

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

BEFORE SMT. ASHA VIJAYARAGHAVAN, JUDICIAL MEMBER

AND

SHRI. ABRAHAM P. GEORGE, ACCOUNTANT MEMBER

I.T(TP).A No.876/Bang/2013  
(Assessment Year : 2004-05)

Deputy Commissioner of Income-tax,  
Circle 11(3), Bangalore

..Appellant

v.

M/s. Electronics for Imaging India P. Ltd,  
Kalyani Platina, 4<sup>th</sup> floor, Block -I,  
24, EPIP Zone, Phase -II, Whitefield,  
Bangalore 560 066  
PAN : AAACG6053E

..Respondent

Cross objection No.167/Bang/2015  
I.T(TP).A No.876/Bang/2013  
(Assessment Year : 2004-05)  
(By the Assessee)

Assessee by : Shri. Padam Chand Khindha, CA  
Revenue by : Dr. P. K. Srihari, Addl. CIT

Heard on : 08.09.2015

Pronounced on : 30.09.2015

**ORDER**

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

These are appeal and cross objection filed by Revenue and assessee respectively directed against an order dt.19.03.2013, of CIT (A) -IV, Bengaluru, for the Asst. Year 2004-05.

02. Appeal of the Revenue is taken up first for disposal. Revenue has altogether taken seven grounds of which grounds 1, 6 and 7 are general needing no specific adjudication.

03. Vide its grounds 2 and 3, Revenue is aggrieved with the direction of CIT (A) for exclusion of M/s. Synergy Log-in Systems Ltd and M/s. Transworld Infotech Ltd from the list of comparables selected by TPO for bench marking the value of international transactions of assessee with its AE.

04. Facts apropos are that assessee engaged in software development, messaging and marketing support activities, was rendering such services to its principal Electronics for Imaging Inc., USA. For justifying the revenue of Rs.10,02,75,735/- it received on account of international transactions, it adopted cost plus method in its TP study. TPO was of the opinion that assessee's methodology of working of cost plus 10% for software services to AE and cost plus 8% for marketing services could not be accepted since reliable data establishing functional comparability of the companies selected by the assessee as comparables, with the assessee, could not be established. There after the TPO adopted TNMM as the most appropriate method for bench marking the value of international transactions. For such TNMM he took five companies as comparables which incidentally appeared in the list provided by the assessee in its cost plus method analysis. Comparables selected were the following :

1. M/s. Motherson Sumi Infotech and Designs Ltd,
2. M/s. Synergy Log-in Systems Ltd,
3. Transworld Infotech Ltd,

4. M/s. Visu International Ltd,

5. M/s. Zigma Software Ltd

Average PLI of the comparables arrived at by the TPO was 19.43%.

05. TPO recommended an upward adjustment of Rs.1,30,68,729/-, as worked out hereunder :

Total operative cost incurred	Rs.9,64,39,382/-
Arm's length price @ 119.43%	Rs.11,51,77,553/-
Price received	Rs.10,02,75,736/-
Adjustment u/s.92CA	Rs.1,30,68,729/-

Assessment was completed accordingly.

06. Aggrieved, assessee moved in appeal before the CIT (A). CIT (A) directed exclusion of M/s. Synergy Log-in Systems Ltd and M/s. Transworld Infotech Ltd from the list of comparables considered by TPO. Reason stated by CIT (A) was that the financial year of the said company did not coincide with that of the assessee. As per CIT (A), the published accounts of these two companies were for year ending 30.06.2004 and hence could not be considered as proper comparables since assessee's financial year was ending on 31.03.2004.

07. Now before us, Ld. DR submitted that the two companies, namely, M/s. Synergy Log-in Systems Ltd and M/s. Transworld Infotech Ltd, had appeared in assessee's own list in its TP study. Hence according to him, CIT (A) fell in error in directing exclusion of these companies.

08. Per contra, Ld. AR supported the order of CIT (A).

09. We have perused the orders and heard the rival contentions. There is no dispute that accounting period of M/s. Synergy Log-in Systems Ltd and M/s. Transworld Infotech Ltd, was one ending on 30.06.2004 and the data considered for working out their PLI was results of such accounting period. For benchmarking an international transaction, comparison should be with an uncontrolled transaction and an uncontrolled transaction would be comparable with international transaction only if there are no differences between the transactions being compared that are likely to materially affect the prices of cost incurred or paid in or the profit arising from such transaction in the open market. Relevant Rule 10B(4) is reproduced hereunder :

*10B(4) The data to be used in analysing the comparability of an uncontrolled transaction with an international transaction shall be the data relating to the financial year in which the international transaction has been entered into :*

*data relating to a period not being more than two years prior to such financial year may also be considered if such data reveals facts which could have an influence on the determination of transfer prices in relation to the transactions being compared.*

10. Unless and until there are reliable published accounting records, which would help to cull out the result of a comparable company for a financial year comparable to that of the tested party any attempted comparison would not yield correct results. In our opinion the CIT (A) was justified in directing exclusion of M/s. Synergy Log-in Systems Ltd and M/s. Transworld Infotech Ltd, since their accounting year ended on a different date, when compared to that of the assessee. We do not find any reason to interfere. Grounds 2 and 3 of the Revenue stand dismissed.

11. Vide its ground 4, grievance raised by the Revenue is that CIT (A) held foreign exchange loss / gain as operating in nature.

12. Ld. DR in support of the above ground submitted that CIT (A) had not established the nexus between the foreign exchange loss / gain with the export activity of the assessee.

13. Per contra, Ld. AR supported the order of CIT (A).

14. We have perused the orders and heard the rival contentions. Assessee's submission with regard to foreign exchange gain of Rs.29,96,409/- which it considered to be operating in nature was as under :

*“82. It was submitted that while computing the operating margins of the appellant the TPO had not considered the foreign exchange gain of Rs.29,96,409. Exchange gain or loss arose on account of factors like realisation of sales, payment to suppliers, and restatement of the values of assets and liabilities. These causes and factors were operating in nature, as per paragraph 134 on page 46 of OECD Draft Guidelines on Transactional Profit Methods. Reliance was placed on the decision of the Bengaluru bench of the hon'ble ITAT in the case of Sap Labs 6 ITR (Trib) 81, where it was held that foreign exchange gain needed to be considered as operating in nature while determining the ALP.”*

Considering the nature of activities of assessee and the nature of revenues earned by it from software development activities rendered abroad, we are of the opinion that the foreign exchange gain could have been construed only as incidental to the sales, payment to suppliers etc., We cannot therefore find any fault with the direction of the CIT (A) to consider such foreign exchange gain as operating in nature. Ground 4 of the Revenue stands dismissed.

15. Vide its ground 5, grievance raised by Revenue is that CIT (A) directed reworking of the operating margin by allocating cost on the basis of man-hours.

16. Facts apropos are that assessee was having both AE and non-AE segments and the indirect cost was allocated by assessee between these two segments on the basis of man-hours, in its TP study. TPO had rejected this basis of allocation and on the other hand adopted the turnover ratio as basis for allocation. Contention of the assessee was that its main assets were its employees and accounts were maintained on ERP, enabling it track all costs based on cost centres linked to each segment. Assessee submitted that man power was its most critical resource and therefore allocation on the basis of man-month was scientific and appropriate. Though the TPO was not appreciative of the above contentions, CIT (A) accepted it, considering the judgment of Hon'ble Delhi High Court in the case of CIT v. EHPT India P. Ltd [(2011) 16 taxmann.com 305].

17. Now before us, Ld. DR submitted that allocation made by assessee had no scientific basis. According to him, cost could be better allocated on the basis of revenues in different segments. Assessee could not show how the method of man-hour basis was better than turnover basis for allocation of indirect cost.

18. Per contra, Ld. AR submitted that assessee was billing on cost plus basis. Billings were thus based on the total cost incurred by the assessee. Such costs were worked out by the assessee by allocating the indirect costs on the basis of head count. Thus the revenue earned by assessee itself was based on man-hours

spent by the employees. According to him, allocation based on revenue earned would be inappropriate in assessee's case when the revenue stream itself was dependent on the cost allocated on head-count basis. Reliance was once again placed on Hon'ble Delhi High Court judgment in the case of EHPT India P. Ltd (supra).

19. We have perused the orders and heard the rival contentions. There is no dispute that assessee was billing its AE on cost plus basis. Such cost was arrived at by the assessee by allocating the indirect cost on the basis of man-hours and direct cost directly. When the revenue of the assessee itself was based on an allocation done on man-hour basis, in our opinion, it was not appropriate to adopt a different yardstick for working out its PLI. That for a software development company, the most appropriate method for allocating indirect cost is head-count method has been clearly brought out by Hon'ble Delhi High Court judgment in the case of EHPT India P. Ltd (supra). Relevant para 8 of the judgment read as under :

*8. We have examined the matter in the light of the submissions made before us. The fate of the appeals must depend upon the answer to the question whether the method adopted by the assessee, namely, that of apportioning the indirect expenses between the STP unit and the non-STP domestic unit on the basis of the "head-count" is an unreasonable method and if it has been followed consistently by the assessee in the past and has also been accepted by the department, should the revenue authorities be permitted to disturb the same in the years under appeal. It seems to us that the settled position in such matters is to examine whether the method which is canvassed for acceptance is the one (a) which has been consistently*

*accepted by both the parties, namely, the assessee and the revenue in the past; (b) which is a reasonable method having regard to the nature of the business and other relevant factors and (c) which does not distort the profits. There is no dispute that the head-count method has been consistently followed and accepted without demur in the past. A departure therefrom is sought to be made only in the years under consideration by the departmental authorities. That it is a reasonable method and fair to both sides is indicated by the conduct of the revenue authorities in accepting it in the past. The reasonableness or fairness of the method of head-count adopted by the assessee can be said to be indicated by the fact that in the assessment year 2002-03 the assessee apportioned more common expenses to the STP unit, thereby reducing its profits and consequently reducing the claim for deduction under Section 10A and at the same time offering a higher income in the domestic unit than what would have been offered had the turnover method of apportionment adopted by the Assessing Officer been followed. This aspect has been noticed by the CIT(A) in his order for the assessment year 2002-03 as follows:*

*"In view of the above facts, though the right course of allocating the common expenses is on the basis of turnover basis. The appellant had filed a calculation on turnover basis, the deduction available to the appellant company comes to Rs. 6,53,49,442 instead of Rs. 6,51,50,217 claimed by the appellant. The working given by the appellant counsel has been found to be correct. In view of the above facts, as the assessee had shown more income though the right course of allocation for indirect expenses is turnover basis but as the appellant company had shown more income, the same is to be accepted and cannot be disturbed. In view of the above, no disturbance is required to be made in respect of indirect expenses allocated by the appellant company. In view of the above facts, the addition made by the Assessing Officer is deleted."*

*It was only as a matter of principle that the CIT(A) upheld the method adopted by the Assessing Officer even though the*

*result was in favour of the assessee. Neither the Assessing Officer nor the CIT(A) has raised any serious questions about the validity of the head-count method adopted by the assessee nor have they pointed out any commercial accounting principle or accounting standard that repudiates the method.*

Thus according to us, direction of CIT (A) that apportionment of cost has to be done on man-hour basis and not on turnover basis could not be faulted with.

We do not find any reason to interfere with the direction of CIT (A) in this regard. Ground.5 of the Revenue is dismissed.

20. Coming to the cross objection of the assessee, Ld. AR submitted that if direction of the CIT (A) with regard to exclusion of two companies, namely, M/s. Synergy Log-in Systems Ltd and M/s. Transworld Infotech Ltd was accepted, he had no other grievance. Accordingly we dismiss the cross objection of the assessee.

21. In the result, appeal of the Revenue and cross objection of the assessee are dismissed.

Order pronounced in the open court on 30th day of September, 2015.

Sd/-

(Smt.ASHA VIJAYARAGHAVAN)  
JUDICIAL MEMBER

Sd/-

(ABRAHAM P GEORGE)  
ACCOUNTANT MEMBER

MCN

Copy to:

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

By Order  
Assistant Registrar