IN THE INCOME TAX APPELLATE TRIBUNAL
BANGALORE BENCH ' B '

BEFORE SHRI VIJAYPAL RAO, JUDICIAL MEMBER AND
SHRI INTURI RAMA RAO, ACCOUNTANT MEMBER

I.T. (T.P) A. No.1228/Bang/2010
(Assessment Year : 2006-07)

M/s. Textron India Private Limited,
(Formerly known as Textron Global Technology Centre Pvt. Ltd.)
Global Village, RVCE Post,
Mylasandra, Off Mysore Road,
Bangalore-560 059 .... Appellant.
PAN AACCT 0118M

Vs.

Dy. Commissioner of Income Tax,
Circle 12(4), Bangalore. ..... Respondent.

Appellant By : Shri P.K. Prasad.
Respondent By : Smt. Neera Malhotra, CIT (D.R)

Date of Hearing : 30.11.2015.
Date of Pronouncement : 13.1.2016.

O R D E R

Per Shri Vijaypal Rao, J.M. :

This appeal by the assessee is directed against the assessment order dt.13.9.2010 passed under Section 143(3) rws 144C of the Income Tax Act, 1961 (in short 'the Act') in pursuant to the directions of Dispute Resolution Panel (DRP) dt.31.8.2010 for the Assessment Year 2006-07.

2. In the Memo of appeal in Form 36, the assessee has raised following grounds :

ñ Transfer Pricing Related

. That the order of the learned Deputy Commissioner of Income-tax. Circle 12(4), Bangalore ('Assessing Officer' or 'AO') to the extent prejudicial to the Appellant, is bad in law and liable to be quashed.

2. That the learned AO and the learned Dispute Resolution Panel (‚Panel') erred in upholding the rejection of Transfer Pricing (TP) documentation by the learned Deputy Director of Income-tax (transfer pricing officer - V) (TPO') and thereby erred in not appreciating that the Appellant had prepared the TP documentation bona fide and in good faith and conducted the comparable analysis based on the detailed Functional Asset and Risk analysis performed with due diligence and the data available at the time of conducting the comparability analysis.

3. That the learned AO and the learned Panel erred in ignoring the limited risk nature of the services provided by the Appellant as detailed in the TP documentation and in upholding the conclusion of the learned TPO that no adjustment on account of risk differential is required while determining the Arm's Length Price of the international transactions of the Appellant, but for an adjustment towards .. differences Working capital position between the Appellant and the entrepreneurial comparable companies.

4. That the learned AO and the learned Panel erred both in facts and law in confirming the action of the learned TPO of making an adjustment to the transfer price of the Appellant and thereby adjusting the transfer price by RS.13,325,968 holding that the international transactions do not satisfy the arm's length principle envisaged under the Act and in doing so grossly erred in:

4.1. Upholding the act of the learned TPO of collecting selective information of the companies by exercising power granted to him under section 133(6) of the Act. that was not available to the Appellant in the public domain and relying on the same for comparability purposes in denial of natural justice to be observed in the assessment proceedings.

4.2. Disregarding application of multiple *years* prior year data as used by the Appellant in the TP documentation and holding that current year (i.e. Financial Year 2005-06) data for comparable companies should be used despite the fact that the same was not necessarily available to the Appellant at the time of preparing the TP documentation, and in doing so have grossly erred in:

4.2.1. interpreting the requirement of 'contemporaneous' data in the Rules to necessarily imply current *year's* single year (i.e. FY 2005-06) data; and

4.2.2. expecting the Appellant to perform act of impossibility in terms of being able to use data subsequently available (i.e. during audit proceedings).

4.3. Upholding the rejection of comparability analysis of the Appellant in the TP documentation and confirming the comparability analysis as adopted by the learned TPO in the TP Order by applying additional filters and introduction of companies as com parables that are either functionally dissimilar or have differing asset base and risk profile, and also rejectionof other potentially comparable companies.

4.4. Concluding that the amended proviso to section 92C(2) of the Act *under* Finance (No 2) Act, 2009, would be applicable for Assessment Year 2006-07 and in not appreciating that even if the arms' length price falls outside the 5% tolerance band the adjustment would have to be reckoned after allowing the benefit of +/- 5% variation as provided in proviso to Section 92C(2) of the Act, while determining the arms' length price.

Other than Transfer Pricing Related

5. That the learned AO erred in not allowing deduction under section lOA of the Act of the entire profits of the undertaking registered with the Software Technology Park of India.

6. That on the facts and in circumstances of the case, the Learned AO has erred in not allowing the reduction in telecommunication charges incurred outside India amounting to Rs 16,880,900 in computing the Total Turnover of the Company for the purpose of computing deduction under section 10A of the Act.

7, (i) That on the facts and in the circumstances of the case, the Learned AO erred in reducing the telecommunication charges incurred in India amounting to Rs 2.735,887 from 'export turnover' while computing deduction under section lOA of the Act as 'expenditure attributable to delivery of software outside India' under Explanation 2(iv) to Section lOA of the Act.

(ii) That the Learned AO has erred in not allowing the reduction of telecommunication expenses of Rs 2,735,887 in computing the total turnover of the Assessee for the purpose of computing deduction under section lOA of the Act.

8. (i) That on the facts and in the circumstances of the case, the learned AO erred in considering the insurance expenses of Rs 29.995, which comprises of y'~hicle. insurance, as 'expenditure attributable to delivery of software outside India' under E.g~$flation 2(iv) to Section lOA of the Act and reducing the same from 'export turnover' while computing deduction under section lOA of the Act.

(ii) That the learned AO has erred in not allowing the reduction of insurance expenses of Rs 29,995 in computing the total turnover of the Assessee *for* the purpose of computing deduction under section lOA of the Act.

9. (i) That on the facts and in the circumstances of the case, the learned AO erred in reducing the expenses incurred in foreign currency towards travelling and conveyance of Rs 4,602,235 from 'export turnover' while computing deduction under section 10A of the Act, merely because these expenses were incurred in foreign currency.

(ii) That the learned AO has erred in not allowing the reduction of travelling and conveyance incurred in foreign exchange of Rs 4,602,235 in computing the total turnover of the Assessee for the purpose of computing deduction under section lOA of the Act.

10. (i) That on the facts and in the circumstances of the case, the learned AO *erred* in considering the professional fees of Rs 1,160,711, which comprises of expenses incurred in local currency, as .expenditure attributable to delivery of computer software outside India including technical services' under Explanation 2(iv) to Section lOA of the Act and reducing the same from 'export turnover' while computing deduction under section 10A of the Act.

(ii) That the Learned AO has erred in not allowing the reduction of professional fees incurred in local currency of Rs 1,160,711 in computing the total turnover of the Assessee for the purpose ofcomputing deduction under section 10A of the Act.

11. That on the facts and in the circumstances of the case, the learned AD erred in not appreciating the fact that the Company is not engaged in the business of providing technical services outside India.

12. That the learned AD erred in not allowing deduction under section 10A of the Act, before set-off of brought forward business loss, in computing the total income of the Company.

13. Consequently, the learned AO erred in charging interest under section 2348 and 2340 of the Act.

14. Notwithstanding the above, the learned AO has erred in not giving credit for Self Assessment Tax of Rs 311,065 paid by the Company

That the Appellant craves leave to add to and/or to alter, amend, rescind, modify the grounds herein above or produce further documents before or at the time of hearing of this Appeal.ò

3. The assessee has raised additional grounds vide petition dt.26.6.2015. The additional grounds sought to be admitted are as under :-

ñ 1. To reject Aztec Software & Technology Services Limited ("Aztec Software") from the final list of comparables, even though Aztec Software was selected as comparable by the Appellant in its Transfer Pricing Report ("TP Report").

2. To reject Megasoft Limited ("Megasoft") from the final list of comparables, even though Megasoft was selected as a comparable by the Appellant in its TP Report.

3. To reject Accel Transmatic Limited ("Accel") from the finalist of comparables, even though Accel was selected by the Appellant as a comparable in its TP Report.

4. To reject Geometric Software Limited ("Geometric Software") from the final list of comparables, even though the Appellant had accepted for its inclusion before the lower authorities.

5. To allow the Appellant to contest the exclusion of the below mentioned comparables on the basis of application of turnover filter of INR 1-200 crores, though the application of this filter was not put forward before the lower authorities:

   a. iGate Global Solutions Limited b. Infosys Limited

   c. Mindtree Limited

   d. Persistent Systems Limited

   e. Sasken Communication Limited.

   f. Flextronics Software Systems Limited.

The Appellant craves leave to add, alter, amend or withdraw all or any of the Grounds of Appeal and to submit such statements, documents and papers as may be considered necessary either at or before the appeal hearing. Further, this ground of appeal is independent of the grounds of appeal already filed by the Appellant.ò

4. At the time of hearing, the learned Authorised Representative of the assessee has stated that the Ground Nos.1, 4, 4.1, 4.2, 4.2.1, 4.2.2 and 4.4 are not pressed by the assessee and the same may be dismissed. The learned Departmental Representative has no objection if these grounds of the assessee's appeal are dismissed as not pressed. Accordingly, the Ground Nos.1, 4, 4.1, 4.2, 4.2.1, 4.2.2 and 4.4 are dismissed being not pressed.

5. The Ground Nos.2, 3 & 4.3 are relating to the Transfer Pricing adjustments and comparability of the companies selected by the Transfer Pricing Officer (TPO).

Therefore, these grounds are discussed and disposed off in the composite finding in the subsequent paragraphs.

6. The assessee is a company incorporated under the Companies Act on 2.4.2004 and is subsidiary of Textron Inc, USA. The assessee has reported its financial results from two segments of services as under :-

Description	**Software Development Services**	**Sourcing of Material Services**	**Amount**
Operating Revenue	Rs. 18,74,21,22/-	Rs. 60,18,597/-	Rs. 19,34,39,869/-
Operating Cost	Rs. 16,79,75,266/-	Rs. 55,46,333/-	Rs. 17,29,78,707/-
Operating Profit (PBIT)	Rs. 1,94,46,006/-	Rs. 4,72,264/-	Rs. 2,04,61,162/-
Operating Profit to Cost Ratio	**12%**	**9%**	**11.82%**

The assessee is providing software-design and development service to its group companies as a contractor. The assessee provides the service of software designed, developed, amended, tested or modified is the property of Textron group and at no point in time, such ownership vests with Textron India (assessee) either wholly or in part. The assessee undertakes contract software design & development services to the parent company and received a fixed mark up of the costs incurred for the said services. The primary work of the assessee is to undertake contract software design and development services to various units of Textron group. The assessee also provides resources of material service to other units of Textron group. The assessee reported the international transactions during the year as under :-

1.	Receipts for Software Development Services	Rs. 18,74,21,274/-	Readjustment done by TPO
2.	Receipts for Sourcing	Rs. 60,18,598/-	Treated at Arm's Length

	of Materials Services		by the TPO
3.	Reimbursement of Expenses - Paid	Rs. 48,35,170/-	

7. As regards the receipt for sourcing of material service, the TPO accepted the same at Armôs Length. Therefore there is no dispute regarding the international transactions in respect of sourcing of material services provided to its Associated Enterprises (AEs). The assessee has bench marked for its international transactions by adopting **Transactional Net Margin Method** (TNMM) as **Most Appropriate Method** (MAM) and Profit Level Indicator (PLI) as OP/TC. The assessee has selected in its TP analysis 44 comparables and arrived at mean margin of 11% in comparison to the assessee's price charged to AEs at 10.45%. Therefore, the assessee claimed that its international transactions are at armôs length. The entity selected by the assessee as its comparables for determination of armôs length price are as under :-

Sl. No	Comparable Company	Without Adjs. Markup on Total Cost
1.	**Aztec Software & Technology Services Ltd.**	**9%**
2.	Blue Stat Infotech Ltd.	23%
3.	C G-V AK Software & Exports Ltd.	3%
4.	California Software Co. Ltd	9%
5.	Compucom Software Ltd.	20%
6.	E. Star Infotech Ltd	19%
7.	FCS Software Solutions Ltd.	13%
8.	Goldstone Technologies Ltd.	7%
9.	KPIT Cummins Info systems Ltd.	14%
10.	Larsen Toubro Infotech Ltd.	8%
11.	Mason Global Ltd	8%
12.	Mastek Ltd.	20%
13.	**Megasoft Ltd**	**- 4%**
14.	Melstar Information Technologies Ltd.	2%
15.	NIIT Technologies Ltd.	20%
16	Netvista Information	17%

Sl. No	Comparable Company	Without Adjs. Markup on Total Cost
	Technologies Ltd.	
17	Ontrack Systems Ltd.	4%
18	Orient Information Technology Ltd.	15%
19	Pentamedia Graphics Ltd.	21%
20	Satyam Computers Services Ltd.	28%
21	Shree Tulsi Online Com Ltd.	2%
22	Sonata Software Ltd.	15%
23	Sun Beam Infotech Ltd.	6%
24	Synergy Log-In Systems Ltd.	-11%
25	Transworld Infotech Ltd.	32%
26	VJIL Consulting Ltd.	7%
27	VMF Soft Tech Ltd.	17%
28	Zensar Technologies Ltd.	9%
29	Onward Tecnologies Ltd.	12%
30	Akshay Software Technologies Ltd.	8%
31	Jayamaruthi Software Systems Ltd.	30%
32	Kale e Travel Technologies Ltd.	3%
33	Pentagon Global Solutions Ltd.	10%
34	Powersoft Global Solutions	22%
35	Quintegra Solutions Ltd.	8%
36	Systemlogic Solutions Ltd.	30%
37	**Accel Transmatic Ltd.**	**-18%**
38	Advanced Micronic Devices Ltd.	7%
39	Software Technology Group International Ltd.	9%
40	Tata Infotech Ltd.	10%
41	CMC Ltd	17%
42	Computech International Ltd	4%
43	Indus Networks Ltd	-4%
44	ORG Informatics Ltd	1%

8. The TPO rejected 41 comparables selected by the assessee and accepted only three companies namely **Aztec Software & Technology Services Ltd., Megasoft Ltd. and Accel Transmatic Ltd.** however, the operating profit of these companies were revised by the TPO by considering the current year data. The TPO has undertaken fresh search for selecting separate set of comparables and added 17 more companies for determining the ALP by considering 20 comparables as under :-

Sl. No.	Comparable Company Name	OP to Total Cost % as per TP Order (Pre WC Adj)
1.	Aztec Software Limited	18.09
2.	Geometric Software Limited	6.70
3.	iGate Global Solutions Limited	15.61
4.	Infosys Limited	40.38
5.	KALS Info Systems Limited	39.75
6.	Mindtree Consulting Limited	14.67
7.	Persistent Systems Limited	24.67
8.	R Systems International Limited	22.20
9.	Sasken Communication Limited (seg.)	13.90
10.	Tata Elxsi Ltd (seg.)	27.65
11.	Lucid Software Limited	8.92
12.	Mediasoft Solutions Private Limited	6.29
13.	R S Software (India) Limited	15.69
14.	SIP Technologies & Exports Limited	3.06
15.	Bodhtree Consulting Limited	15.99
16.	Accel Transmatics Limited (seg)	44.07
17.	Synfosys Business Solutions Limited	10.61
18.	Megasoft Limited	52.74
19.	Lanco Global Solutions Limited	5.27
20.	Flextronics Software Systems Limited	27.24
Arithmetic Mean Mark-up of Comparables before Working Capital Adjustment		20.68
Arithmetic Mean Mark-up of Comparables after Working Capital Adjustment of 1.11% as determined by the TPO		19.57
Appellant's Margin : 11.58		

9. The TPO has computed the arithmetic mean of the selected companies at 20,68% before working capital adjustment and at 19.57% after working capital adjustment. The TPO applied various filters for selection of the comparable companies as under :-

- Companies whose data is not available for the FY 2005-06 were excluded.
- Companies whose Software Development Service revenue <Rs.1crore were excluded.
- Companies whose Software Development Service revenue is less than 75% of the total operating revenues were excluded unless segmental details are available and the segment qualifies this filter.
- Companies who have more than 25% related party transactions (income as well as expenditure combined) of the operating revenues were excluded)
- Companies who have less than 25% of the Operating Revenues from Software Development Services as export sales were excluded.
- Companies who have diminishing revenues / persistent losses for the period under consideration were excluded.
- Companies having different financial year ending (i.e. not March 31, 2006) or date of the company not available for the 12 month period i.e. 01-04-2005 to 31-03-2006, were rejected.
- Companies whose employee cost to Operating Revenues from Software Development Services is less than 25% were excluded.
- Companies whose onsite revenue is more than 75% of the export revenues from Software Development Services were excluded.

- Companies that are functionally different from that of taxpayer, after giving valid reasons, were excluded.

10. The assessee challenged the inclusion of the various companies by the TPO and also raised objection of adopting the filter of Related Party Transactions (RPT) at 25% by the TPO instead of 15% sought by the assessee. The DRP did not accept the objections of the assessee and confirmed the action of the TPO in determining the ALP and consequential adjustment.

11. Before us, the learned Authorised Representative of the assessee has submitted that has applied that the issue of filter of RPT has been decided by this Tribunal in assessee's own case for the Assessment Year 2005-06 wherein the Tribunal has held that the CIT/TPO ought to have adopted a threshold limit of 15% which is attributable to the RPT as a ground for rejecting the comparable company. Thus the learned Authorised Representative has submitted the filter of RPT should be applied at 15% and the comparable companies selected having more than 15% RPT should be excluded from the list of comparables. On the other hand, the learned Departmental Representative has submitted that the assessee did not apply any RPT filter in its T.P. Study and further the limit of RPT at 15% is not a standard criteria to be applied in each and every case. He has further submitted that the Tribunal in its series of decisions have applied RPT from 5% to 25% depending upon the facts of the each case. Therefore, there is no fixed or standard criteria of 15% threshold limit of RPT for selecting comparables. He has relied upon the orders of the authorities below.

12. We have considred the rival submissions as well as the relevant material on record. In strict sense, the ALP has to be determined by considering uncontrol

comparable prices which means uncontrolled, unrelated comparable prices has to be taken into account to bench mark the international transactions which are the control and RPTs. However, 0% RPTs of the comparable price is an impossible situation and therefore a reasonable tolerance range of the revenue from RPT can be considered for selecting the uncontrolled comparables. There cannot be a single criteria / parameter which can be applied as a general rule in all cases. Therefore, this tolerance range varies from case to case and depending upon the availability of the comparables. If the comparables of international transactions are easily available, then, this tolerance of RPT should be restricted to minimum. There is no specified tolerance range in the Act or Rules under the Transfer Pricing provisions, however, in due course of discussion and adjudication of this issue in a series of decisions of this Tribunal, commonly accepted tolerance range of 5% to 25% of the total revenue from RPT has been considered as reasonable depending upon the facts and circumstances of each case. In the case on hand, the availability of the comparables is abundant in number as the assessee selected 44 comparables whereas the TPO selected 20 comparables by applying the filter of 25% of revenue from related parties. Therefore, in this case, good number of comparables are available and there is no difficulty in searching the comparables. Accordingly, in order to determine the ALP by considering the comparable uncontrolled transactions, it should be kept in mind that the uncontrolled transactions should be least influenced by the RPT. **In the case of DCIT Vs. Textron Global Technology Centre Pvt. Ltd.** in IT(TP)A No.29/Bang/2012 & C.O. No.40/Bang/2012 Dt.20.3.2015 for the Assessment Year 2005-06. The Tribunal has held in para 17 as under :-

" 17. In view of the conclusion above that exclusion of comparable companies with RPT of less than zero percent is not valid, and that companies where RPT is less than 15% alone can be considered, then the comparable rejected by the CIT (Appeals) on the basis of the said filter will have to be included along with the four comparable retained by the CIT (Appeals). Although 12 comparable which were rejected on the basis of RPT being more than zero percent, one comparable viz., Four Soft Ltd, will have to be excluded since the RPT is at 19.89% and thus in excess of 15%. Sathyam Computers Ltd. and Infosys Technologies Ltd. will get excluded for the reason that the financial results are not reliable in the case of Sathyam Computers Ltd. and for the reason that the high turnover, brand value, high risks etc. The remaining 9 comparable companies which were excluded by the CIT (Appeals) by applying the RPT filter of 0% related party transaction willnot have to be included. Their comparability with the assessee in terms of other filters will be discussed in the following paragraphs."

In view of the facts and circumstances of the case when there is good number of comparables available then, we concur with the view of the co-ordinate bench that the RPT filter of 15% is proper in the case of the assessee. Accordingly we direct the Assessing Officer/TPO to exclude the comparable companies having the revenue of more than 15% from related parties. The learned Authorised Representative of the assessee has referred Annexure A to TPO order which mentions the percentage of RPTs. Thus as per the Annexure A of the TPOôs order, the following companies having more than 15% of RPT are directed to be excluded.

Sl. No.	**Comparable Company Name**	**% of RPT Over sales**
1.	Aztec Software Limited	17.78
2.	Geometric Software Limited	19.34
3.	Megasoft Limited	17.08

13. The assessee has also raised objections against the other comparables selected by the TPO which we will deal with one by one as under :-

13.1 **Kals Infosystems Ltd.**

13.1.1 The learned Authorised Representative of the assessee has submitted that this company is into a product business and has earned revenue from sale of software product. Therefore this company is not functionally comparable with the assessee which is purely a software development service provider to its parent company. In support of his contention, he has referred the Annual Report of this company and submitted that it engaged in the software product as stated in the Annual Report and also incurred sales and marketing expenditure. The learned Authorised Representative has pointed out that comparability of this company has been examined by this Tribunal in a series of decisions and it has been held that this company cannot be considered as functionally comparable with the software development service provider company. He has relied upon the following decisions :-

CASES PERTAINING TO ASSTT. YEAR : 2006 - 07	CASES PERTAINING TO OTHER ASSTT. YEARS
Cypress Semiconductor technology India Private Limited IT (TP) A No. 1167/Bang 2010	Trilogy E ï Business Software India Pvt. Ltd vs. DCIT (AY : 2007-08) ITA No. 1054/BANG/2012.
Verisign Services India Private Limited IT(TP)A No 1404 bang 2010	Conexant Systems India Pvt. Limited (AY : 2006-07 & 2007-08) (ITA No. 1429/Hyd/2010, ITA No. 1978/Hyd/2011).
Misys Software Solutions India Private Limited ï IT(TP) A No.1425/Bang/2010	Symbol Technologies India Private limited Vs IT (TP) (AY 2007-08) A No. 1352/Bang/2010.
Thoughtworks Technologies (India)Private Limited- IT(TP)A No.1326/Bang/2010	

13.1.2 On the other hand, the learned Departmental Representative has relied upon the orders of the authorities below and submitted that the TPO has considered the objections of the assessee and has decided that this company is functionally comparable with the assessee. The DRP has also upheld the finding of the TPO about the functional comparability of this company.

13.1.3 We have considered the rival contentions as well as the relevant material on record. At the outset we note that the functional comparability of this company to that of software development service provider has been examined by this Tribunal in a series of decisions as relied upon by the assessee and referred (supra). In the case of **Triology e-Business** Vs. DCIT in ITA No.1054/Bang/2012 (supra), the Tribunal has dealt with this issue in paragraphs 46 & 47. We further note that in the case of Misys Software Solutions (India) Pvt. Ltd. in IT(TP)A No.1425/Bang/2010 Dt.23.9.2015, the Tribunal has again considered functional comparability of this company in paragraphs 7.1 to 7.4.2 as under :-

*" 7.1 (4) **KALS Infosystems Ltd.***

This company was selected as a comparable by the TPO and was retained as a comparable even though the assessee objected to its inclusion before the DRP. It is the contention of the assessee that this company is into software products, and training apart from provision of software development services and therefore being functionally different, from the assessee who is purely into provision of software development services, ought to be excluded from the list of comparable companies. In support of this contention for exclusion of this company from the list of comparables, the learned Authorised Representative of the assessee placed reliance on the decision of the co-ordinate bench of the Tribunal in the case of Huawei Technologies India Pvt. Ltd. for Assessment Year 2006-07 (supra)."

13.1.4 The learned Departmental Representative has not disputed the facts considered by the co-ordinate bench of this Tribunal regarding the nature of functions and business, revenue earned by this company from the sale of software products.

Therefore, by following the decisions of the co-ordinate bench (supra), we direct the A.O./TPO to exclude this company from the list of comparables.

13.2 **Tata Elxsi Ltd. (Seg.)**

13.2.1 The learned Authorised Representative of the assessee has submitted that this company is functionally not comparable with the assessee as it fails the test of R&D expenditure to sale which is more than 3% filter. He has further contended that the company is engaged in the R&D activity resulting in creation of Intellectual Property Rights (IPRs). This company is not only into software products as explained in the Annual Report of this company but also is engaged in the embedded product development based on current and emerging technologies such as Multi-media, Wimax, Imaging, Imaging Process etc. The company actively engaged in developing house expertise in current and emerging markets through house development products and training. Further the software development business segment of this company also comprising of diversified activities such as hardware design, industrial design, engineering design and visual computing. Even this company in its response to notice under Section 133(6) has accepted that this company is not comparable with the software development services provider. In support of his contention, he has relied upon the following decisions :-

CASES PERTAINING TO ASSTT. YEAR : 2006 - 07	CASES PERTAINING TO OTHER ASSTT. YEARS
Cypress Semiconductor technology India Private Limited IT (TP) A No 1167/Bang 2010	Conexant Systems India Pvt. Ltd (AY 2006-07 & 2007-08) (ITA No. 1429/Hyd/2010, ITA No. 1978/Hyd/2011.
Verisign Services India Private Limited IT(TP)A No 1404 bang 2010	Logica Pvt. Ltd. Vs ACIT (ITA No. 1129/Bang/2011) (Page 20-21, Para 14)
Misys Software Solutions India Private Limited ï IT(TP) A No.1425/Bang/2010	Telcordia Technologies India Pvt. Ltd. Vs ACIT (AY 2007-08)
Thoughtworks Technologies (India)Private Limited- IT(TP)A No.1326/Bang/2010	

13.2.2 We have considered the rival submissions as well as the relevant material on record. At the outset we note that this company is not in the activity of pure software development services but engaged in the diversified product development activity which includes Multi-media, Wimax, Imaging and Imaging Process. Further, this company is also involved in the activities such as hardware design, industrial design, engineering design and visual computing. Therefore, the diversified activities as mentioned above are not comparable with the software development services provider like the assessee. The identical issue has been considered by the co-ordinate bench of this Tribunal in the case of **Misys Software Solutions (India) Pvt. Ltd.** (supra) in paragraphs 8.3.1 to 8.3.2 as under :

" 8.3.1 We have heard the rival contentions and perused and carefully considered the material on record, including the judicial pronouncements relied on by the assessee. We find that the co-ordinate bench in the case of Huawei Technologies India Pvt. Ltd. for Assessment Year 2006-07 (supra) has excluded these two companies from the set of comparables holding as under at paras 14 & 15 thereof :-

" 14. As far as Lucid Software Ltd. and Tata Elxsi Ltd. chosen by the TPO as comparables, we find that the Mumbai Bench of the Tribunal in the case of Telcordia Technologies India Pvt. Ltd. (supra) while dealing with the case of software services provider like the assessee, considered the comparability of Lucid Software Ltd. with similar software services provider and the Tribunal held as follows :-

"7.2 Lucid Software Limited.

It has been submitted before us that this company, besides doing software development services, is also involved in development of software product. The learned AR has tried to distinguish by pointing out that product development expenditure in this case is around 39% of the capital employed by the said company, and, therefore, such a company cannot be considered as tested party. Even as per the information received in response to notice under Section 133(6), the company has described its business as software development company or pure software development service provider. This information itself is very vague as the segmental details of operating revenue has not

been made available to examine how much is the ratio of sale from software product and sale of software service and development. Looking to the fact that it has developed a software product named as "Muulam" which is used for civil engineering structures and the product development expenditure itself is substantial vis-à-vis the capital employed by the said company, this criteria for being taken as comparable party, gets vitiated. For the purpose of comparability analysis, it is essential that the characteristics and the functions are by and large similar as that of the assessee company and T.P. analysis/study can be made with fewest and most reliable adjustment. If a company has employed heavy capital in development of a product then profitability in the sale of product would be entirely different from the company, who is involved in service sector. Therefore, this company cannot be treated as having same function and profitability ratio.

In our view, due to non-availability of full information abut the segmental details as to how much is the sale of product and how much is from the services, therefore, this entity cannot be taken into account for comparability analysis for determining arm's length price in the case of the assessee."

15. In view of the aforesaid decision of the Mumbai Bench of the Tribunal, which is in relation to A.Y. 2006-07, we are of the view that Lucid Software Ltd. and Tata Elxsi Ltd. are also to be excluded as comparables while determining the ALP of the international transaction impugned in this appeal."

8.3.2 As far as the company **Tata Elxsi Ltd**., is concerned, following the decision of the co-ordinate bench of this Tribunal in the case of Huawei Technologies India Pvt. Ltd. for Assessment Year 2006-07 (supra), we hold and direct that this company be excluded from the list of comparables for the software development services of the assessee. It is ordered accordingly."

In view of the above discussion, as well as the decision of the co-ordinate bench, we direct the A.O./TPO to exclude this company from the set of comparables for determining the ALP.

14. **Additional Grounds.**

14.1 The assessee has also sought the exclusion of certain more companies from the list of comparables in the additional grounds raised before this Tribunal. The companies sought to be excluded are discussed as under :

14.2 As regards **M/s. Aztec Software & Technology Services Ltd. & Megasoft Ltd**, since these two companies have not satisfied with the filter of RPT at 15%, therefore, in view of the consistent view taken by the Tribunal and our finding in the foregoing paragraphs, these two companies stand excluded from the list of comparables.

14.3 In the additional grounds, the assessee is also seeking exclusion of some more companies on the ground of turnover filter. The turnover filter was neither applied by the assessee nor by the TPO for selecting comparable companies. Further, the assessee did not raise any such objection either before the TPO or before the DRP. Thus, this plea raised by the assessee does not pertain to any finding of the authorities below and therefore this issue does not emanate from the orders of the authorities below. Moreover, the assessee company sought exclusion of selected companies from the list of comparables of the TPO on the ground of turnover filter. If such a criteria has to be applied in selection of the comparables then, all the comparables selected by the TPO are to be tested by applying such filter of turnover. The assessee cannot be permitted to pick and choose certain companies on the ground of turnover filter which supports the interest of the assessee Even otherwise, the turnover filter of Rs.1 Crore to Rs.200 Crores as sought by the assessee if applied will give absurd results which are not acceptable as per the minimum common logic. Applying such a filter of turnover of Rs.1 Crore to Rs.200 Crores, means that difference of 200 times of turnover is acceptable for selecting the company but at the same time it defies the said criteria when a company of Rs.200 Crores turnover cannot be compared with that of a company of Rs.201 Crores turnover despite the difference is only Rs.1 Crore. Therefore, on this basic and fundamental analysis of

this filter, it is apparent that if such filter of turnover is applied, it will give absurd results. Even otherwise, if 200 times multiple is accepted for selecting comparables and applied the same ratio to the turnover of the assessee which is above Rs.18 Crores, a company of up to Rs.3,600 crores would be considered as a good comparable which itself defies this filter of Rs.1 Crore to Rs.200 Crores. In view of the above facts and circumstances of the case on hand, we decline to grant leave to the assessee to raise this new plea of applying turnover filter on the selective companies.

14.4 However, the plea taken by the assessee in the additional ground regarding the functional dis-similarity even in respect of those comparables selected by the assessee itself cannot be rejected merely on the ground that the assessee has raised its plea for the first time at this stage because if a particular company is found functionally not comparable with the assessee ought to have been excluded from the set of comparables to avoid incorrect results. Even otherwise, in case if the assessee commits some mistakes in the assessment proceedings that results incorrect assessment of the tax liability then the assessee cannot be barred from raising such a plea at the appellate stage in order to assess correctly the tax liability of the assessee. We find that the functional comparability of these companies namely **Accel Transmatics Ltd., Geometric Software Ltd., Flextronic Software System Ltd. and Infosys Technologies Ltd.** has been examined in a number of cases by this Tribunal and therefore in view of the findings of the Tribunal on the issue of comparability of these companies, we incline to admit the additional grounds of the assessee raising objection on the ground of functional dis-similarity of these companies mentioned (supra) for deciding the issue on merits.

15. Accel Transmatics Ltd. (Seg.)

15.1 Though this company was part of the T.P. analysis of the assessee and also part of the 44 comparables selected by the assessee itself for bench marking its international transactions, however, the assessee objected the inclusion of this company in the list of comparables selected by the TPO on the ground that this company is functionally not comparable. The TPO as well as DRP rejected the contentions of the assessee.

15.2 Before us, the learned Authorised Representative of the assessee has submitted that the assessee is seeking exclusion of this company as this company provides software design and development product services. Since this is a software product company and therefore is functionally dis-similar to the assessee. Therefore, this company is not a good comparable for the purpose of determining the ALP. The learned Authorised Representative has submitted that as per the Annual Report of this company, it is engaged in the product manufacturing activity as well as diversified business activity like **transmatic system, technology, Accel International Transactions Academy and Accel Studio**. He has further contended that the functional comparability has been considered by the Tribunal in a number of cases and it was held that this company is functionally dis-similar to the software development services provider company. In support of his contention, he has relied upon the following decisions :-

CASES PERTAINING TO ASSTT. YEAR : 2006 - 07	CASES PERTAINING TO OTHER ASSTT. YEARS
Cypress Semiconductor technology India Private Limited IT (TP) A No 1167/Bang 2010	Conexant Systems India Pvt. Ltd (AY 2006-07 & 2007-08) (ITA No. 1429/Hyd/2010, ITA No. 1978/Hyd/2011.

Verisign Services India Private Limited IT(TP)A No 1404 bang 2010	Logica Pvt. Ltd. Vs ACIT (ITA No. 1129/Bang/2011)
Misys Software Solutions India Private Limited ï IT(TP) A No.1425/Bang/2010	Triology E-Business Software India Pvt. Ltd. Vs DCIT in IT A No. 1054/Bang/2012 (AY ï 2007-08)
Thoughtworks Technologies (India) Private Limited- IT(TP)A No.1326/Bang/ 2010	

15.3 On the other hand, the learned Departmental Representative has submitted that this company was part of the T.P. analysis of the assessee and the assessee did not object the comparability of this company before the authorities below. Therefore, this company cannot be excluded from the list of comparables when the assessee itself has selected this company as a comparable. She has relied upon the orders of the authorities below.

15.4 We have considered the rival submissions as well as the relevant material on record. Though this company was part of the T.P. analysis of the assessee and also included in the comparables selected by the assessee however, the functional comparability of the company has been examined by this Tribunal in a series of decisions and it has been consistently held that this company cannot be considered as functional comparable to a pure software development services provider. The Tribunal in a number of decisions as relied upon by the assessee mentioned (supra) has given this consistent finding. In the case of Misys Software Solutions Pvt. Ltd. (supra), the functional comparability has been examined by the Tribunal in paragraphs 7.2 to 7.4.2 which is reproduced below :-

*" 7.2 (5) **Accel Transmatics Ltd.***

This company was selected as a comparable by the TPO and was retained as a comparable even though the assessee objected to its inclusion before the DRP. It is the contention of the assessee that the above company is functionally different from the companies engaged in business of providing software development services to its AEs. It is submitted that apart from software development services, this company is engaged in

provision of Accel Animation Studies Services in the form of ACCEL IT and ACCEL Animation Services for 2D and 3D Animation. It was also engaged in various business activities, some of which are Ushus Technologies – for off shore development centre for embedded software network system, imaging technologies; Accel IT Academy for training services in hardware and networking, VLSI designs, CAD/CAM/BPO, etc., the learned Authorised Representative for the assessee contends that in view of the above services rendered, it is evident that this company is functionally different from the assessee in the case on hand and therefore ought to be excluded from the list of comparables to the assessee. In support of this contention, the learned Authorised Representative for the assessee placed reliance on the decision of the co-ordinate bench of this Tribunal in the case of Huawei Technologies India Pvt. Ltd. for Assessment Year 2006-07 (supra).

7.3 Per contra, the learned Departmental Representative supported the orders of the TPO in including these two companies as comparables to the assessee in the case on hand.

7.4.1 We have heard the rival contentions and perused and carefully considered the material on record, including the judicial pronouncement relied on by the assessee. We find that the co-ordinate bench of this Tribunal in the case of Huawei Technologies India Pvt. Ltd. for Assessment Year 2006-07 (supra) has excluded these two companies from the list of comparables to assessee's engaged in the software development services as they are functionally different. At paras 12 and 13 of its order, the co-ordinate bench has held as under :-

ñ12. In so far Kals Info Systems Ltd., and Accel Transmatics Ltd. chosen by the TPO as comparables, this Tribunal in the case of Triology E-Business Software India Pvt. Ltd. (supra) has taken a view that these companies are not comparable to the software service provider companies as they are functionally different. The following are the relevant observationsof the Tribunal in this regard :-

(d) 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 repot, the salary cost debited under the software development expenditure was Rs. 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 Tribunalôs decision of the ITAT in the case of Bindview India Private Limited Vs. DCI, ITA No. ITA No 1386/PN/1O 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:

ñ16. 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.ò

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.

(e) 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:

ñIn 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 assesseeôs 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.ò

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 ld. counsel for the assessee was that if the above company should not be considered as comparable. The ld. 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 ld. counsel for the assessee, has accepted that this company was not comparable in the case of the assesses 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."

13. In view of the aforesaid decision of the Tribunal, Kals Info Systems Ltd., and Accel Transmatics Ltd. are to be excluded for the purpose of comparison while determining the ALP of the impugned transaction in this appeal. It is ordered accordingly."

7.4.2 Following the aforesaid decision of the co-ordinate bench of this Tribunal in the case of Huawei Technologies India Pvt. Ltd. for Assessment Year 2006-07 (supra), we hold and direct that these two companies, namely KALS Infosystems Ltd. and Accel Telemetrics Ltd. are to be excluded from the set of comparable companies for the software development services segment of the assessee."

In view of the different business activities of this company as referred in the Annual Report of this company as well as the consistent finding of this Tribunal in the cases cited (supra), we direct the A.O./TPO to exclude this company from the list of comparables for the purpose of determining the ALP.

16. **Infosys Technologies Ltd.**

16.1 The learned Authorised Representative of the assessee has submitted that the assessee had opposed inclusion of this comparable before the TPO on the ground that this company has substantial intangible assets, profits earned predominantly due to brand value and has large focus on R&D apart from substantial selling and

marketing expenses. This company has a finance BPO and there is no sub-segment in the software segment. The learned Authorised Representative has referred to the Annual Report of this company and submitted that this company has brands and intangibles having diversified operations at large scale. Further this company is engaged in the development of mixed products like Finacle. This company is carrying out a large scale R&D activities and therefore cannot be considered as a good comparable with the assessee. The learned Authorised Representative has relied upon the following decisions :-

CASES PERTAINING TO ASSTT. YEAR : 2006 - 07	**CASES PERTAINING TO OTHER ASSTT. YEARS**
Cypress Semiconductor technology India Private Limited IT (TP) A No 1167/Bang 2010	Triology E ï Business Software India Pvt. Ltd vs. DCIT ITA No. 1054/BANG/2012 (AY : 2007-08)
Agnity India Technologies Pvt Ltd ITA No. 3856(Del ITAT)/2010 (AY 2006-07)	24/7customer.com vs DCIT (AY : 2004-05) ITA No.227/Bang/2010
Agnity India Technologies P. Ltd. (ITA No. 1204/2011)(Del HC)	Adaptec India Private Limited (AY : 2007-08) ITA No. 1801/Hyd/09.
Misys Software Solutions India Private Limited ï IT(TP) A No.1425/Bang/2010 ï Turnover	Mercedes Benz R & D India Pvt. Ltd. (AY : 2007-08) ITA No. 1222/Bang/2011.
Verisign Services India Private Limited IT(TP)A No 1404 bang 2010 - Turnover	CSR India Pvt. Ltd. (AY : 2007-08) ITA No. 1119/Bang/2011, [2013]
Thoughtworks Technologies (India)Private Limited- IT(TP)A No.1326/Bang/2010 - Turnover	Witness Systems Software India Pvt Ltd (AY : 2007-08) ITA No. 1366/Bang/2011.
	FOR CASES INVOLVING JOINT OPERATION, LARGE INTANGIBLES, HIGH BRAND VALUE, RISK BEARING & HIGH PROFIT MARGIN CASES
	Agnity India Technologies Pvt Ltd ITA No. 3856(Del)/2010], ITAT Delhi" This ruling has been upheld by the High Court (ITA No. 1204/2011, dated July 2013). Scale of operation, brand value etc.
	NTT Data India Enterprise Application Services Pvt. Ltd. [ITA No. 1612/Hyd/2010.]
	Motorola India Electronics Private Limited vs. ACIT ITA No. 1274 & 1413/Bang/2008.
	Logica Pvt. Ltd. Vs ACIT (ITA No. 1129/Bang/2011

16.2 On the other hand, the learned Departmental Representative has submitted that the TPO has taken the segmental data of this company which are functionally similar to that of the assessee. She has relied upon the orders of the authorities below.

16.3 We have considered the rival submissions as well as the relevant material on record. There is no dispute that Infosys Technologies Ltd. has big brand value and intangibles and also engaged in diversified operations at large scale apart from the software development services. This company also engaged in the development of mixed products. Therefore, the revenue earned by this company in this segment is from various diversified activities including the development of product which is owned by this company. Apart from this, it is also engaged in the R&D activity and therefore this company is not functionally comparable with the assessee which is purely software development services provider company and does not have any brand or intangibles. The co-ordinate bench of this Tribunal in the case of Cypress Semi-conductor Ltd. has considered the functional comparability of this company in paragraphs 15 & 16 are as under :-

15. As far as the comparable chosen by TPO viz., Infosys Limited is concerned, it has been held by the co-ordinate bench of ITAT Bangalore in the case of Logica Pvt.Ltd. Vs. ACIT ITA No.1129/Bang/2011 (AY 07-08) that this company is a full fledge risk assuming entrepreneur, holds technology and marketing intangible and is functionally different providing end-to-end solutions encompassing technical consulting, design, development, re-engineering, maintenance, systems integration and package evaluation and implementation. The company generates around 3.96% of its revenue from software products. The relevant observations of the Tribunal in the case of Logical Pvt. Ltd. (supra) were as follows:

ñ13. So also, the comparables listed at Sl.Nos. 10, 14 and 26 have to be rejected as functionally not comparable with that of the assessee in view of the decision of the Mumbai Bench of the Tribunal in the case of *Telcordia Technologies India Private Ltd.*

in ITA No.7821/MUM/2011, wherein it was held as under:-

ñ7.2 Lucid Software Limited

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7.4 Infosys Technologies Ltd.:

The parameter for identifying comparable entity has to be seen from the angle of functions formed by the company, size of the company in terms of the sale revenue, stage of business cycle and companyôs growth cycle. In the case of Infosys, there are huge intangible assets which as per the information provided by the learned AR are valued at Rs.69,522 crores, which comprises of brand value itself at Rs.22,915 crores. Based on such fund valuation, the profit of Infosys is predominantly due to its premium branding. It is Indiaôs No.2 software service exporter and Third in the World as an IT Service company. It is a giant company which is evident from its revenue fund from the sales which itself is more than Rs.13145 crores and expenditure on advertisement/sales promotion and expenditure on R&D is at Rs.69 crores and Rs.167 crores respectively, whereas in the case of the assessee the revenue is only 10.7 crores with no expenditure on advertisement, sales and promotion etc., which are borne by the associated enterprises. Even from the test of õFARôie. function performed, assets employed and risk assumed, comparability analysis miserably fails in this case. The comparison of function and profile as has been reproduced in para 6(iv) above, mostly shows that the profit level indicators in relation to return of cost, return of sales and return of assets are huge between Infosys and the assessee company and therefore, the Infosys cannot be treated as comparable entity for making comparability analysis with the assessee company. The comparability of lnfosys Technology of the company as that of an assessee has been dealt with ITAT Delhi Bench in the case of óAgnity India Technologies Private Limitedô(ITA No.3856/Delhi/2010), wherein it was held that lnfosys is a giant in the area of development of software and it assumes all risks, leading to higher profit and cannot be compared with the company which is a captive unit of its parent company assuming only limited currency risk. In view of the above finding, we hold that the Infosys cannot be taken as a comparable for determining the arms length price in the case of the assessee.ò

16. Respectfully following the decision of the Tribunal referred to above, we direct Infosys Limited should be excluded from the list of comparable companies chosen by the TPO. We order accordingly.ò

Thus it was found that this company is functionally dis-similar to the software development service provider company as it provides end to end solutions in technical consultancy, design, development, re-engineering, maintenance, system integration and implementation. This company also generates revenue from the software products and has brand value and huge intangible assets. In view of the above facts and circumstances as discussed above, this company is functionally not comparable with that of the assessee. Accordingly, we direct the A.O./TPO to exclude this company.

17. **Flextronics Software System Ltd.**

17.1 The assessee has opposed inclusion of this comparable before the TPO on the ground that it is engaged in the R&D development activity giving rise to IPR. The TPO did not accept the contention of the assessee and obtained the information by invoking the provisions of section 133(6) of the Income Tax Act, 1961 (in short 'the Act'). The TPO held that this comparable has a software development services segment and therefore is functionally similar to the business activity of the assessee in providing software development services. The DRP has concurred the view of the TPO.

17.2 Before us, the learned Authorised Representative of the assessee has submitted that apart from the turnover dis-similarity, this company is also not functionally comparable with the assessee.

17.3 On the other hand, the learned Departmental Representative has submitted that the TPO has used the segmental data of this company and given a finding that this company is functionally comparable with the assessee. He has relied upon the orders of the TPO and DRP.

17.4 Having considered the rival submissions and relevant material on record, we note that the objection raised by the assessee regarding the activity of this company in R&D and also acquiring IPRs has not been dealt with by the authorities below. Accordingly, in the facts and circumstances of the case, we direct the A.O/TPO to re-adjudicate this issue after considering the objections of the assessee on functional dis-similarity.

17.5 Since we have directed to exclude certain comparables from the set of comparables, therefore, the TPO/A.O is directed to recompute the ALP, as directed above.

18. The next ground of the assessee is regarding not allowing the deduction of telecommunication and conveyance charges incurred in foreign exchange outside India while computing the total turnover of the company for the purpose of computing the deduction under Section 10A of the Act.

18.1 We have heard the learned Authorised Representative and learned Departmental Representative and considered the relevant material on record. At the outset we note that this issue is covered in favour of the assessee by the decision of the Hon'ble jurisdictional High Court of Karnataka in the case of CIT V Tata Elxsi Ltd & Others (2011) 247 CTR 334 (Karnataka) wherein it has been held that while computing the exemption u/s 10A, if the export turnover in the numerator is to be arrived at after excluding certain expenses, the same should also be excluded from the total turnover in the denominator. The relevant finding of the Hon'ble jurisdictional High Court reads as follows:-

".....Section 10A is enacted as an incentive to exporters to enable their products to be competitive in the global market and consequently earn precious foreign exchange for

the country. This aspect has to be borne in mind. While computing the consideration received from such export turnover, the expenses incurred towards freight, telecommunication charges, or insurance attributable to the delivery of the articles or things or computer software outside India, or expenses if any incurred in foreign exchange, in providing the technical services outside India should not be included. However, the word total turnover is not defined for the purpose of this section. It is because of this omission to define 'total turnover', the word 'total turnover' falls for interpretation by this Court;

……..In section 10A, not only the word 'total turnover' is not defined, there is no clue regarding what is to be excluded while arriving at the total turnover. However, while interpreting the provisions of section 80HHC, the courts have laid down various principles, which are independent of the statutory provisions. There should be uniformity in the ingredients of both the numerator and the denominator of the formula, since otherwise it would produce anomalies or absurd results. Section 10A is a beneficial section which intends to provide incentives to promote exports. In the case of combined business of an assessee, having export business and domestic business, the legislature intended to have a formula to ascertain the profits from export business by apportioning the total profits of the business on the basis of turnovers. Apportionment of profits on the basis of turnover was accepted as a method of arriving at export profits. In the case of section 80HHC, the export profit is to be derived from the total business income of the assessee, whereas in section 10-A, the export profit is to be derived from the total business of the undertaking. Even in the case of business of an undertaking, it may include export business and domestic business, in other words, export turnover and domestic turnover. To the extent of export turnover, there would be a commonality between the numerator and the denominator of the formula. If the export turnover in the numerator is to be arrived at after excluding certain expenses, the same should also be excluded in computing the export turnover as a component of total turnover in the denominator. The reason being the total turnover includes export turnover. The components of the export turnover in the numerator and the denominator cannot be different. Therefore, though there is no definition of the term 'total turnover' in section 10A, there is nothing in the said section to mandate that, what is excluded from the numerator that is export turnover would nevertheless form part of the denominator. When the statute prescribed a formula and in the said formula, 'export turnover' is defined, and when the 'total turnover' includes export turnover, the very same meaning given to the export turnover by the legislature is to be adopted while understanding the meaning of the total turnover, when the total turnover includes export turnover. If what is excluded in computing the export turnover is included while arriving at the total turnover, when the export turnover is a component of total turnover, such an interpretation would run counter to the legislative intent and impermissible. Thus, there is no error committed by the Tribunal in following the judgments rendered in the

context of section 80HHC in interpreting section 10A when the principle underlying both these provisions is one and the same".

Respectfully following the judgment of Hon'ble jurisdictional High Court, we decide this issue in favour of the assessee.

19. The next issue in appeal is regarding not allowing deduction under Section 10A of the Act before set off of brought forward business losses.

19.1 The learned AR of the assessee has relied upon the decision of the Hon'ble jurisdictional High Court in the case of CIT vs. Yokogawa India Ltd. & others (341 ITR 385) as well as the decision in the case of CIT vs. M/s.Auringene Discovery Technologies Ltd. in ITA No.549/2013 dated 05/09/2014 and submitted that the Hon'ble High Court has reiterated the view taken in the case of Yokogawa India Ltd.(supra). He has also relied upon the decision of this Tribunal dated 30/4/2014 in the case of CIT vs. M/s.Biocon Ltd. in ITA Nos.248, 368 to 371 & 1206/2010.

19.2 On the other hand, learned Departmental Representative has relied upon the decision of the Hon'ble jurisdictional High Court in the case of *CIT vs. Himatsinghika Seide Ltd.* (156 Taxman 151) and submitted that the decision of the jurisdictional High Court has been confirmed by the Hon'ble Supreme Court and the SLP filed by the assessee has been dismissed.

19.3 We have considered the rival submissions as well as the relevant material on record. There is no dispute that the Hon'ble jurisdictional High Court in the case of *Himatsinghika Seide Ltd.* (supra) had decided this issue in favour of the revenue and against the assessee. However, it is pertinent to note that the said decision of the Hon'ble jurisdictional High Court was in respect of the dispute for the assessment year 1994-95 and there is an amendment in the provisions of sec.10A and 10B of the Act vide Finance Act, 2000 w.e.f. 1/4/2001. By virtue of the amendment and substitution

of provisions of sec.10A and 10B, the incentive u/s 10A and 10B was no longer in the nature of exemption but it is in the nature of deduction. By considering the amendment/substitution of sec. 10A and 10B vide Finance Act, 2000 w.e.f. 1/4/2001, Hon'ble jurisdictional High Court vide judgment in the case of Yokogawa India Ltd.(supra) has held in paras.16 to 23 as under:

> **"16.** The substituted s. 10A continues to remain in Chapter III. It is titled as "Incomes which do not form part of the total income". It may be noted that when s. 10A was recast by the Finance Act, 2001 (sic-2000), the Parliament was aware of the character of relief given in Chapter III. Chapter III deals with incomes which do not form part of total income. If the Parliament intended that the relief under s. 10A should be by way of deduction in the normal course of computation of total income, it could have placed the same in Chapter VI-A which houses the sections like 80HHC, 80-IA, etc. The Parliament was aware of the various restricting and limiting provisions like s. 80A and s. 80AB which were in Chapter VI-A which do not appear in Chapter III. The fact that even after its recast, the relief has been retained in Chapter III indicates the intention of Parliament that it is to be regarded as an exemption and not a deduction. The Act of the Parliament in consciously retaining this section in Chapter III indicates its intention that the nature of relief continues to be an exemption. Chapter VII deals with the incomes forming part of the total income on which no income-tax is payable. These are the incomes which are exempted from charge, but are included in the total income of the assessee. The Parliament despite being conversant with the implications of this chapter, has consciously chosen to retain s. 10A in Chapter III.
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> **17.** If s. 10A is to be given effect to as a deduction from the total income as defined in s. 2(45), it would mean that s. 10A is to be considered after Chapter VI-A deductions have been exhausted. The deductions under Chapter VI-A are to be given from out of the gross total income. The term "gross total income" is defined in s. 80B(5) to mean the total income computed in accordance with the provisions of this Act, before making any deduction under this chapter. As per the definition of gross total income, the other provisions of the Act will have to be first given effect to. There is no reason why reference to the provisions of the Act should not include s. 10A. In other words, the gross total income would be arrived at after considering s. 10A deduction also. Therefore, it would be inappropriate to conclude that s. 10A deduction is to be given effect to after Chapter VI-A deductions are exhausted.

18. It is after the deduction under Chapter VI-A that the total income of an assessee is arrived at. Chapter VI-A deductions are the last stage of giving effect to all types of deductions permissible under the Act. At the end of this exercise, the total income is arrived at. Total income is thus, a figure arrived at after giving effect to all deductions under the Act. There cannot be any further deduction from the total income as the total income is itself arrived at after all deductions.

19. From the aforesaid discussion it is clear that the income of 10A unit has to be excluded before arriving at the gross total income of the assessee. The income of 10A unit has to be deducted at source itself and not after computing the gross total income. The total income used in the provisions of s. 10A in this context means the global income of the assessee and not the total income as defined in s. 2(45). Hence, the income eligible for exemption under s. 10A would not enter into computation as the same has to be deducted at source level.

2nd substantial question of law

20. Prior to the introduction of sub-s. (6) of s. 10A and s. 10B by the Finance Act, 2000, which came into effect from 1st April, 2001, in computing the total income of the assessee of the previous year relevant to the assessment year immediately succeeding the last of the relevant assessment years, or of any previous year, relevant to any subsequent assessment year, sub-s. (2) of s. 32, cl. (ii) of sub-s. (iii), s. 32A cl. (ii) of sub-s. (3) of s. 32A, cl. (ii) of sub-s. (2) of s. 33 and sub-s. (4) of s. 35 of the Act or the second proviso to cl. (ix) of sub-s. (1) of s. 36 shall not be applicable in relation to any such allowance or deduction. Similarly no loss as referred to in sub-s. (1) or in s. 72 or sub-s. (1) or sub-s. (3) of s. 74 insofar as such loss relates to the business of the undertaking was permitted to be carried forward or set off where such loss relates to any of the relevant assessment years.

21. It is in this background the Finance Act, 2003 was introduced by inserting the words "the year ending upto the first day of April, 2001", for that in cls. (1) and (2) of sub-s. (6) restricting the disallowance only upto the first day of April, 2001 and granting the benefit, of those provisions even in respect of units to which ss. 10A and 10B are applicable. The Finance Act, 2003, amended this sub-section with retrospective effect from 1st April, 2001 by lifting the embargo in the aforesaid clauses in respect of depreciation and business loss relating to the asst. yr. 2001-02 onwards. The amendment indicates the legislative intention of providing the benefit of carry forward of depreciation and business loss relating to any year of the tax holiday period to be set off against income of any year post tax holiday. This is supported by Circular No. 7 of 2003 [(2003) 184 CTR (St) 33] wherein the board has stated that the purpose of amendment is to entitle an assessee to the

benefit of carry forward of depreciation and loss suffered during the tax holiday period. The circular dt. 5th Sept., 2003 reads as under :

> "20. Providing for carry forward of business losses and unabsorbed depreciation to units in Special Economic Zones and 100 per cent export oriented units.
>
> 20.1 Under the existing provisions of ss. 10A and 10B, the undertakings operating in a Special Economic Zone (under s. 10A) and 100 per cent export oriented units (under s. 10B) are not permitted to carry forward their business losses and unabsorbed depreciation.
>
> 20.2 With a view to rationalize the existing tax incentives in respect of such units sub-s. (6) in ss. 10A and 10B has been amended to do away with the restrictions on the carry forward of business losses and unabsorbed depreciation.
>
> The amendments have been brought into effect retrospectively from 1st April, 2001 and have been made applicable to business losses or unabsorbed depreciation arising in the asst. yr. 2001-02 and subsequent years."

22. It is interesting to note that such relaxation has not been made in s. 10C which provides for exemption in respect of profits of certain undertakings in north eastern region. This makes clear the legislative intention of providing relaxation wherever it deems fit and in the present case, such relaxation has been made in s. 10A but not in s. 10C.

23. It is to be noted that the aforesaid amendment read with the Board circular does not militate against the proposition that the benefit of relief under this section is in the nature of exemption with reference to the commercial profits. However, in order to give effect to the legislative intention of allowing the carry forward of depreciation and loss suffered in respect of any year during the tax holiday for being set off against income post tax holiday, it is necessary that the notional computation of business income and the depreciation as per the provisions of the Act should be made for each year of the tax holiday period. While so computing, attention will have to be given to provisions of ss. 70, 71, 72 and s. 32(2). The amount of depreciation and business loss remaining unabsorbed at the end of the tax holiday period should be determined so that the same may be set off against the income post tax holiday period.

19.4 We further note that this view has been reiterated by the Hon'ble jurisdictional High Court in the case of M/s.Aurigene Discovery Technologies Ltd., in ITA

No.549/13. A similar issue was considered by the co-ordinate bench of this Tribunal in the case M/s.Biocon Ltd. (supra) and held in para.23 to 26 as under:

> "23. We have given a very careful consideration to the rival submissions. The issue raised by the assessee in ground no.21 is identical to the ground raised by the assessee in Biocon (supra). The facts of the case before the Tribunal in the case of Biocon (supra) were that the assessee during the previous year had four units which were entitled to claim deduction u/s. 10B of the Act viz., CMZ Unit, SAP Unit, RHI Unit and IFP Unit. The assessee had claimed deduction u/s. 10B of the Act in respect of the aforesaid units totaling Rs.157,22,33,066 which is the sum total of deduction u/s. 10B for the four units as follows:-
>
> | | | |
> |---|---|---|
> | (1) CMZ Unit | : | 6,87,70,229 |
> | (2) SAP Unit | : | 76,60,29,880 |
> | (3) RHI Unit | : | 52,42,56,278 |
> | (4) IFP Unit | : | 21,31,76,679 |
> | Total | | 157,22,33,066 |
>
> The assessee had non-10B units as well. In those non-10B units, there was a loss of Rs.105,92,19,172. In the return of income filed by the assessee, the assessee sought to carry forward the loss of non-10B units for set off against the profits of non-10B units in the subsequent assessment years. The AO firstly noticed that there was income from other sources to the extent of Rs.4,71,15,896 and such had to be set off against the loss of the non-10B units. Accordingly, the AO held that the loss of the non-10B units that had to be considered for carry forward would be Rs.101,21,03,280. Thereafter, the AO was of the view that income of the 10B units had to be set off against the loss of the non-10B units and if it is so set off, there will be no loss that needs to be carried forward. In coming to the aforesaid conclusion, the AO expressed the opinion that provisions of section 10B are deduction provisions and therefore effect will have to be given to the provisions of section 72 of the Act, even in respect of profits of the 10B unit. Accordingly, the claim of the assessee for carry forward of loss of non-10B unit was not allowed by the AO. On appeal by the assessee, it was contended that the provisions of section 10A and section 10B are exemption provisions and therefore the profit of 10A and 10B units will not enter the computation of total income at all and therefore the profits of these units need not be set off against the loss of non-10B unit by invoking the provisions of section 72 of the Act. The CIT(Appeals) did not agree with the contention of the assessee and in doing so, he placed reliance on the decision of the Hon'ble Karnataka High Court in the case of CIT v. Himatsingike Seide Ltd., 286 ITR 255 (Kar). In the aforesaid decision, the Hon'ble High Court has taken the view that deduction u/s. 10B has to be allowed after set off of unabsorbed depreciation and unabsorbed investment allowance. The

Hon'ble Court took the view that the aforesaid provision was only an exemption provision. The CIT(Appeals) noticed that the aforesaid decision was followed by the ITAT Bangalore Bench in the case of Intelnet Technologies India Pvt. Ltd. v. ITO, ITA No.1021/Bang/2009 dated 12.3.2010. Similar view expressed by the Delhi Bench of the Tribunal in the case of Global Vantage Pvt. Ltd. v. DCIT, 2010 TIOL 24 ITAT (DEL) was also referred to by the CIT(A). A contrary view was expressed by the Bangalore Bench of the Tribunal in the case of KPIT Cummins Info Systems (Bangalore) Pvt. Ltd. v. ACIT, 120 TTJ 956. The CIT(A) found that in the case of Global Vantage Pvt. Ltd. (supra) decided by the Delhi Tribunal this decision has been held to be not in tune with the decision of the Hon'ble High Court of Karnataka in the case of Himatsingike Seide Ltd. (supra). The CIT(A) also referred to the decision of the Chennai Bench of the Tribunal in the case of Sword Global India Pvt. Ltd. v. ITO, 306 ITR 286 (AT), wherein the provisions of section 10A and 10B have been held to be deduction provisions and not exemption provisions. For all the above reasons, the CIT(Appeals) confirmed the order of the Assessing Officer. Against the order of the CIT(A), the Assessee was in appeal before the Tribunal.

25. This Tribunal dealt with the issue in the following words :

> 63. We have given a careful consideration to the rival submissions. The issue as to whether the provisions of Sec.10B of the Act are deduction provisions or exemption provisions will assume great importance. The reason is that if the provisions are considered as exemption provisions then they will not enter the computation of total income and therefore the loss of the eligible unit cannot be set off against the profits of the non-eligible unit. This issue has already been settled by the Hon'ble Karnataka High Court in the case of Yokogawa India Ltd. (supra). The Hon'ble Karnataka High Court in the case of Yokogawa (supra) had to deal with two substantial question of law. The first substantial question of law was on the right of set off of loss of non-eligible unit against the profit of the eligible unit on which deduction u/s.10B was to be allowed. The Hon'ble Court in para 10 to 20 of its judgment dealt with the issue. The Hon'ble Court noticed that Sec.10-A(1) of the Act (which is in pari materia with Sec.10-B of the Act) read as follows:
>
> > "10B. Special provisions in respect of newly established undertaking in free trade zone etc.,-(1) Subject to the provisions of this section, a deduction of such profits and gains as are derived by undertaking from the export of articles or things or computer software for a period of ten consecutive assessment years beginning with the assessment year relevant to the Previous-year

> in which the under-taking begins to manufacture or produce articles or things or computer software, as the case may be, shall be allowed from the total income of the assessee :"
>
> (emphasis supplied)

64. The expression "Deduction" and "shall be allowed from the total income of the Assessee" used in the aforesaid provisions was considered by the Hon'ble High Court and it held in para 13 to 15 of its judgment that the expression " shall be allowed from the total income of the Assessee" does not mean total income as defined u/s.2(45) of the Act but that expression means "profits and gains of the STP undertaking as understood in its commercial sense or the total income of the STP unit. Thus the view expressed is that income of the STP undertaking gets quarantined and will not be allowed to be set off against loss of either another STP undertaking or a non STP undertaking. The Hon'ble Court thereafter held that though the expression used in Sec.10A was "Deduction" but in effect it was only an exemption section. These conclusions clearly emanate from para 17 of the Hon'ble Court's judgment.

65. The situation with which we are concerned in the present case is a situation where there is positive income of the eligible unit then the same should be allowed deduction u/s.10B of the Act without setting of the loss of non-eligible unit. The Hon'ble Karnataka High Court in the case of Yokogawa (supra) was concerned with similar situation as set out above. In view of the aforesaid decision of the Hon'ble Karnataka High Court, we are of the view that the claim as made by the Assessee for carry forward of loss of the non-eligible unit had to be allowed without set off of profits of the 10A/10B unit. We hold accordingly and allow the relevant grounds of appeal of the Assessee.

66. We may also observe that the Hon'ble Karnataka High Court's decision in the case of Himatasingike Seide (supra) has held that unabsorbed depreciation (and business loss) of same (s. 10A/10B) unit brought forward from earlier years have to be set off against the profits before computing exempt profits. The assessee in that case set up a 100% EOU in AY 1988-89. For want of profits it did not claim benefits u/s 10B in AYs 1988-89 to 1990-91. From AY 1992-93 it claimed the said benefits for a connective period of 5 years. In AY 1994-95, the assessee computed the profits of the EOU without adjusting the brought forward unabsorbed depreciation of AY 1988-89. It claimed that as s. 10B conferred "exemption" for the profits of

the EOU, the said brought forward depreciation could not be set-off from the profits of the EOU but was available to be set-off against income from other sources. It was also claimed that the profits had to be computed on a "commercial" basis. The AO accepted the claim though the CIT revised his order u/s 263 and directed that the exemption be computed after set-off. On appeal by the assessee, the Tribunal reversed the order of the CIT. On appeal by the department, the High Court in CIT Vs. Himatasingike Seide Ltd. 286 ITR 255 (Kar) reversed the order of the Tribunal and held that the brought forward depreciation had to be adjusted against the profits of the EOU before computing the exemption allowable u/s 10B. In Civil Appeal No.1501 of 2008 dated 19.9.2013 against the aforesaid decision of the Hon'ble Karnataka High Court, the Hon'ble Supreme Court observed as follows while dismissing the appeal:-

> "Having perused the records and in view of the facts and circumstances of the case, we are of opinion that the civil appeal being devoid of any merit deserves to be dismissed and is dismissed accordingly."

67. Thus the ratio has to be confined to the facts and circumstances of the case. The aforesaid observations have to be confined to the facts of that case and as applicable to a case where brought forward losses and depreciation of the very same STP undertaking are not adjusted while arriving at the profits of the 10B unit for allowing deduction u/s.10A/10B of the Act and not in respect of brought forward losses and depreciation of other undertakings/non-10A/10B units. S. 10A/10B(6) as amended by the FA 2003 w.r.e.f. 1.4.2001 provides that depreciation and business loss of the eligible unit relating to the AY 2001-02 & onwards is eligible for set-off & carry forward for set-off against income post tax holiday which means that they need not be so set off as mandated in the decision of the Hon'ble Karnataka High Court in the case of Himatasingike Seide Ltd. (supra). As we have already seen, in Yokogawa India Ltd. 341 ITR 385 (Kar), it was held that even after s. 10A/10B were converted into a "deduction" provision w.e.f 1.4.2001, the benefit of relief u/s 10A/10B is in the nature of "exemption" with reference to "commercial profits" and that as the income of the s. 10A unit has to be excluded at source itself before arriving at the gross total income, the question of setting off the loss of the current year's or the brought forward business loss (and unabsorbed depreciation) against the s. 10A profits does not arise. Therefore the decision of the Hon'ble Karnataka High Court in the case of

Himatasingike Seide (supra) will not apply to the facts of the present case."

26. In view of the aforesaid decision, we are of the view that the claim made by the assessee deserves to be accepted. We may also observe that CBDT circular No.7 dated 16.07.2013, on the facts and circumstances of the present case is not a benevolent circular vis-à-vis, the assessee, and therefore the decision to the contrary of the Hon'ble Karnataka High Court in the case of Yokogawa India (supra) will continue to apply. For the reasons given above, we direct the Assessing Officer to accept the claim of the assessee, as raised in ground no.21."

19.5 Accordingly by following the latest judgment of the Hon'ble jurisdictional High Court based on the substituted/amended provisions of sec.10A/10B which are applicable in the case of the assessee as well as the decision of the Tribunal in case of Biocon (supra), we decide this issue in favour of the assessee and direct the AO to allow deduction u/s 10A without setting off the domestic losses.

20. In the result, the appeal of the assessee is partly allowed.

Order pronounced in the open court on 13.01.2016.

Sd/-	Sd/-
(INTURI RAMA RAO)	**(VIJAYPAL RAO)**
Accountant Member	Judicial Member

*Reddy gp

Copy to :

1. Appellant
2. Respondent
3. C.I.T.
4. CIT(A)
5. DR, ITAT, Bangalore.
6. Guard File.

(True copy) By Order

Asst. Registrar, ITAT, Bangalore