

IN THE INCOME TAX APPELLATE TRIBUNAL
"B" BENCH : BANGALORE

BEFORE SHRI B. RAMAKOTAIAH, ACCOUNTANT MEMBER
AND
SHRI NARENDRA KUMAR CHOUDHURY, JUDICIAL MEMBER

IT(TP)A No. 841/Bang/2013
Assessment year : 2005-06

Income Tax Officer, Ward-11(1), Bangalore.	Vs.	M/s. Citrix R&D India Pvt. Ltd., Prestige Dynasty, 33, Ulsoor Road, Bangalore – 560 100. PAN: AABCN3639C
APPELLANT		RESPONDENT

C.O. No. 172/Bang/2015 [in IT(TP)A No. 841/Bang/2013]
Assessment year : 2005-06

M/s. Citrix R&D India Pvt. Ltd., Prestige Dynasty, 33, Ulsoor Road, Bangalore – 560 100. PAN: AABCN3639C	Vs.	Income Tax Officer, Ward-11(1), Bangalore.
CROSS OBJECTOR		RESPONDENT

Revenue by	:	Dr. G. Manoj Kumar, Addl. CIT
Assessee by	:	Shri Raghunathan, S. Advocate

Date of hearing	:	15-03-2016
Date of Pronouncement	:	18-03-2016

ORDER

Per B. Ramakotiah, Accountant Member

The appeal is by Revenue against the order of Ld. Commissioner of
Income Tax (Appeals)-IV Bengaluru dated 08-03-2013. Cross Objection is

preferred by assessee mainly supporting the order Ld.CIT(A) and also on certain filters which Ld.CIT(A) did not accept.

2. Briefly stated, assessee is a wholly owned subsidiary of M/s. Citrix Systems, USA and is engaged in providing software development services. In the TP analysis, the Transfer Pricing Officer (TPO) selected 17 comparables, arrived at Arithmetic Mean at 26.59% and after working out working capital adjustment, determined the margin at 22.23% and proposed an adjustment of Rs. 1,04,88,511/-. Assessing Officer (AO) passed order accordingly. While completing assessment, AO also excluded certain expenditure from export turnover only and reduced the claim of 10A deduction.

3. Ld.CIT(A) on appeal, accepted certain filters, excluded some companies on functionality and filters and also decided to include two comparables in the list of comparables earlier rejected by the TPO. The Revenue is aggrieved and raised grounds on these issues.

4. Ground No. 2 to 4 is on the issue of computation u/s. 10A of the Act. AO while computing deduction u/s. 10A excluded certain expenditure under the head 'Telecommunication Charges' from the export turnover. Ld.CIT(A) accepted assessee contention that the same should be excluded from the total turnover also. This issue is covered in favour of assessee by the jurisdictional High Court in the case of Tata Elxsi Ltd., Vs. CIT [349 ITR 98 (Kar)], wherein the Hon'ble High Court has held that whatever is

excluded from export turnover should also be excluded from total turnover for the purpose of computing deduction u/s. 10A of the Act. The order of Ld.CIT(A) is in accordance with the principles on the issue. The grounds of Revenue are accordingly rejected.

5. Ground Nos. 5, 6, 7, 10, 11 & 12 is as under:

"5. The learned CIT(A) erred in holding that the size, turnover of the company are decided factors for treating a company as a comparable, and accordingly erred in excluding solutions, iGate Global Solutions Ltd., L&T Infotech Ltd., Satyam Computers Ltd., M/s. Infosys Technology Ltd., M/s. Flextronics Software Systems Ltd., as a comparable in the segment.

6. The Ld.CIT(A) erred in rejecting companies on the basis of Abnormal Profit without defining what constitutes abnormal profit filter and how the same is determined and thereby also erred in excluding the comparable companies Exensys Software Solutions Ltd and Thirdware Solutions Ltd.

7. The Ld.CIT(A) erred in rejecting the diminishing revenue filter used by the TPO to exclude companies that do not reflect the normal industry trend.

10. The learned CIT(A) erred, in the facts and circumstances of the case in holding that M/s. Tata Elxsi Ltd., cannot be taken as comparable, being functionally different when it satisfies all the qualitative and quantitative filters applied by the TPO.

11. The learned CIT(A) erred, in the facts and circumstances of the case in holding that M/s. Bodhtree Consulting Ltd., cannot be taken as comparable, when the company qualifies all the qualitative and quantitative filters applied by the TPO in selection of this company as a comparable.

12. The learned CIT(A) on the facts and in the circumstances of the case erred in holding that M/s. Geometric Software Solutions Co. Ltd., cannot be taken as comparable, when the company qualifies all the qualitative and quantitative filters applied by the TPO in selection of this company as a comparable".

5.1. Ld.CIT(A) has excluded the above comparables on adopting various filters. His decision on turnover filters is as under:

“99. I am of the considered opinion that the TPO was justified in applying the turnover filter, but he is ought to apply the same objectively both for low and high turnover companies, as a one sided application of the turnover filter would render the analysis unreliable. In this context, I place reliance on the decision of the Hon'ble jurisdictional Bench of ITAT in the case of Genesis Integrating Systems (India) (P.) Ltd., V. DCIT [2012] 53 SOT 159 (Bang) where it was held that when there was a limit for the lower end for identifying the comparables, there was no reason why there should not be an upper limit also, as size mattered in business.

100. While a big company would be in a position to bargain the price, attract more customers and have a broad base of skilled employees who were able to give better output, a small company might not have these benefits and therefore, the turnover also would come down reducing profit margin. Thus, when companies which were loss making were excluded from comparables, then the super profit making companies should also be excluded. For the purpose of classification of companies on the basis of net sales or turnover and of classification made by Dun & Bradstreet, the turnover filter was very important and companies which had turnover of Rs. 1 to Rs. 200 Crore should be taken into consideration for the purpose of making TP study.

101. The Hon'ble Delhi Bench of ITAT has in the case of Sony India (P.) Ltd., Vs. DCIT [2008] 114 ITD 448 (Del) upheld the objection of assessee on inclusion of a comparable when the distinctive difference like size and turnover materially affected performance or prices of products. It was held in E-Gain Communication Private Limited (2008-TIOL-282-ITAT-Pune) that there was no justification for considering oversized companies and the Commissioner (Appeals) was in error in considering turnover as the only relevant factor needed to be considered for a proper analysis, and in Deloitte Consulting India Pvt. Limited V. DCIT (ITA No. 1082/Hyd/2010) that in the event of use of the TPO's filter of a turnover of less than Rs. 1 Crore, it would be appropriate to reject companies having higher sales turnover as well to neutralize the impact of both low and high turnover companies and to provide a more reliable result.

102. For the foregoing reasons and following the decisions cited above and considering that the appellant's turnover during the year under appeal was less than Rs. 25 Crores, I allow this ground of appeal and direct the AO to apply, for computing the arithmetic mean of net margins, the turnover filter at both the lower and upper ends and exclude from the final set of comparables the following companies falling outside that range of turnover and companies that had abnormally high profits (>50%):

Sl. No.	Company	Turnover (Rs. Crore)	OP/OC (%)
1.	Exensys Software Solutions Ltd.,	70.68	07.30
2.	Flextronics Software Services Ltd.,	457.45	32.19
3.	IGate Global Solutions Ltd.,	406.00	4.32
4.	Infosys Technologies Ltd.,	6859.70	42.83
5.	L&T Infotech Ltd.,	562.45	10.33
6.	Satyam Computer Services Ltd.,	3464.20	29.44
7.	Thirdware Solutions Ltd.,	29.11	66.09

5.2. His finding diminishing of the revenues filter is as under:

“112. I have carefully considered the appellant’s submissions on this aspect. The reason given by the TPO for applying this filter is that the filter was designed to eliminate companies having peculiar economic circumstances which were not in line with the growing trend of the software industry. However, the rationale given for applying this filter contradicts that used for current year’s data for the TP analysis in terms of Rule 10B(4), as the filter focuses on the ‘trend’ of revenue earned by companies ‘over a period of time’ and does against the TPO’s own stand that only current year’s data was required to be used. Further, the TPO has used another filter to exclude companies that had experienced peculiar economic circumstances, the justification for which is discussed elsewhere in this order. In any case, diminishing revenues or persistent losses do not necessarily result from ‘peculiar economic circumstances’ alone, but could also be a result of mismanagement, use of inappropriate business models or strategies, inability to meet competition even in a normal market, etc., which are all endogenous factors that have little do with economic circumstances.

113. I find merit in the appellant’s contention that revenue is not a true indicator of a company’s performance that may depend on its own business cycle, and that a company with increasing revenues over a period of time did not necessarily reflect better performance, as increase in expenses in the corresponding period could be higher than that in revenues and the company might still incur losses. Conversely, a company with diminishing revenues over a period of time may not necessarily be performing, badly, if it still had a good profit margin achieved through cost efficient. Growth of the Indian software industry cannot be attributed solely to existing companies, but also to new companies being set up.

114. Considering these aspects, I uphold the appellant’s arguments on this issue. However, the rejection of M/s. Melstar Information Technology Ltd., is upheld on the ground that it had a negative operating margin in the relevant FY. This ground of appeal is dismissed”.

5.3. Ground No. 6 on abnormal profit was not separately adjudicated and the above comparables contested in ground were excluded on turnover filter. On the basis of Co-ordinate Bench decision, the Ld.CIT(A) has adopted the above filter with which we concur. Even though, the companies Exensys software solutions Ltd and Thirdware solutions Ltd were also excluded on this filter, we find that the companies were otherwise being excluded on functionality as well, in various Co-ordinate Bench

decisions for this assessment year. So, the Revenue's contentions are not acceptable. Grounds are accordingly rejected.

5.4. Learned Counsel also placed a chart on record informing that various comparables selected by the TPO were also rejected in Co-ordinate Bench decisions of:

- i. Sysarris Software P. Ltd., Vs. DCIT in IT(TP)A No. 1360/Bang/2011 & IT(TP)A No. 85/Bang/2012;
- ii. DCIT Vs. Kodiak Networks India Pvt. Ltd., in IT(TP)A No. 532/Bang/2013 & C.O. No. 119/Bang/2015;
- iii. ADP Pvt. Ltd., Vs. DCIT [62 Taxmann.com 352]; and
- iv. DCIT Vs. Textron Global Technology Centre (P) Ltd., [56 Taxmann.com 465]

The companies rejected by the Ld.CIT(A) are also rejected in the above orders on functionality as well. Consequently, we do not find any merit in Revenue's Ground Nos. 5, 6, 7, 10, 11 & 12. Accordingly, they are rejected.

6. Ground Nos. 8 & 9 are as under:

"8. The CIT(A) erred in computation of the margins of M/s. Quintegra Solutions Ltd., by determining the same as average of margins of 6.85% and 10.68% for FY ended 30/09/2004 and 30/09/2005 respectively, in view of the fact that an average cannot represent the arm's length margin of any comparable company for the purpose of arm's length margin

determination, and also since the same is contradictory to CIT(A)'s own decision who has upheld the rejection by the TPO of a multiple year's data and use of only current year's data for the purpose of TP analysis.

9. The Hon'ble CIT(A) has erred in holding that the different accounting year filter, was an inappropriate filter for the purpose of comparability analysis”.

6.1. TPO excluded the above comparables on the reason of having accounts of different financial years and was difficult to compare the financial results. Assessee's contention that Accounting Standard (AS) 21 issued by the ICAI on consolidation of accounts as well as Section 212 of the Companies Act permit difference in the dates of financial year closure of companies within a six months time frame. Ld.CIT(A) accepted the above contention and directed to include. Revenue is aggrieved.

6.2. On considering the rival contentions and order of Ld.CIT(A), we are of the opinion that the TPO is correct in rejecting this comparable on the different financial year filter. AS 21 may allow consideration of accounts and Company Law may permit having different financial year ending for consolidation accounts, but the data available in public domain cannot be adjusted to the financial year of assessee-company. There may be many factors which may affect the results in the intervening period. Unless the data is completely available, averaging the financial results to suit assessee's financial year may give a distorted picture. Since the public data available pertain to a different financial year, we are of the opinion that the same can not be considered as comparable in the absence of suitable

financial data. We direct the same to be excluded from the list of comparables. We also find that this company is not selected as a comparable in the similar cases in this assessment year.

7. Ground No. 13 is as under:

“13. The learned CIT(A) erred in directing inclusion of the M/s. VJIL Consulting Ltd., rejecting the TPO's conclusion that the company does not satisfy the qualitative filters applied for the purpose of comparability analysis and therefore is an inappropriate comparable for the purpose of determining the arm's length price”.

7.1. The issue on this ground is with reference to inclusion of the above company, rejecting the TPO's contentions. TPO after finding the company as a comparable has rejected the same in the final list on the basis of VAT payments indicating product sales. It was clarified by assessee before Ld.CIT(A) that the VAT payments were made in UK and not in India. Ld.CIT(A) accepted the same.

7.2. After considering the rival contentions, we are of the opinion that that the company can be excluded, as there is no clarity on why the VAT was paid be it in UK or India. The same company was rejected in other similarly placed companies and we do not find any case in which this company is selected as comparable. Consequently, we are of the opinion that this company has to be excluded. We order accordingly. Revenue's ground is allowed.

8. In the Cross-Objection, assessee raised many grounds. Learned Counsel fairly admitted that the issues raised are academic in nature, as

various issues are already considered by the Ld.CIT(A) on the basis of coordinate bench decisions. Consequently, we treat the Cross-Objection as academic and dismiss the same.

9. In the result, Revenue's appeal is partly allowed and assessee's Cross-Objection is rejected.

Pronounced in the open court on this 18th day of March, 2016

Sd/-

(NARENDRA KUMAR CHOUDHURY)
Judicial Member

Sd/-

(B. RAMAKOTAIAH)
Accountant Member

Bangalore,
Dated, the 18th March, 2016.

TNMM

Copy to:

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

By order

Assistant Registrar,
ITAT, Bangalore.