup>th</sup> day of March, 2016.

Sd/-

(VIJAY PAL RAO)  
JUDICIAL MEMBER

Sd/-

(ABRAHAM P GEORGE)  
ACCOUNTANT MEMBER