

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

BEFORE SHRI SUNIL KUMAR YADAV, JUDICIAL MEMBER

AND

SHRI. S. JAYARAMAN, ACCOUNTANT MEMBER

I.T (TP).A No.499/Bang/2015
(Assessment Year : 2010-11)

Assistant Commissioner of Income-Tax,
Circle -2(1)(1), Bengaluru .. Appellant
v.

M/s. Curam Software International P. Ltd,
C/o.IBM India P. Ltd,
Subramanya Arcade, 12, Bannerghatta Main Road,
Bengaluru 560 029 .. Respondent
PAN : AACCC5472F

Cross objection No.136/Bang/2015
(In I.T (TP).A No.499/Bang/2015)
(Assessment Year : 2010-11)

M/s. Curam Software International P. Ltd,
C/o.IBM India P. Ltd,
Subramanya Arcade, 12, Bannerghatta Main Road,
Bengaluru 560 029 .. Appellant
v.

Assistant Commissioner of Income-Tax,
Circle -2(1)(1), Bengaluru .. Respondent

Assessee by : Shri. Nageshwar Rao, Advocate
Revenue by : Ms. Neera Malhotra, CIT-DR

Heard on : 28.12.2016
Pronounced on : 21.03.2017

ORDER**PER S. JAYARAMAN, ACCOUNTANT MEMBER :**

These appeal and cross objection filed by the Revenue and the assessee, respectively, are against the order of the ACIT, Circle -2(1)(1),

Bengaluru, dt.30.01.2014, passed in pursuance to the directions of the DRP, for the assessment year 2010-11.

02. Curam India, the assessee, is a wholly owned subsidiary of Curam Ireland, incorporated in Bangalore as a private limited company, registered as a 100% Export Oriented Unit under the Software Technology Park of India scheme, operates as a dedicated software development center for Curam Ireland, performs software development that supports and supplements Curam Ireland's product offerings in the social enterprise management sector and is remunerated on a cost plus basis for the services rendered. For this ay , it filed its return declaring a taxable income of Rs.43,210 after claiming a deduction u/s.10A at Rs.3,41,93,046/-. The AO has recomputed the deduction u/s.10A , by reducing Rs.35,32,499/- & Rs.15,57,339/-, incurred towards communication expenses & expenses on travel in foreign currency as attributable to delivery of services outside India, respectively, from the export turnover without simultaneously reducing similar amount from the total turnover and hence reduced the deduction claimed u/s.10A .

03. On its international transactions pertaining to "provision of software development and support services" with its AE, the assessee had undertaken analysis selecting the TNMM as the most appropriate method. For the 21 companies identified as comparables, weighted average of operating profit earned on operating costs were computed .The arithmetic

mean of the unadjusted net margins of the comparable companies was at 11.26 % on operating cost. The assessee's net margin of 13.02 % was higher than the mean margin of the comparables and hence it considered that the price charged by the assessee in respect of the software development and support services was at arm's length.

04. The TPO did not concur with the analysis undertaken by the assessee. In his TP order dt.29.01.2014, he retained 7 comparables chosen by the assessee, introduced 4 new comparables and computed the average net margin of the comparables at 21.22 % on operating cost (after undertaking a working capital adjustment of 1.49%) as against 11.26% originally computed by the assessee. Accordingly, the TPO made an addition of Rs.1,66,67,453/- to the total income in connection with its international transaction.

05. On the assessee's objections, the DRP has rejected the objections on filter specific grounds of upper turnover filter, application of different financial year ending, employee cost filter and export earning filter. With respect to the comparable specific arguments, the DRP rejected the contentions on the comparables selected by the assessee in its TP documentation and on the additional comparables. On the comparables selected by the TPO, the DRP upheld the assessee's contentions on exclusions of comparables viz ICRA Techno Analytics Ltd, Infosys

Technologies Ltd, Kals Info Systems Ltd & Tata Elxsi Ltd. Further, the DRP, suo-moto, excluded two comparables, viz R S Software Ltd & Persistent Systems Ltd, which were not contested either by the assessee or the TPO. No relief was granted by the DRP with respect to risk adjustment.

Aggrieved, the Revenue filed its appeal with following grounds :

1. The directions of the Dispute Resolution Panel are opposed to law and facts of the case.
2. On the facts and in the circumstances of the case the Dispute Resolution Panel erred in law in directing the AO to exclude the expenditure incurred in foreign currency both from the export turnover as well as from total turnover for the purpose of computation of deduction u/s 10A, without appreciating the fact that the statute allows exclusion of such expenditure only from export turnover by way of specific definition of export turnover as envisaged by Sub-clause (4) of Explanation 2 below Sub-section (8) of Section 10A and the total turnover has not been defined in this Section.
3. On the facts and in the circumstances of the case the Dispute Resolution Panel erred in directing the AO to compute deduction u/s 10A in the above manner by placing reliance on the decision of Hon'ble High Court of Karnataka in the case of M/s Tata Elxsi Ltd., which has not become final since the same has not been accepted by the Department and SLPs are pending before the Hon'ble Supreme Court.
4. On the facts and in the circumstances of the case, whether the Hon'ble Dispute Resolution Panel were justified in directing the TPO to exclude M/s Infosys Ltd, M/s Tata Elxsi Ltd and M/s Kals Information Systems Ltd as a comparable, without considering the facts discussed in the case of the taxpayer by the TPO in respect of the comparable company in the TP order.
5. On the facts and in the circumstances of the case, whether the Hon'ble Dispute Resolution Panel were justified in directing the TPO to exclude M/s ICRA Techno Analytics Ltd as a comparable, without considering the discussion made by the TPO in respect of the comparable company in the TP order.
6. On the facts and in the circumstances of the case, whether the Hon'ble Dispute Resolution Panel were justified in excluding M/s Infosys Ltd, M/s Kals Information Systems Ltd and M/s Tata Elxsi Ltd. on the basis of decision in a different case when in Transfer Pricing rejection or acceptance of a comparable in a case on the basis of its appropriateness / inappropriateness in some other case is not possible.
7. On the facts and in the circumstances of the case, whether the Hon'ble Dispute Resolution Panel were justified in directing the TPO to exclude M/s R S Software India Ltd and M/s Persistent Systems & Solutions Ltd without considering the discussion made by the TPO in respect of the comparable company which was accepted by the taxpayer during the TP Proceedings.

6. The assessee filed its cross objection with the following grounds :

GROUNDS OF CROSS OBJECTIONS

On the facts and circumstances of the case and in law:

1. The learned AO has erred, in law and in facts, by not finding merit in the view of the DRP for excluding M/s Infosys Ltd, M/s Tata Elxsi Ltd and M/s Kals Information Systems Ltd from the final set of comparable companies for the transaction due to the following reasons:
 - M/s Infosys Ltd – Difference in level of functions performed and levels of risk assumed vis-à-vis the assessee, huge revenues derived, market leader and owns significant intangibles, huge expenditure on research and development.
 - M/s Tata Elxsi Ltd – Engaged in providing services other than software development as well and revenue break-up not available.
 - M/s Kals information Systems – Derives revenue from software services and products and segmental information is not available.
2. The learned AO has erred by not taking cognizance of the fact that the three companies stated in Ground 1 above have been held not comparable by the Honourable ITAT in assessee's own case for AY 2008-09 [ITA No 1280/Bang/2012]. Considering that the functional profile remains the same for the year under question, the said companies should not be accepted.
3. The learned AO has erred, in law and in facts, by not finding merit in the view of the DRP for excluding M/s ICRA Techno Analytics Ltd as the company is functionally different, engaged in the provision of host of other services apart from software development and break-up of revenue relating to each of the services is not available.
4. The learned AO has erred, in law and in facts, by not finding merit in the view of the DRP for excluding M/s R S Software India Ltd and M/s Persistent Systems & Solutions Ltd from the final set of comparables as M/s R S Software India Ltd is predominantly an onsite software development company and hence functionally different; and M/s Persistent Systems & Solutions Ltd does not provide any segment information in respect of sale of software services and products and hence cannot be retained as comparable.

07. The assessee also filed additional grounds as under :

5. The learned DRP/TPO/AO have erred, in law and on facts, by rejecting following comparable companies adopted by the Assessee based on unreasonable comparability criteria:

- ▶ Akshay Software Technologies Ltd
- ▶ LGS Global Limited
- ▶ Silverline Technologies
- ▶ Caliber Point Business Solution
- ▶ Goldstone Technologies Ltd

6. The learned DRP/TPO/AO have erred, in law and in facts, by treating donation paid as operating in nature while computing the operating margin of the Assessee.

7. The learned DRP/TPO/AO have erred, in law and facts, by not making suitable adjustments to account for differences in the risk profile of the Appellant vis-à-vis the comparables.

8. The learned DRP/TPO/AO have erred, in law and facts, by accepting companies having turnover exceeding ten times the Petitioner's turnover and the same ought to be deleted.

The Petitioner submits that the above additional ground is being raised by way of abundant caution. The additional ground raise issue which is fundamental to the appeal and the non-admission and non-adjudication of the same would result in an incomplete appreciation and adjudication of the matter. The Petitioner submits that the failure to raise these grounds at an earlier stage is neither wilful nor wanton but due to the reasons stated above. No prejudice would be caused to the Respondent by reason of the above additional ground being admitted and adjudicated and accordingly the balance of convenience is in favour of such an order being passed by this Hon'ble Tribunal.

The Petitioner states and submits that the issues raised in the additional ground above are legal issues and arise out of the order of the lower authorities. Reliance is based on the decisions of the Hon'ble Supreme Court in the case of Jute Corporation of India vs. C.I.T. (187 ITR 688) and National Thermal Power Corporation vs. C.I.T. (229 ITR 383) as well as the full Bench of the Bombay High Court in the case of Ahmadabad Electricity Co. Ltd. (199 ITR 351).

In the above circumstances the Petitioner prays that this Hon'ble Tribunal be pleased to;

- ▶ admit and adjudicate the above additional ground,
- ▶ pass any other order that may be required in the circumstances of the case and render justice.

08. We heard the rival submissions and admit the additional grounds after considering its reason. On the ground nos 2 & 3 of the Revenue's appeal, we find that this issue is covered by the Jurisdictional High Court's decision in CIT v Tata Elxsi 349 ITR 98. It clearly lays down the principle that while computing deduction u/s 10A, if the export turnover is calculated after excluding certain expenses, such expenses should also be excluded in computing the total turnover. Since the DRP's decision is in accordance with the ratio of the jurisdictional High Court, supra, we confirm it. Therefore, the Revenue's appeal grounds fail.

09. In respect of Revenue's ground nos 4, 5 & 6, the DR argued the case based on the TPO/AO's order and on the lines of the grounds of appeal. The AR opposed them with charts, paper books, copies of case laws and other material. The gist of the AR's submissions are extracted as under:

Sl. No.	Comparable companies	DRP's reasons for exclusion	Remarks
1	ICRA Techno Analytics Limited	<ul style="list-style-type: none"> Functionally different No breakup of various services provided (Refer Page 29 and 30 of Paperbook) 	<ul style="list-style-type: none"> Functionally different as the company is engaged in wide array of services like engineering services, web development & hosting, business analytics, BPO services. (Refer Page 524 of Paperbook) Revenue break of the same is not provided in the AR. (Refer Page 528 of Paperbook)
2	Infosys Technologies Limited	<ul style="list-style-type: none"> Functionally different Market leader Owns significant intangibles Significant R&D expenditure (Refer Page 30 – 32 of Paperbook) 	<ul style="list-style-type: none"> The company was excluded by the Hon'ble ITAT in Appellant's own case for AY 2008-09 on ground of being functionally different. (Refer Page 1047 of Paperbook) Infosys provides end to end solutions in various fields. It also generates revenue from software products and no segmental breakup available between service revenue and product

Sl. No.	Comparable companies	DRP's reasons for exclusion	Remarks
			<p>revenue. (Refer Page 567 and 579 of Paperbook)</p> <ul style="list-style-type: none"> Infosys is a giant company with different risk profile and nature of services, has brand value and owns IPs. (Refer Page 555, 590 and 579 of Paperbook)
3	Kals Info Systems Limited	<ul style="list-style-type: none"> Functionally different Has significant inventory Product company (Refer Page 32 of Paperbook) 	<ul style="list-style-type: none"> The company was excluded by the Hon'ble ITAT in Appellant's own case for AY 2008-09 on ground of being functionally different. (Refer Page 1045 of Paperbook) Functionally different as the company is engaged in sale of software products as well and no segmental breakup available between service revenue and product revenue. (Refer Page 654 and 656 of Paperbook) The company has inventories which clearly indicate that the company is a product company. (Refer Page 650 of Paperbook)
4	Tata Elxsi Limited	<ul style="list-style-type: none"> Functionally different No further segmental data for the software segment In house technology expertise development & R&D programs (Refer Page 32 and 33 of Paperbook) 	<ul style="list-style-type: none"> The company was excluded by the Hon'ble ITAT in Appellant's own case for AY 2008-09 on ground of being functionally different. (Refer Page 1051 of Paperbook). The company operates in 2 segments: 1) Systems integration & support services and 2) Software development & services. However, no further break up is available under the "software development & services" segment for computation of margin. (Refer Page 689, 711, 675 and 679 of Paperbook)

9.1. In support of its contentions, the assessee relied on the following case laws :

1. Curam Software International P. Ltd v. ITO [ITA No.1280/Bang/2012]
2. Agnity India Technologies P. Ltd v. CIT [ITA No.1204/Del/2011]

3. DCIT v. Ikanos Communication India P. Ltd [ITA No.137/Bang/2015]
4. DCIT v. Applied Materials India P. Ltd [IT(TP)A.180/Bang.2015] and
5. DCIT v. Novell Software Development India P. Ltd [IT(TP)A.281/Bang/2015].

Now, let us examine the relevant portion of the order of this Tribunal, in the assessee's own case, supra, in the earlier year as under :

“11.0 (3) KALS Information Systems Ltd.

11.1 This 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 the grounds of functional differences and that the segmental details have not been provided in the Annual Report of the company with respect to software services revenue and software products revenue. The TPO, however, rejected the objections of the assessee observing that the software products and training constitutes only 4.24% of total revenues and the revenue from software development services constitutes more than 75% of the total operating revenues for the F.Y. 2007-08 and qualifies as a comparable by the service income filter.

11.2 Before us, the assessee contended that this company is not functionally comparable, as it is into software products. The assessee had also submitted that :-

(i) this company has two segments namely ; Application Software Segment which includes software product revenues, while the 'Training Segment' does not have any product revenue.

(ii) from the Annual Report of KALS for the year ended 31.3.2008; i.e. the year under consideration, it is observed that the company is into provision of software development services as well as sale of software products.

“Inventories” under schedule to the financial statements on page 16 of the Annual Report discloses “Software Development” as inventory and

work-in-progress. It is to be noted that a pure software development service provider would not be able to disclose such details as it does not carry any such inventory or work-in-progress.

"Background" under the Schedules to the financial statements on page 18 of the Annual Report states :-

" The company is engaged **in development of software and software products** since its inception. This company consisting of STPI unit engaged in **Development of Software and Software Products** and a Training Centre engaged in training of software professionals on online projects" (emphasis provided)

" Revenue Recognition" under Notes to the financial statements on page 18 of the Annual Report states :-

"The company derives its revenues primarily from software services and **software products.**"

(iii) As per the Website of KALS, the company has developed two products, namely; 'Virtual Insure' and 'La-Vision' establishing the fact that KALS earns revenues from the development of software products.

(iv) The segmental information provided under 'Notes on Accounts' of the Annual Report provides the break-up of revenues from two segments, namely 'Application Software' and 'Training' which shows that revenue from software products forms part of Application Software and there are no segmental details.

(v) The assessee also placed reliance on the judicial decisions rendered in the following cases :

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

b) Mercedes Benz Research & Development India Pvt. Ltd. (IT(TP)A No.1222/Bang/2011).

11.3 Per contra, the learned Departmental Representative contended that the decision of the co-ordinate bench of the Tribunal in the case of Triology E-Business Software India Pvt. Ltd. (supra) was

rendered with respect to F.Y.2006-07 and therefore there cannot be an assumption that it would continue to be applicable to the year under consideration i.e. A.Y. 2008-09. To this, the counter argument of the learned Authorised Representative is that the functional profile of this company continues to remain the same for the year under consideration also and the same is evident from the details called out from the Annual Report and quoted above (supra).

11.4 We have heard both parties and perused and carefully considered the material on record including the judicial decisions cited. As discussed earlier in this order, there is merit in the contention of the learned Departmental Representative that the ruling rendered in the case of Trilogy E-Business India Pvt. Ltd. (supra) was with respect to an earlier period i.e. F.Y. 2006-07 and there cannot be an assumption or presumption that it is applicable for the year under consideration as well. At the same time, we find that the TPO has drawn conclusions on the basis of information obtained under section 133(6) of the Act, which was not in the public domain and could not have been used by the TPO, when the same is contrary to the Annual Report of the company as has been highlighted by the assessee in its submissions. We also find that the co-ordinate bench of this Tribunal in the case of Trilogy E-Business Software India Pvt. Ltd. (supra) has held that this company was developing software products and was not purely or mainly a software development service provider. Further, apart from relying on the decision of Trilogy E-Business Software India Pvt. Ltd. (supra), the assessee has brought on record substantial evidence quoting from various portions of the Annual Report of that this company is functionally dis-similar and different from the assessee and hence is not comparable and therefore the finding rendered in respect of this company in the case of Trilogy E-Business Software India Pvt. Ltd. for Assessment Year 2007-08 is applicable for this year i.e. Assessment Year 2008-09 also. In view of the facts and circumstances of the case as discussed above, we hold that this company i.e. KALS Information Systems Ltd., is to be omitted from the set of comparable companies.

12. (4) 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.

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14.0 (6) 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 o 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.

9.2. Now, let us examine the relevant portion of the order of this Tribunal in DCIT v. Ikanos Communication India P. Ltd in ITA No.137/Bang/2015 for ay 2010-11 dt 10.11.2015, which was providing contract software development services to its principal, as under:

"

04. Vide its ground 4, grievance raised by the Revenue is that DRP directed exclusion of M/s. Infosys Ltd, M/s. ICRA Techno Analytics Ltd, M/s. Kals Information Systems Ltd and M/s. Persistent Systems Ltd from the list of comparables considered by the TPO for analysing the pricing of the international transactions of the assessee with its Associated Enterprises (AE).

05. Ld. DR submitted that assessee was providing contract software development services to its principal at USA, called Ikanos Communications Inc. USA and Ikanos Technology Ltd, Cayman Island. As per the Ld. DR, both the assessee as well as the TPO had followed TNMM for bench marking the pricing of its international transactions with its AE. Ld. DR pointed out that assessee had before the TPO objected to Infosys Ltd being taken as a comparable for reasons like huge turnover, software product revenues, owning

of intangibles and significant R & D expenditure. As per the Ld. DR, TPO had pointed out that Infosys Ltd was comparable with the assessee since the assessee had itself selected certain comparables which had branding expenditure in its profit and loss account. As per the Ld. DR revenue from software products sale of Infosys Ltd was only 4.3% of its total revenues and its R &D expenditure was only 1.26% of its revenues. Relying on the decision of Mumbai Bench of the Tribunal in the case of Capgemini India Pvt. Ltd v. ACIT [(2014) 147 ITD 330], Ld. DR submitted that size of the company had no relevance and there was no correlation between sales volume and profits in software development services. According to him, DRP had simply relied on the annual report of Infosys Ltd, while direction its exclusion without closely verifying the reasons why TPO had rejected the contentions of the assessee.

06. Per contra, Ld. AR supported the order of the DRP. Reliance was also placed on the decision of Hyderabad bench of this Tribunal in the case of Pegasystems Worldwide India P. Ltd v. ACIT [ITA.1758 & 1936/Hyd/2014, dt.16.10.2015. As per the Ld. AR, Pegasystems Worldwide India P. Ltd, was also into software development services and the Tribunal had considered the comparability of Infosys Ltd, in the said case.

07. We have perused the orders and heard the rival contentions. It is not disputed that Infosys brand has a significant intangible value and it had revenue from software product segment also. Hon'ble Delhi High Court in the case of CIT v. Agnity India Technologies P. Ltd [93 DTR 375], while affirming a decision of this Tribunal where it was held that Infosys Ltd could not be considered as a comparable, had upheld the view that it was a giant company in the area of development of software, assuming all risks leading to higher

profits. Further in the case of Pegasystems Worldwide India P. Ltd (supra), which was also for the very same assessment year, this Tribunal had held as under at para 22 of its order :

22. Ground No.2 pertains to rejection of Infosys Technologies Ltd., from the list of comparables by DRP. We have already considered the opinion of DRP which is consistent not only in Assessee's case but also in the case of M/s. Sumtotal Systems India Pvt. Ltd., (supra), extracted above while considering the exclusion of L&T Infotech Ltd. Since DRP's decision is consistent with the stand taken by the Revenue in other cases and also by the ITAT in a number of cases on reason of turnover, brand equity, functional dissimilarity, we are of the opinion that DRP is correct in excluding the above company from the list of comparables. Therefore, there is no merit in the Revenue's ground and the same is rejected.

Accordingly we are of the opinion that DRP was justified in directing exclusion of Infosys Ltd from the list of comparables.

08. Assailing the direction of the DRP directing exclusion of ICRA Techno Analytics Ltd, Ld. DR pointed out that assessee had cited functional incompatibility for excluding this company before the TPO. As per the Ld. DR, Directors' report of the said company mentioned that it was providing technology solutions and the services rendered done by it were not different from that of the assessee. As per the Ld. DR, DRP had erroneously held that services segment of the said company comprised of software consultancy, engineering services, web development, web hosting etc., in addition to software development and segmental information was not available. As per the Ld. DR even if segmental information was not readily available, DRP should have directed the AO to obtain such data from the concerned company instead of directing its exclusion.

09. Per contra, Ld. AR submitted that segmental results being unavailable, ICRA Techno Analytics Ltd, could not be considered as a good comparable. As per the Ld. AR, revenue of the said company included licensing and sub-licensing fee, web development and hosting, but these were not separately available for analysis. As per the Ld. AR, the said company was purchasing and reselling branded computer software. Reliance was placed on the directors' report of the said company for F. Y. 2009-10.

10. We have perused the orders and heard the rival contentions. Notes to accounts of ICRA Techno Analytics Ltd forming a part of its audited financial statement of accounts and annual report for year ended 31.03.2010 mentions as under :

- Significant accounting policies and Notes to Accounts (Page 169 of the Annual report)

BACKGROUND:- The Company was incorporated on July 27, 1992 as Computer Exchange Private Limited (CEPL) and subsequently became wholly owned subsidiary of ICRA Limited on August 25, 2005 and was renamed as ICRA Techno Analytics Limited (ICTEAS). The company is engaged in the software development & consultancy, engineering services, web development & hosting and subsequently diversified itself into the domain of business analytics and business process outsourcing.

In the note detailing of the revenue recognition which also form a part of its annual report it has been stated that its revenue stream consisted of software development consultancy, engineering services, web development and hosting. Thus ICRA Techno Analytics had more than one segment. There is no case for the Revenue that the segmental results were separately available in public domain or was not obtained by the TPO from the said company, invoking the powers vested on him. In such a situation the DRP, in our opinion, was justified in directing exclusion of ICRA Techno Analytics Ltd from

the list of comparables.

11. Ld. DR assailing the order of DRP for exclusion of Kals Information Systems Ltd, submitted that Kals Information Systems Ltd was a software development services company not a software product development company. As per the Ld. DR though the assessee had stated that Kals Information Systems Ltd was a full-fledged product development company, the data which was relied on by the assessee for coming to such conclusion was not available in the annual report. As per the Ld. DR, the said company did not own any software product of its own, but was only providing software development services to other parties. According to him, conclusion of the DRP that it was into product development and not providing software development services was incorrect.

12. Per contra, Ld. AR supported the directions of the DRP.

13. We have perused the orders and heard the rival contentions. In the annual report for F. Y. 2009-19 of Kals Information Systems Ltd, background of the said company has been mentioned as under :

1. Background

The company was incorporated under the Companies Act 1956 as a Private Limited Company in the year 1993. Subsequently the company was converted into a public limited company in the year 2000. The company is engaged in development of Software and Software products since its inception. The company consisting of STPI unit engaged in Development of Software and Software Products and a Training Centre engaged in training of Software professionals on online projects.

14. Said company was having significant inventory coming to 27% of its current assets. Inventory held by Kals Information Systems Ltd came to Rs.60,47,977/-. We also find that Hyderabad bench in the case of Pegasystems Worldwide India P. Ltd (supra) had held as under at para 10.1 of its order vis-à-vis the comparability of M/s. Kals Information Systems Ltd :

10.1. Assessee's main objection before us is on functionality of the comparable company. As seen from the annual report of 2008-09 and 2009-10 and comparative statement placed by Assessee, the company classified itself as 'the company engaged in development of software and software products since its inception'. The company consisting of STPI unit engaged in development of software and software products and a training centre engaged in training of software professionals on on-line projects. This indicates that company is engaged in development of software and products and its inventory also indicates that Assessee has been using its readymade libraries for sales. This company was rejected in earlier year on functional analysis by ITAT in the case of Planet Online Pvt. Ltd., in ITA No. 464/Hyd/2014 where in it was held that company is engaged in development of software products. Since its annual report states the same facts in this assessment year also, we are of the opinion that the company cannot be selected as a comparable as it was engaged in development of software and software products. Accordingly, Assessee's objections are accepted and AO is directed to exclude the company.

Accordingly we are of the opinion that DRP was correct in directing exclusion of the said company from the list of comparables.

15. Assailing the directions of the DRP for exclusion of Persistent Systems and Solutions Ltd, Ld. DR submitted that assessee had not raised any objection on this comparable before the TPO. According to him assessee had for the first time assailed its comparability before the DRP, while accepting it as a good comparable before the TPO. According to him, DRP had accepted the contentions of the assessee without verifying the data furnished by it.

16. Per contra, Ld. AR submitted that Persistent Systems and Solutions Ltd was rendering outsourced product development services and not any software development as such. According to him, its revenue was from sale of product software development services and segmental results were not available. Relying on the annual report of Persistent Systems and Solutions for F. Y. 2009-10, Ld. AR submitted that it was providing end to end product development services. Further as per the Ld. AR web-site of the said

company clearly indicated that it was developing products like paxpro, ChemLMS, VieMOR, CLAP, e2GMigrator, TLALOC, eMee. Thus according to him, directions of the DRP were just and proper.

17. We have perused the orders and heard the rival contentions. No doubt assessee had raised no objections with regard to inclusion of Persistent Systems and Solutions Ltd as a comparable, when it was so suggested by the TPO. However before the DRP assessee had stated that the said company was engaged in outsourced product development services and not into software development services. Annual report of Persistent Systems and Solutions, states as under :

Established in 1990, Persistent Systems is recognised as an award-winning technology company and a leading provider of end-to-end software product development services - from Research to Testing to Professional Services and Customer Support.

Our philosophy is to leverage our product development skills and provide our customers with world class engineering and operations related services to augment their product development capabilities.

It is also mentioned that they were providing out-sourced product development services and significant portion of its revenue was from export of software services as well as products. In the P & L account for the year ending 31.03.2010, revenue from sale of software services and products came to Rs.5,044.13 millions. There was no segmentation of the results into software services and software product development. Thus segmental results were not available and the assessee has also shown that M/s. Persistent Systems & Solutions Ltd, was developing products like paxpro, ChemLMS, VieMOR, CLAP, e2GMigrator, TLALOC, eMee. In such a situation we are of the opinion Ld. DRP rightly directed exclusion of Persistent Systems and Solutions

Ltd from the list of comparables. DRP has also given a finding that assessee was rendering contract software development services to its principal abroad and such services were provided by it through projects and assignments contracted to it by their principals abroad. Thus, according to us, DRP was justified in directing exclusion of persistent Systems and Solutions Ltd, considering the functional profile of the assessee as dissimilar from that of Persistent Systems and Solutions Ltd.

18. To summarise we are of the opinion that no proper reasons have been shown by the Revenue for interfering with the directions of the DRP to exclude Infosys Ltd, ICRA Techno Analytics Ltd, Kals Information Systems Ltd and Persistent Systems and Solutions Ltd from the list of comparables considered by the TPO for bench marking the pricing of the international transactions in the nature of software development services rendered by the assessee to its AE abroad. Ground 4 of the Revenue therefore stands dismissed.”

Since this Tribunal has found that the comparables, ICRA Techno Analytics Ltd, Infosys Technologies Ltd, Kals information Systems Ltd (Seg) and Tata Elxsi Ltd (Seg) are functionally different, in the above cases, following them, the DRP’s decision is upheld and the corresponding grounds of the Revenue are dismissed. Per contra, ground nos.1, 2 & 3 of the CO of the assessee are allowed.

10. The next issue is seeking inclusion of the following two comparables (Ground No.7 of Revenue’s appeal and ground no 4 of the assessee’s CO). The gist of the AR’s submissions are as under :

1. R S Software (India) Ltd :

The TPO's/DRP's reason for exclusion is that 82% expenses in the P & L are incurred by foreign branches , hence it is an onsite software development company

The assessee's reasons for inclusion are that :

- The company is engaged in the provision of software development services. Onsite development should not be a criteria to judge comparability.
- Onsite revenue is not one of the filters adopted by the TPO in the order.

2. Persistent Systems & Solutions Ltd :

The TPO's/DRP's reason for exclusion is that no segmental information is available with regard to software services and product separately.

The assessee's reasons for inclusion are :

- As per notes to accounts, the company is predominantly engaged in providing software development services to its global customers.
- As per revenue recognition, the company derives income from software services.

We heard the rival submissions. The assessee submitted that it is in agreement with the ground of the Revenue and requested to restate the above comparables in the final set of comparables . Accordingly, the TPO/AO is directed to include them. The Revenue's ground no 7 and the ground no 4 of the assessee's CO are allowed.

11. The next issue is seeking inclusion of the following 5 comparables (Ground no.5 of the assessee's additional ground). The gist of the AR's submissions are as under :

1. Akshay Software Technologies Ltd : The DRP's reasons for exclusion are : Predominantly engaged in onsite development of software & Abnormal employee cost of 87%.

The assessee's reasons for inclusion are :

- The company is engaged in the provision of software development services. Onsite development should not be a criteria to judge comparability.
- Onsite revenue is not one of the filters adopted by the TPO in the order.
- Threshold for employee cost filter applied by TPO is 25%, hence it passes the filter.

2. Goldstone Technologies Ltd : The DRP's reason for exclusion : Export turnover is 67%, which is less than the threshold of 75% applied by the TPO.

The assessee's reasons for inclusion are :

- TPO and DRP have considered the earnings in foreign currency to total turnover, instead of considering the export turnover.
- As per the filters applied by the TPO, the filter is 'companies who have export sales less than 75% of the sales were excluded'. Accordingly export sales turnover should be considered for computational purposes.

3. LGS Global Ltd : The DRP's reasons for exclusion are :Export turnover is 49% which is less than the threshold of 75% applied by the TPO & Engaged in onsite development of software

The assessee's reasons for inclusion are :

- The company is engaged in the provision of software development services. Onsite development should not be a criteria to judge comparability.
- Onsite revenue is not one of the filters adopted by the TPO in the order.
- LGS passes the filter, export turnover is 98.71%. TPO and DRP have considered the earnings in foreign currency to total turnover, instead of considering the export turnover.

4. Silverline Technologies Ltd : The DRP's reasons for exclusion are :

- Company has different financial year ending.
- Company is providing IT services comprising if software development system solution, application software system and maintenance of software and no segmental information is provided in this regard.
- Engaged in onsite development of software.

The assessee's reasons for inclusion are :

Extrapolated data can be considered in the light of the High Court ruling in Mckinsey Knowledge Centre India Pvt Ltd

- The company is engaged in the provision of software development services. Onsite development should not be a criteria to judge comparability.
- Onsite revenue is not one of the filters adopted by the TPO in the order.
- As per the Annual Report of the company, there is only one segment i.e., IT Service. The other services provided are a sub-classification of the IT services provided and hence functionally comparable.

5. Caliber Point Business Solution : The DRP's reasons for exclusion are : Revenue from foreign branches are a part of the business turnover, assets and liabilities, other income and interest have not been identified to segments. Hence, the segmental are unreliable.

The assessee's reasons for inclusion are :

Assets and liabilities have no role to play for determination of margin computation. Further, interest and other income would be non-operating in nature and hence not relevant.

The segment titled 'Others' can be considered as comparable which represents software support, maintenance and consulting related activities and hence functionally comparable.

The AR took us through relevant pages in the paper book. We have heard the rival submissions. Since these inclusions are sought on the basis of the additional grounds, these issues are remitted back to the TPO/AO for re-adjudication in accordance with law.

12. The next issue argued on the basis of additional ground is that the donation is to be considered as non-operating in nature

In this regard, the assessee submitted that donation is not closely linked to the business operations and should be considered as non-operating in nature. The assessee placed reliance on the decision of this Tribunal in the case of M/s. Capital One Services India P. Ltd [IT(TP)A No.28/Bang/2014], wherein it has been held that donation is not in the nature of normal business activity and hence should not be considered as operating. Following the decision, the AO is directed to treat donation as non operating one.

13. The next issue argued is seeking Risk adjustment on the basis of additional ground :

In this regard, the assessee submitted that suitable adjustment should be provided to account for differences in risk profile of the

comparables. The assessee placed reliance on the Tribunal decision of Hyderabad Bench in Heliosoft India P. Ltd [ITA.645/Hyd/2009], wherein the Tribunal held as under :

"17. We have heard the submissions of the parties in this regard. The materials on record clearly prove the fact that the assessee is a captive service provider. It has transactions only with its AE. It is also a fact that all the risks lies with the AE. Different benches of the Tribunal have also taken a divergent view on this issue. The Income-tax Appellate Tribunal, Mumbai Bench in the case of Simontech (supra) has held that no separate adjustment is required on account of risk and functional difference, the Income-tax Appellate Tribunal Delhi Bench in the case of Sony India Pvt. Limited V/s. DCIT (114 ITD 448) has held that deduction on account of ownership of intangibles, risk factors can be allowed. In aforesaid view of the matter, we are inclined to accept the view favorable to the assessee. We therefore uphold the direction of the CIT (A) in this regard in allowing the benefit of risk adjustments at 1%. Accordingly, the ground raised by the department is dismissed."

On the other hand, the DR submitted that the TPO is not against granting any risk adjustment but the risk has to be established by the assessee . In the facts and circumstances, this issue is remitted back to the TPO/AO shall re-adjudicate it in accordance with law.

14. In the result, the Revenue's appeal and the cross objection filed by the assessee , both are allowed partly.

Order pronounced in the open court on 21st March, 2017.

Sd/-

(SUNIL KUMAR YADAV)
JUDICIAL MEMBER

MCN*

Sd/-

(S. JAYARAMAN)
ACCOUNTANT MEMBER

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, Bangalore

By Order

Assistant Registrar.