

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH 'I' NEW DELHI**

**BEFORE SHRI R.S. SYAL, VICE PRESIDENT
AND
SHRI SUDHANSHU SRIVASTAVA, JUDICIAL MEMBER**

**ITA No. 2587/Del/2014
AY: 2007-08**

**Mentor Graphics (India) Private Limited, vs DCIT,
Building-A, Circle-6(1),
Logix Techno Park, New Delhi.
Plot #5, Sector-127,
Noida-201301
(PAN: AABCM5494Q)
(Appellant) (Respondent)**

Appellant by : Shri Himanshu Sinha, Adv.
Ms Vrinda Tulsian, Adv.
Respondent by : Shri Amrendra Kumar, CIT DR

ORDER

PER SUDHANSHU SRIVASTAVA, JUDICIAL MEMBER

This appeal has been preferred by the assessee against the assessment order passed u/s 144C of the Income Tax Act, 1961 ('the Act') subsequent to the directions of the Hon'ble Dispute Resolution Panel-III, New Delhi dated 24.03.2014 and pertains to assessment year 2007-08.

2.0 Mentor Graphics Corporation, USA, hereinafter collectively referred to as 'Mentor Group', along with its affiliates and individually referred to as 'Mentor Corporation' headquartered in Wilsonville, Oregon, USA was incorporated in 1981. It is a technology leader in Electronic Design Automation (EDA)

providing software and hardware design solutions that enable companies to develop better electronic products faster and more cost-effectively. Mentor Group offers innovative products and solutions that help engineers to overcome the design challenges they face in the increasingly complex world of board and chip design. It has the broadest industry portfolio of best-in-class products and is the only EDA Company with an embedded software solution. 59.83% of equity of Mentor India is held by Mentor Graphics Holding Ltd, Ireland a Mentor Group company and 40.17% is held by Mentor Corporation.

2.1 Mentor Graphics (Noida) Private Limited (hereinafter referred to as 'Mentor Noida') was a subsidiary of IKOS Systems Inc, USA which in turn is a subsidiary of Mentor Graphics Corporation. The unit is registered as a Software Technology Park unit in India.

2.2 Mentor India has software development facilities at Hyderabad and Noida. Both Hyderabad and Noida units of the company have been registered with the Software Technology Park of India (STPI). The assessee is engaged in rendering software development and quality analysis services to Mentor Graphics

(Ireland) Limited (Mentor Ireland). It acts as a contract service provider that undertakes software development support and quality analysis services for the Mentor Group. Thus, Mentor India provides value-adding services and hence is entitled to receive a compensation appropriate to the functions performed and capital employed in its business.

2.3 Mentor Group owns virtually all the valuable intellectual property rights (know-how, copyrights, etc.) and other commercial or marketing intangibles (brand names, trademarks and products developed by the group e.g. C-based design, Design for test, Data Management System, etc.) and is involved in complex operations of developing proprietary technologies and marketing of the same. Mentor Group also bears all the significant business and entrepreneurial risks of product acceptability and performance in the market. On the other hand, Mentor India does not own any interest in these intangibles and is a mere service provider.

2.4 During the year under consideration, the relevant international transactions consisted of software development and quality analysis services undertaken by Mentor India for Mentor Group as an independent contractor. Brief facts of the case are that proceedings u/s 147 were initiated by issue of notice u/s

148 dated 19.01.2011 of the I. T. Act, 1961 for the A.Y. 2007-08. During the course of assessment proceedings, it was noticed that the assessee company had entered into international transactions with associate enterprises during the financial year 2006-07 relevant to the A.Y. 2007-08, the aggregate value of which exceeded Rs.15 crores. After obtaining statutory approval from the CIT - IV, Hyderabad, the then AO i.e. ITO, Ward 16(2), Hyderabad referred the matter to the Addl. CIT, Transfer Pricing Hyderabad vide letter dated 15.11.2011. Subsequently, the assessment jurisdiction of the case was transferred to DCIT, Circle 6(1), Delhi. Accordingly, the Transfer Pricing Reference u/s 92CA was also transferred to Addl. CIT, Transfer Pricing Officer, 1-(3). New Delhi. A Draft Order under the provisions of section 144C was served on the assessee on 06.03.2013. The assessee filed its objections before the Hon'ble Dispute Resolution Panel-III, New Delhi on 05.04.2013. The objections of the assessee were disposed of by the Hon'ble Dispute Resolution Panel-III, New Delhi vide order dated 30.12.2013. The Hon'ble Dispute Resolution Panel-III, New Delhi vide its order dated 30.12.2013 has issued directions under section 144C after considering the Transfer Pricing adjustment and other additions made by the

Assessing Officer in the Draft assessment order. The Hon'ble Dispute Resolution Panel-III, New Delhi has directed the TPO to exclude Bodhtree Consulting Ltd from the final set of comparables thereby re-compute the arm's length adjustment of the assessee company. The final set of comparables, as determined by the Hon'ble DRP, is as under -

Sl.No.	Name of the company	OP/OC%
1.	AvaniCimcon Technologies Ltd.	50.28%
2.	Datamatics Ltd.	7.27
3.	E-Zest Solutions Pvt. Ltd.	36.12%
4.	Flextronics Software Systems Ltd.	24.44%
5.	Geometric Lintied	10.71%
6.	Helios & Matheson information Technology limited	40.35%
7.	Infosys Technologies Ltd.	40.30%
8.	KALS Information Systems Limited	30.55%
9.	LGS Global Limited (Lanco Global Systems Limited)	15.75%
10.	Lucid Software Ltd.	18.60%
11.	Mediasoft Solutions Pvt. LTD.	3.66%
12.	MINDtREE Consulting Limited	16.90%
13.	Quintegra Solutions Ltd.	12.56%
14.	Revenue S Software (India) Ltd.	13.47%
15.	SIP Technologies & Exports Ltd.	10.19%

16.	Tata Elxsi Ltd.	26.51%
17.	Thirdware Solutions Ltd.	25.12%
18.	Wipro Limited	33.65%
	Average	23.14%

2.5 In compliance to the directions of the Hon'ble DRP, the TPO has revised the amount of adjustment to Rs.5,99,75,325/- from Rs.11,36,80,487/-as proposed in the draft assessment order.

2.6 Further, there was also a difference of opinion between the assessee and the department on the issue of computation of exemption u/s 10A of the Act without excluding communication expenses of Rs. 3,63,70,508/- from the export turnover. The department was of the opinion that 'Export Turnover' as per Explanation 2 to Section 10A did not include telecommunication charges and, accordingly, deduction u/s 10A was recomputed at Rs. 15,50,62,490/- as against the deduction of Rs. 16,15,31,503/- claimed by the assessee. The Hon'ble DRP did not give any relief to the assessee on this issue also. Now the assessee has approached the ITAT and has raised the following grounds of appeal:-

“ 1. On the facts and in law, the learned Transfer Pricing

Officer (hereinafter referred to as 'Ld. TPO'), the learned Assessing Officer (hereinafter referred to as 'Ld. AO') and the Hon'ble DRP have erred in making an adjustment of Rs. 5,99,75,325 to the value of international transactions pertaining to provision of software development services by the Appellant under Section 92CA(3) of the Income-Tax Act, 1961 ('the Act').

2. On the facts and in law, the Ld. AO/ Ld. TPO and the Hon'ble DRP erred in rejecting the Transfer Pricing ('TP') Documentation maintained by the Assessee u/s 92D of the Act read with Rule 10D of the Rules, inter alia rejecting comparables namely (a) Larsen & Toubro Infotech Limited, (b) ICRA Techno Analytics Limited and (c) Computech International Limited.

3. On the facts and in law, the Ld. AO/ Ld. TPO and the Hon'ble DRP erred in considering a set of 'secret data', i.e. data which was not available in public domain, in arriving at a fresh set of companies using his power under section 133(6) and not sharing the data so obtained with the Assessee, thereby violating the principle of natural justice.

4. On the facts and in law, the Ld. AO/ Ld. TPO and the Hon'ble DRP erred in selecting companies exhibiting very high margins as comparables with a prejudiced intention of making an addition to the returned income of the Appellant, contrary to the provisions of Rule 10B(2) of the Income-Tax Rules.

5. On the facts and in law, the Ld. TPO, the Ld. AO and the Hon'ble DRP erred in violating the provisions of Rule 10B(2) by alleging KALS Information Systems Limited as comparable to the Appellant.

6. On the facts and in law, the Ld. TPO, the Ld. AO and the Hon'ble DRP erred in violating the provisions of Rule 10B(2) by alleging Infosys Technologies Limited as comparable to the Appellant.

7. *On the facts and in law, the Ld. TPO, the Ld. AO and the Hon'ble DRP erred in violating the provisions of Rule 10B(2) by alleging Wipro Limited as comparable to the Appellant.*

8. *On the facts and in law, the Ld. TPO, the Ld. AO and the Hon'ble DRP erred in violating the provisions of Rule 10B(2) by alleging Avani Cimcon Technologies Limited as comparable to the Appellant.*

9. *On the facts and in law, the Ld. TPO, the Ld. AO and the Hon'ble DRP erred in violating the provisions of Rule 10B(2) by alleging Helios & Matheson Information Technology Limited as comparable to the Appellant.*

10. *On facts and in law, the Ld. TPO, the Ld. AO and the Hon'ble DRP erred in law and on facts in not allowing appropriate adjustments under 10B(l)(e)(iii) and Rule 10B(3) to account for differences in risk profile of the comparables vis-a-vis the Appellant.*

11. *On facts and in law, the Ld. AO/ Ld. TPO and the Hon'ble DRP erred in not granting the benefit of reduction/ variation of 5 percent from the arithmetic mean while determining the arm's length price to the Appellant as per the proviso to section 92C(2) of the Act.*

12. *On facts and in law, the Ld. AO/ Ld. TPO and the Hon'ble DRP has erred in proposing to initiate penalty proceedings under Section 271(l)(c) of the Act.*

Corporate Tax

13. *That on facts and in law the Ld. AO/ Hon'ble DRP erred in upholding that while computing deduction under section 10A of the Act, communication expenses of Rs.36,370,508/- are to be excluded from within the ambit of "export turnover" as defined in Explanation 2 (iv) to section 10A of the Act.*

13.1 That on facts and in law the Ld. AO/ Hon'ble DRP erred in not appreciating that recovery of expenses in respect of communication expenses were not included in the figure of "export turnover" considered by the Appellant while computing deduction under section 10A of the Act.

13.2 That notwithstanding and without prejudice to the above, the Ld. AO/ Hon'ble DRP has erred in not reducing the communication expenses from the total turnover (though said expenses have been reduced from export turnover) while computing the deduction under Section 10A of the Act.

13.3 That on the facts and circumstances of the case and in law, the Ld. AO/ Hon'ble DRP has erred in not considering various judicial pronouncements, including the jurisdictional High Court's decision in case of Genpact India and the decision of Hon'ble Income Tax Appellate Tribunal, Hyderabad Bench in Appellant's own case where Hon'ble Income Tax Appellate Tribunal has held that once the communication expenses are excluded from the export turnover by the Ld. AO, the same cannot form part of total turnover also.

The grounds of appeal herein above are independent and without prejudice to each other.

The Appellant craves leave to alter, amend and/ or withdraw all or any of the grounds of appeal herein or add any further grounds as may be considered necessary and to submit such statements, documents and papers as may be considered necessary either before or during the appeal hearing."

3.0 At the outset, the ld. AR submitted that out of the total 18 comparables remaining after the Hon'ble DRP deleted one comparable, the assessee was challenging six comparables which were namely: Infosys, Kals Info Systems Limited (KALS), Tata

Elxsi Limited and Wipro Limited. Ld AR also submitted that out of these six comparables, 3 comparables viz. Infosys, KALS and Tata Elxsi were covered in favour of the assessee in assessee's own case by the order of the ITAT in ITA No. 1565/Hyd/2010 for assessment year 2006-07 wherein the ITAT Delhi '1-2' Bench had directed the exclusion of these three comparables from the final set of comparables. It was further submitted that this order of the Tribunal was confirmed by the Delhi High Court wherein the department's appeal was dismissed vide order dated 2.5.2017 in ITA 318/2017 in Principal Commissioner of Income Tax-VI, New Delhi vs Mentor Graphics India Pvt. Ltd. Ld. AR read out extensively from the order of the ITAT and vehemently argued that these three comparables ought to be excluded this year also as the facts in this year are identical to that in assessment year 2006-07. Ld. AR also submitted that if these three comparables are excluded, then the other three comparables being contended by the assessee viz. Avani Cimcon Technologies, E-Zest Solutions Limited and Wipro Limited need not be argued as the assessee would be within the acceptable range of $\pm 5\%$ and that then the exclusion of these three comparables will become academic in nature.

3.1 On the second issue being raised in appeal by the assessee, the Ld. AR submitted that this issue had also been decided in favour of the assessee by the ITAT in assessee's own appeal for assessment year 2006-07 in ITA No. 1565/Hyd/2010b wherein vide order dated 21.9.2016, ITAT Delhi Bench 'I-1' had ruled that communication charges need to be excluded from both the export turnover as well as from the total turnover for the purpose of computing exemption u/s 10A of the Act. Ld. AR further submitted that this adjudication of the Tribunal had also been upheld by the Hon'ble Delhi High Court in the department's appeal against the said order of the Tribunal in I.T.A. No. 318/2017 vide order dated 2.5.2017.

4.0 Ld. CIT DR placed heavy reliance on the order of the TPO and read out extensively from the same while emphasising that each assessment order has to be looked into on a stand-alone basis and that the exclusion of comparables in the earlier years would not automatically lead to the conclusion that the same merited exclusion in the present year's appeal also.

5.0 We have heard the rival submissions and carefully perused the relevant material placed on record. As far as the issue of comparables is concerned, it is undisputed that the three

comparables viz. Infosys, KALS and Tata Elxsi were excluded by the ITAT in assessee's own case for assessment year 2006-07. The department has not been able to demonstrate that there were factual differences between the assessment year 2006-07 and the year under appeal. The observations of the ITAT while excluding Infosys Ltd. are in Para 5.01 and 5.01.1. The same are being reproduced as under for a ready reference:-

“5.01. Infosys Limited – The Ld. AR has submitted that the TPO has observed that this Company was functionally similar to the assessee company. However, Infosys is engaged in providing software consulting and products, application design, development, re-engineering and maintenance, system integration, package evaluation and implementation and business process management etc. and, therefore, it was not functionally similar to the assessee company as claimed by the TPO. The Ld. AR has further submitted that Infosys Limited has a significant turnover of Rs.9,028 crores which is approx. 125 times the assessee's turnover of INR 72 crores. It was further submitted that Infosys develops/owns proprietary products like Finacle which is not so in the case of the assessee company. It was further submitted that Infosys's brand value stood at Rs. 22,915 crores, while the assessee has no brand value in India. The Ld. AR has also submitted that Infosys has a significant Advertising/Sales promotion and brand building expenditure of INR 499 crores (i.e. 5.53% of revenue). On the

other hand, the assessee does not undertake any AMP expenditure.

5.01.1 It is seen that the ITAT Delhi Bench in Agnity India Technologies P. Ltd. vs. ITO Ward 12(1) in ITA No. 3856/Del/2010 for AY 2006-07 ordered to exclude Infosys from the list of comparables by citing – “It is argued that the case of the assessee is not comparable with Infosys Technologies Ltd., the reason being that the latter is joined in the area of development of software and assumes all risks, leading to higher profit. On the other hand, the assessee is a captive unit of its parent company in the USA and it assumes only limited currency risk. Having considered these points, we are of the view that the case of aforesaid Infosys and the assessee are not comparable at all as seen from the financial data etc. of the two companies mentioned earlier in this order. Therefore, we are of the view that this case is required to be excluded.” This decision of the ITAT was confirmed by the Hon’ble High Court of Delhi in ITA No. 1204/2011. It is also seen that Infosys Limited was rejected in assessee’s own case by the ITAT in ITA No. 2634/Del/2011 for AY 2005-06 and by the Hon’ble DRP in assessment years 2010-11 and 2011-12. Hence, in the light of the above judicial precedent, we order the exclusion of Infosys from the final list of comparables.

5.2 It is also pertinent to note that Infosys Limited was rejected by the ITAT in I.T.A. No. 2634/Del/2011 for assessment year 2005-06 and also by the Hon’ble DRP in assessment year 2010-

11 and 2011-12. Further, the Hon'ble Delhi High Court has confirmed the order of the ITAT for assessment year 2006-07 in which this comparable was directed to be excluded. Accordingly, in light of the above judicial precedent, we order exclusion of Infosys Ltd. from the final list of comparables.

5.3 Similarly, the observations of the ITAT while excluding KALS Info Systems Ltd. are in Para 5.02 and 5.02.1. The same are being reproduced as under for a ready reference:-

“5.02 KALS Info Systems Limited (“KALS”) – The Ld. AR has submitted that this company has been included as a comparable on the ground that it was functionally comparable to the assessee company. It was submitted that this company earns revenue from software products.

5.02.1 The Pune Bench of the ITAT in the case of Bindview India P. Ltd. vs. DCIT in ITA No. 1386/PN/2010 for AY 2006-07 has held that, “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 IT 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.” ITAT Bangalore Bench in Hewlett – Packard (India) Globalsoft P. Ltd. vs. DCIT in IT (TP) No. 1031/Bang/2011 followed the view of the Pune Bench as aforesaid and also excluded this company as a comparable. Taking strength from these judicial precedents and the fact that this company is not functionally comparable to the assessee company, we order exclusion of this company from the final set of comparables.

5.4 The department has not been able to demonstrate that there were factual differences between the assessment year 2006-07 and the year under appeal. Accordingly, we order that KALS be excluded from the final list of comparables.

5.5 Similarly, the observations of the ITAT while excluding Tata Elxsi Ltd. are in Para 5.04 and 5.04.1. The same are being reproduced as under for a ready reference:-

“5.04 Tata Elxsi Limited (“Tata Elxsi”) – The Ld. AR has submitted that this company has been included by the TPO on the ground that it is functionally similar to the assessee company. The Ld. AR has also submitted that this company has software segment and that this segment does not contain any revenue by way of sale of products and, therefore, the

company was not functionally comparable. The Ld. AR has submitted that Tata Elxsi Ltd. has two segments viz. Systems Integration & Support and Software Development & Services.

5.04.1 It is seen that this company was excluded as a comparable on the ground that it was engaged in the development of specialized/niche products in the following rulings: JDA Software India (P) Ltd. Vs. ITO ([2016] 66 taxmann.com 327) (AY 2006-07), Yodlee Infotech P. Ltd. Vs. ITO [TS-63-ITAT-2013(Bang)-TP] (AY 2006-07), HCL EAI Services Ltd. Vs. DCIT [TS-133-ITAT-2013(bang)-TP], Goldman Sachs Services Private Limited [TS-435-ITAT-2015(Bang)-TP] (AY 2006-07), Novell Software Development (India) P. Ltd. [TS-257-ITAT-2016 (Bang)] (AY 2007-08), Telecordia Technologies India P. Ltd. [TS-325-ITAT-2012(Mum)] (AY 2007-08), Virtusa (India) Pvt. Ltd. Vs. DCIT [TS-253-ITAT-2013(HYD)-TP] (AY 2007-08). In Virtusa (India) Pvt. Ltd. Vs. DCIT [TS-253-ITAT-2013(HYD)-TP] the Hyderabad Bench of the ITAT in ITA No. 1962/Hyd/2011 followed the decision of the Mumbai Bench rendered in the case of Telcordia Technologies India P. Ltd. in ITA No. 7821/Mum/2011, wherein the Mumbai Bench had held that, "From the facts and material on record and submissions made by the Ld. AR, it is seen that Tata Elxsi is engaged in development of niche product and development services, which is entirely different from the assessee company. We agree with the contention of the Ld. AR that the nature of the product developed and services provided by this company are different from the assessee as have been narrated above.

Even the segmental details for Revenue sales have not been provided by the TPO so as to consider it as a comparable party for comparing the profit ratio from product and services. Thus, on these facts, we are unable to treat this company fit for comparability analysis for determining the arm's length price for the assessee, hence, should be excluded from the list of comparable parties." Following the aforesaid decisions, this company cannot be considered as comparable with the assessee and we direct exclusion of the aforesaid company from the final list of comparables while determining ALP.

5.6 The department has not been able to demonstrate that there were factual differences between the assessment year 2006-07 and the year under appeal. Accordingly, we order that Tata Elxsi be excluded from the final list of comparables.

5.7 The only other issue remaining for adjudication is inclusion of communication charges in the gross turnover for the purpose of calculating the deduction u/s 10A. This issue is also covered in favour of the assessee by the order of the ITAT in assessee's own case for AY 2006-07 (supra). The relevant paragraph is reproduced here-in-under-

"5.2 Ground Nos. 22.1 to 22.3 agitate the action of the Hon'ble DRP in not accepting the assessee's plea of inclusion of communication charges of Rs. 28,599,470/- in the gross turnover for the purpose of exemption u/s 10A. The assessee company has claimed the deduction u/s 10A in respect of the

two units/undertakings viz. Mentor Hyderabad and Mentor Noida. Mentor Noida was merged with the company w.e.f 1st April, 2005 as per the scheme of merger approved by the Hon'ble High Court of Delhi and Hon'ble High Court of Andhra Pradesh. During the course of assessment proceedings, the assessee had filed an adjusted claim u/s 10A wherein, it had excluded communication expenses both from the total turnover as well as from the export turnover relying on the decision of the ITAT Hyderabad Bench in assessee's own case for AY 2002-03 in ITA No. 696/Hyd/2009 wherein the ITAT, in view of its earlier order in ITO vs. DE Block India Software (P) Ltd (ITA NOs 983 & 984/Hyd/2006) and ITO vs Sak Soft Ltd 313 ITR (AT) 353, had held that while calculating the deduction u/s 10A, if communication charges are excluded from the export turnover, the same are also to be excluded from the total turnover as both the numerator and denominator have to be of the same factor. On this issue, several benches of the ITAT are in favour of the assessee's claim including assessee's own case in Mentor Noida and we are inclined to accept the plea of the assessee that communication charges need to be excluded both from the export turnover as well as from the total turnover for the purpose of computing exemption u/s 10A and we direct the TPO/AO to recalculate the exemption by excluding the amount of impugned communication charges from both the total turnover as well as export turnover. This Ground is accordingly allowed."

5.8 Thus, this issue is also covered in favour of the assessee. Further, this adjudication of the Tribunal had also been upheld by the Hon'ble Delhi High Court in the department's appeal against the said order of the Tribunal in I.T.A. No. 318/2017 vide order dated 2.5.2017. Accordingly, this ground also deserves to succeed and it is allowed accordingly.

6.0 In the final result, the appeal of the assessee stands allowed.

Order pronounced in the open court on 27.09.2017.

Sd/-

Sd/-

(R.S. SYAL)
VICE PRESIDENT

(SUDHANSHU SRIVASTAVA)
JUDICIAL MEMBER

DT. 27th September, 2017
'GS'

Copy forwarded to:-

1. Appellant
2. Respondent
3. CIT(A)
4. CIT
5. DR

By Order

Asstt. Registrar