

IN THE INCOME TAX APPELLATE TRIBUNAL “C” BENCH : KOLKATA

[Before Hon’ble Sri N.V.Vasudevan, JM & Shri M.Balaganesh, AM]

I.T.A No. 587/Kol/2015
Assessment Year : 2010-11

D.C.I.T., Circle-2(2)
Kolkata

(Appellant)

-vs- M/s.Nomura Research Institute &
Financial Technologies Pvt.Ltd.Kolkata
[PAN : AADCA 8967 A]

(Respondent)

I.T.A No. 590/Kol/2015
Assessment Year : 2010-11

M/s. Nomura Research Institute &
Financial Technologies Pvt.Ltd.
Kolkata

[PAN : AADCA 8967 A]
(Appellant)

-vs-

D.C.I.T., Circle-2(2),
Kolkata

(Respondent)

For the Department : Shri G.Mallikarjuna, CIT(DR)
For the Assessee : Shri J.P.Khaitan, AR

Date of Hearing : 19.09.2017.

Date of Pronouncement : 04.10.2017.

ORDER

Per N.V.Vasudevan, JM

I.T.A.No.590/Kol/2015 is an appeal by the Assessee while ITA No.587/Kol2015 is an appeal by the revenue. Both these appeals are directed against the order passed by D.C.I.T., Central-2 (1), Kolkata dated 18.02.2015 u/s 143(3) r.w.s. 144C of the Income Tax Act, 1961 (Act.)

2. The assessee in its appeal has filed revised grounds of appeal. Grounds No.1 to 16 of the revised grounds of appeal filed by the assessee read as follows :-

“Technical Issues

1. For that the Assessing Officer erred in not giving full effect to the directions of the Hon'ble Dispute Resolution Panel RP under section 144C(5) of the Act thereby violating section 144C(13) the Act by:

a. not including Akshay Software Technologies Ltd. in the final set of comparables

b. not excluding interest income in the cases Kuliza Technologies Pvt. Ltd. and Inteq Software Ltd.

2. For that the Assessing Officer erred in assessing the total income of the Appellant at Rs. 1,91,03,939/- as against the total income of Rs. 40,62,622 computed by the Appellant under the normal provisions of the Act.

3. For that the Authorities below erred in rejecting the transfer pricing documentation maintained by the Appellant in accordance with the provisions of the Act read with the Income Tax Rules, 1962 ('Rules') and in making an adjustment of Rs. 14,741,337/- to the international transactions with Associated Enterprise.

4. For that the Transfer Pricing Officer erred in not providing the detailed search process for selecting his own set of companies which he considered as comparables during the transfer pricing proceedings and also erred in conducting fresh search and economic analysis.

5. For that the Authorities below erred in rejecting the use of multiple year data despite the Appellant demonstrating the circumstances warranting use thereof.

Rejection and inclusion of comparable companies

6. For that the Authorities below erred in including E-Infochips Bangalore Limited and Inteq Software Limited in the [mal set of comparables although they are secret comparables for which no data was otherwise available, they are not functionally comparable and also have supernormal operating margin.

7. For that the Authorities below erred in including Infinite Data Systems Pvt. Ltd. (Merged) in the final set of comparable although it is not functionally comparable and has a supernormal operating margin.

8. *For that the Authorities below erred in including (a) Thirdware Solutions Limited and (b) Comp-U-Learn Tech India Ltd in the final set of comparables although they are not functionally comparable.*

9. *For that the Authorities below erred in selecting Kuliza Technologies Private Ltd in the final set of comparables, a secret comparable for which no data is otherwise available and in any event in considering the bad debt of the said company as a non-operating expense for the purpose of computing operating margin.*

10. *For that the Authorities below erred in excluding CG- V AK Software Exports Limited from the set of comparables by erroneously considering it as a consistent loss-making company.*

11. *For that the Authorities below erred in rejecting Goldstone Technologies Limited erroneously considering it to be functionally different.*

12. *For that the Authorities below erred in rejecting R S Software (India) Limited and Zylog Systems Limited from set of comparables by applying AMP filter of more than 5 percent.*

13. *For that the Authorities below erred in rejecting Helios and Matheson Information Technology Limited from the set of comparables on the ground of its having different financial year ending from that of the appellant.*

14. *For that the Authorities below erred in rejecting Mindtree Limited and Quintegra Solutions Limited on the ground of their having an exceptional year of operation due to merger/acquisition.*

Economic adjustments

15. *For that the Authorities below erred in not adjusting the net margins by failing to consider the working capital differences between the Appellant and the companies treated as comparables.*

16. *For that the Authorities below erred in not adjusting the net margins of the companies treated as comparable by failing to consider the functional and risk differences in accordance with the provisions of Rule 10B(1)(e).*

3. The aforesaid revised grounds of appeal can be conveniently decided together with the grounds raised by the revenue which read as follows :-

“1. Whether on the basis of facts and in circumstances of the instant case, the Ld. DRP, Kolkata has erred in directing to allow foreign exchange loss as non-operating income for the purpose of computation of Profit Level indicators (PLI) of the comparables without appreciating the facts in case to case basis as to whether such loss has arisen in the normal course of business and not resulted from speculative transaction or otherwise.

2. Whether on the basis of facts and in circumstances of the instant case, the Ld. DRP, Kolkata has erred in directing to allow bad debts as non-operating income for the purpose of computation of Profit Level indicators (PLI) of the comparables without appreciating the facts in case to case basis as to whether bad debts has arisen in the normal course of business and not resulted from speculative transaction or otherwise.

3. The appellant craves leave to amend, modify or alter any grounds of appeal during the course of hearing of this case.”

4. The aforesaid grounds of appeal are with reference to the determination of Arms Length Price (ALP) in respect of an international taxation between the assessee and its Associated Enterprises (AE). The Assessee is a company. It is engaged in the business of rendering software development services. The Assessee renders services to Anshin Software Corporation, USA incorporated as a company under the laws of California, USA. In fact the assessee is a captive service for Anshin Software Corporation, USA. It is not in dispute that the assessee and Anshin Software Corporation, USA are associated enterprises because of common share holding in both the companies by Shri Arnab Debnath and Miss Mausumi .Debnath. The assessee received a sum of Rs.13,37,18,400/- for rendering software development services to Anshin Software Corporation, USA. Under the provision of section 92 of the Act, any income arising out of an international taxation has to be computed having regard to the Arms length price. Under section 92F(ii) of the Act Arms Length Price means a price which would be charged between persons if they are not associated enterprises and there are no uncontrolled conditions prevailing with reference to the transactions. It is not in dispute that the provision of section 92 of the Act are applicable in respect of the transactions of

rendering services of software development services by the assessee to its associated enterprises and therefore the provision of section 92 of the Act are applicable.

5. To justify the price received by the assessee as one at arm's length, the assessee filed a transfer pricing analysis in which the assessee adopted operating profit to operating cost (OP/OC) as profit level indicator(PLI). The operating profit to operating cost of the assessee was determined at 21.64%. The assessee adopted Transactional Net Margin Method (TNMM) as the most appropriate method for determining the arms length price. The assessee on an analysis of similar companies, who are engaged in providing software development services, identified 21 companies as comparable with the Assessee. The assessee took the weighted average of operating profit to operating cost of the 21 comparable companies so selected for three financial years, viz., 2007-08, 2008-09 and 2009-10. By doing so the assessee arrived at an average OP/OC i.e., arithmetic mean of 6.54% of 21 comparable companies. Since the assessee's operating profit/operating cost was 21.64%, the assessee claimed that the transactions with the associated enterprises was at arms length. The profit margin of the comparable companies chosen by the assessee in its transfer pricing study is as follows :-

Sl. No.	Name of the company	FY 2007-08	FY 2008-09	FY 2009-10	Weighted average of operating profits on operating costs (%)
1	Akshay Software Technologies Limited	6.054%	10.993%	NA	8.91%
2	Ancent Software International Ltd	-19.356%	-8.212%	NA	-13.88%
3	Aztecsoft Limited	2.502%	3.671%	NA	3.16%
4	CG-VAK Software & Exports Limited (Segmental)	-7.900%	3.993%	-13.849%	-5.46%
5	Goldstone Technologies Limited	20.037%	-10.216%	NA	8.52%
6	Helios & Matheson Information Technology Limited	30.145%	NA	13.199%	19.64%
7	Indium Software (India) Limited	-3.483%	-13.391%	NA	-7.85%
8	Infosys Technologies Limited	36.442%	39.612%	44.476%	40.48%
9	K P I T Cummins Infosystems Limited	9.274%	9.594%	NC	9.45%
10	Larsen & Toubro Infotech Limited	14.337%	13.806%	16.904%	14.99%
11	LGS Global Limited	23.144%	14.365%	NA	17.97%
12	Mindtree Limited (Segmental)	13.110%	1.731%	17.004%	9.79%
13	Persistent Systems Private Limited	25.058%	13.752%	28.052%	21.69%
14	Quintegra Solutions Limited	13.943%	-8.295%	NA	2.61%
15	R S Software (India) Limited	5.792%	9.249%	8.136%	7.95%
16	Sasken Communication Technologies Limited	13.837%	13.928%	26.352%	17.69%
17	S I P Technologies and Exports Limited	-39.449%	-33.580%	NA	-37.24%
18	Softsol India Limited	10.862%	NC	NA	10.86%
19	Thinksoft Global Services Limited	13.719%	16.058%	9.106%	13.08%
20	TVS Infotech Limited	NC	-15.850%	NA	-15.85%
21	Zylog Systems Limited	12.374%	9.498%	NA	10.74%
	Arithmetic mean				6.54%

6. The AO made a reference u/s 92CA (1) of the Act to the Transfer Pricing Officer for determination of arms length price in respect of the international transaction between the assessee and its associated enterprises. The TPO vide its order dated 30.01.2014 passed 92CA(3) of the Act, firstly accepted the Transactional Net Margin Method (TNMM) as the most appropriate method of determining arms length price of the international taxation. He however, rejected the action of the Assessee in adopting the weighted average of three financial years operating profit to operating cost to arrive at the profit margins (arithmetic mean) of the comparable companies. He held that multiple year data cannot be used for comparison purpose and it was only the data of the relevant previous year that has to be used in arriving at the arithmetic mean of profit margin of the comparable companies. The TPO thereafter rejected 20 out of 21 companies chosen by the assessee i.e., except the company Global services Ltd., chosen by the Assessee in its Transfer Pricing Analysis, all other companies chosen as comparable companies by the Assessee were rejected as not comparable with the business profile of the assessee. The TPO on his own identified eight more companies as comparable companies of the assessee and arrived at the operating profit to operating cost of these companies and determined the arms length price of the international taxation as follows :- (Quote from AO's order)

“19. The list of final comparables selected by the TPO, along with the margins is as follows :

Principal comparables selected by the IFO, along with the margins

Sr No.	Name of the company	OP / TC
1	Spry Resources India Pvt. Ltd.	33.25%
2	Kuliza Technologies Pvt Ltd	30.75%
3	Evoke Technologies Pvt Ltd	18.75%
4	C T I L Ltd.	19.56%
5	Infinite Data Systems Pvt. Ltd. [Merged]	88.25%
6	E-Infochips Bangalore Ltd.	71.92%
7	Thirdware Solutions Limited	33.36%
8	Thinksoft Global Services Ltd.	17.35%
9	Inteq Software Ltd	49.91%
Average		40.34%

Description	Amount (Rs.)
Software Development Service	14,01,82,916/-
Operating Revenues	14,01,82,916/-
Expenses debited to P&L account	11,52,45,297/-
Operating Expenses	11,52,45,297/-
Operating Profit	2,49,37,619/-
OP / TC (PLI)	21.63%
OP/OR	17.78%

20. Therefore the calculation of the adjustment in the case of the assessee is as follows

Average PLI	40.34%
Operating Cost(A)	Rs.11,52,45,297 /-
Arm's Length Mean Margin profit(B)	40.34 % of the Operating Cost
Arm's Length Price (ALP) @140.34 % of operating cost	Rs.16,17,35,250 /-
Price received	Rs 14,01,82,916/-
Shortfall being adjusted	Rs2,15,52,333 /-
5% of the price shown in the books(5% of F)	Rs 10,77,616/-

21. Since the adjustment is less than +/-5% limit, in view of the facts of the case, upper Adjustment is proposed to be made to the total income of the assessee.

22. It is hereby clarified that the findings and discussions made in this order are applicable only in respect to reference received for A.V 2010-11 and shall apply accordingly.

(TOTAL UPWARD ADJUSTMENT IN RESPECT OF MARKET SUPPORT SERVICE: Rs 2,15,52,333/-)"

7. Aggrieved by the determination of the arms length price by the APO as above the assessee filed objections before the Dispute Resolution Panel (DRP). The DRP gave relief to the assessee by directing the TPO to consider foreign exchange gain as part of the operating income while computing operating profit/operating cost. Similarly the DRP also directed that the bad debts written off should also be considered as an operating expenditure while arriving at the Profit level indicator of the comparable and arrived at the operating profit/operating cost of the comparables. In respect of the foresaid two directions of the DRP, which was incorporated by the AO in the impugned order, the revenue is in appeal before the Tribunal in its appeal. Aggrieved by the action of the DRP in not rejecting the comparables chosen by the TPO and also excluding some of the comparables chosen by the assessee in its TP analysis and not allowing the working capital adjustment and other risk adjustment and not excluding interest income while computing the operating profit/operating cost of comparables vz., Kuliza Technologies Ltd. And Inteq Software Pvt. Ltd., the assessee has raised grounds no.1 to 16 before the Tribunal. We will deal with all the grounds in seriatim in the following paragraphs.

8. As far as Ground No.1(a) raised by the assessee in its appeal is concerned, the assessee is aggrieved by the action of DRP/AO in not including Akshay Software Technologies Ltd., in the final list of comparables chosen by the TPO. We have already seen that the assessee had chosen a set of 21 comparable companies and adopted the average of those companies operating profit /operating cost to arrive at the arithmetic mean of the comparable companies. One such company chosen by the assessee in its transfer pricing study was Akshay Software Technologies Ltd.. The TPO was of the view that the aforesaid company cannot be considered as a comparable company for the reason that the related party transaction carried out by this company during the relevant financial year and other data available for the purpose of carrying out comparability analysis properly, was insufficient.

9. Before the DRP the assessee demonstrated the existence of all the relevant data so far as this comparable company chosen by the assessee is concerned. The DRP was convinced with the arguments of the assessee and at page 19 of its order directed the TPO to consider the aforesaid company as a comparable company. The following were the relevant observations of the TPO :-

“The same are being considered in respect of Akash Software Technologies Ltd. The AO has not given detailed reasons for holding that this company was functionally non-comparable. It is seen from its annual report that this company has revenue primarily from software services and only .07% revenue is earned from sale of products. Further this company has been taken as comparable in the case of SDS and has similar activities to that of E-Infochips Pvt. Ltd which has been taken by the TPO as comparable. The TPO is accordingly directed to include this company as a comparable provided it qualifies all other filters adopted by the TPO.”

10. It can be seen from the aforesaid directions of the DRP that instead of mentioning Akshay Software Technologies Ltd., the DRP has given a different name Akash Software Technologies Ltd. For this reason the AO in the order giving effect to the directions of the DRP had not considered Akshay Software Technologies Ltd., as a comparable company. The assessee filed an application u/s 154 of the Act dated 13.05.2015 before DRP pointing out this apparent error. The DRP has however not acted on this application. The ld. DR submitted the functional profile of this company has not been considered by DRP. We are of the view that the DRP has considered the functional profile. Besides this the issue is not with regard to the comparability of functional profile of the assessee and Akshay Software Technologies Ltd. The issue is whether Akshay Software Technologies Ltd has been wrongly mentioned as Akash Software Technologies Ltd., in the directions of DRP. On a reading of the order of the DRP and the contentions of the assessee, it is clear that DRP has wrongly mentioned the name of Akshay Software Technologies Ltd., as Akash Software Technologies Ltd. Therefore ground no.1(a) raised by the assessee is allowed and the AO is directed to

consider Akshay Software Technologies Ltd as a comparable company in the final set of comparables.

11. As far as ground no.1(b) raised by the assessee is concerned, the same relates to including interest income of comparable companies Kuliza Technologies Ltd., and Inteq Software Ltd., while working out the operating profit/operating cost of these comparable companies. As far as this objection is concerned the DRP dealt with the same in page 29 of its order at para 8.2 as follows :-

“8.2. This issue has been considered. The TPO is directed to consider foreign exchange gains as operating income. However one time or extra-ordinary expenses like Extra Ordinary Bad Debt like in the case of Kuliza Technologies Pvt. Ltd. Needs to be excluded therefore the action of the TPO to this extent is upheld. The contention of the assessee regarding interest income as non-operating is found to be not correct therefore the objection of the assessee is accepted. The TPO is accordingly directed to recompute the PLI of Kuliza Technologies Pvt. Ltd following these directions.”

12. A reading of the order of the DRP clearly shows that the DRP has agreed with the contention of the assessee that interest income is not an operating income but the use of the word “not correct” and the use of the words “therefore the objection of the Assessee is accepted” shows that there is contradiction. On the issue whether interest income can be considered as part of operating profit, we find that the Hon’ble Delhi High Court in the case of Marubeni India Pvt. Ltd. Vs DIT in IT No.1042 of 2011 judgment dated 25.04.2013 has held that interest income earned from investments on surplus funds which are not required immediately for the business of the assessee cannot be considered to be part of its operating income. Apart from the above it is also seen that at page 8 para 5.2, the TPO himself in the last sentence has set out what are not operating income and has given some examples. One such example of income which is not operating in nature as set out by the TPO himself is interest income. It thus appears that even the TPO accepted the fact that the interest income in question cannot form part of

the operating income of the assessee for the purpose of working operating profit to operating cost. Keeping in mind, the above circumstances and the judicial precedent set out above, we are of the view that the interest income in question should be excluded while working out operating profit to operating cost of the aforesaid two comparable companies Kuliza Technologies Pvt. Ltd., and Inteq Software Ltd. This finding is without prejudice to the comparability of Inteq Software Ltd., which is challenged by the Assessee in Gr.No.6 before us.

13. Grounds No.2 and 3 raised by the assessee are general in nature and calls for no specific adjudication.

14. Ground No.4 was not pressed by the Id. Counsel for the assessee.

15. As far as ground no.5 is concerned, the admitted position of law is that multiple data cannot be used in the transfer pricing analysis as per the law as it stood at the relevant point of time in A.Y.2010-11. Rule 10B(4) of the Income Tax Rules, 1962 (Rules) provides that the data to be used in analysing the comparability of an uncontrolled transaction with an international transaction shall be the data relating to the financial year in which the international transaction has been entered into. This being the admitted position, we are of the view that there is no merit in ground no.5 raised by the assessee and we hold that for the purpose of comparability, multiple year data i.e., the weighted average of three financial years of the comparable companies cannot be used in TP Analysis as per the laws that existed for AY 2010-11.

16. As far as ground no.6 raised by the assessee is concerned, the same is with regard to the action of the TPO and the DRP in accepting E-Infochips Bangalore Limited and Inteq Software Limited as comparable companies with that of the assessee. As far as the aforesaid companies are concerned the facts are that admittedly the information

regarding the financial statement of these two companies were not available in the public domain and the AO obtained the details about the financial results of these two companies by issuing notices u/s 133(6) of the Act to these two companies. At the time of hearing the Id. Counsel for the assessee brought to our notice that E-Infochips Bangalore Limited was not considered as a comparable company by the Hon'ble ITAT in the case of another software development services company such as the assessee and that order of the tribunal is also in relation to A.Y.2010-11. Our attention was drawn to the decision of ITAT, Kolkata in the case of Lab Vantage Solution Pvt. Ltd., in ITA No.1051/Kol/2015 in para 8.2. order dated 19.10.2016 wherein the tribunal held that this company cannot be compared with a software service provider as this company was into both the business of Software Development Services (IT) as well as providing Information Technology Enabled Services (ITES) and also for the reason that segmental details of IT and ITES were not available. The following were the relevant observations of the Tribunal:-

“8.3. Exclusion of Infinite Date Systems Pvt. Ltd. (Merged)

We find that this company had reported NCP of 88.25%. It is not in dispute that the assessee is engaged in software development. Hence, comparable should also be in the companies engaged in the similar section. We find that this company is having a different business model and engaged in providing entire gamut of solutions comprising of technical consulting, design and development of software, maintenance, system integration, implementation, testing and infrastructure management services. We find from the paper book that the Revenue is primarily derived from technical support and infrastructure management services. We find that Infinite Date Systems Pvt. Ltd. commenced its operation on 1st January, 2009 and as per segment reporting disclosure, the company's operations predominantly relate to providing software technical consultancy services to its sole customer Fujitsu Services Limited. Further, as per the Annual Report of 2009, at Page 1, it is stated that the Holding Company M/s Infinite Computer Solutions ((India) Limited signed an agreement (Build, Operate and Transfer – BOT Model) with Fujitsu Services Limited to set up Global Delivery Centers in India to provide offshore delivery capabilities to Fujitsu & Fujitsu's associated companies. We find that these facts have also been acknowledged by the Ld. TPO at page 77 of his order. The Ld. AR stated that it would be worthwhile to note that Infinite Date Systems Pvt. Ltd. completed its three years contract with Fujitsu, post which, the business

was transferred to Fujitsu and thus the company has been merged with its Holding Company- Infinite Computer Solutions (India) Ltd. during the financial year 2011-12. We are inclined to agree with the submissions of the Ld. AR that this Comparable Infinite Date Systems Pvt. Ltd. was created for purpose of transfer of business. Hence, the nature of services and business model of assessee company and comparable company are entirely different. Apart from this, we also find that there exist abnormal circumstances in the said comparable. During the last 3 years, variations in margins earned show an abnormal circumstances leading to huge fluctuations and supernormal profit, the margin earned by Infinite is 88.25% which is abnormally high. It was argued that such companies which are making more than twice the arithmetical mean margin as compared by the Ld. TPO should not be considered as comparable. The Ld. AR referred to page 591 of the Paper Book where the details of the fluctuation in the revenue, profit and margins has been provided. It is true that where company in which extraordinary events had taken place during the year like major acquisitions which had impact on profits of company, it could not be selected as comparable to assessee engaged in software development. We place reliance in this regard on the decision of Hyderabad Tribunal in the case of Excellance Data Research (P) Ltd. vs. ACIT reported in [2016] 74 taxmann.com 13 (Hyd Trib) dated 12.09.2016 for Asst Year 2010-11, wherein it was held that:

8. Having regard to the rival contentions and the material on record, we find that the DRP has directed the AO to consider whether the extra ordinary event of amalgamation during the year is found to have an impact on the profits of the company. We find that instead of carrying out the exercise, the AO has simply followed the order of the TPO in holding that the fact of amalgamation on the margin of the said company has no effect on the margin of the said company. This, in our opinion, is not a correct approach of the AO. Where a direction has been given by the DRP to follow a certain procedures, the AO has simply followed the TPO order. Therefore, order of the AO on this issue needs to be set aside. In the case of Hyundai Motors India Engg. (P) Ltd. (2015) 64 taxmann.com 442 (Hyd.-Trib), which is also engaged in rendering of ITES to its AEs, the Tribunal has taken note of the same at para 9.1. and 9.3 of its order. Therefore, the decision of the Tribunal in the said case is applicable to the case on hand, more particularly since the comparables adopted by the TPO in the said case are the same in the assessee's case also. In the case of Hyundai Motors India Engg. (P) Ltd. (supra) at page 20, para 18, the Tribunal has held as under:

“18. As regards M/s Accentia Technologies Ltd., is concerned, we find that the DRP has directed to exclude this company by placing reliance upon the order of the ITAT in the assessee's own case for the A.Y. 2009-10 by holding that this company operates in a different business strategy of acquiring companies for

inorganic growth as its strategy and considering the profit margins of the company and insufficient segmental data, held that his company cannot be selected as a comparable. It was also held by the DRP that on the very same reason of acquisition of various companies, being an extraordinary event, it had an impact on the profit of the company and the said company was directed to be excluded.

18.1. For the relevant A.Y. 2010-11, the Ld. Counsel for the assessee has drawn our attention to the information available on Accentia Technologies Ltd. to demonstrate that the said company is not diversified knowledge process outsourcing activities. It is seen there from that the said company is involved in Healthcare documentation as well as receivables, management services including installation and maintenance of all software, hardware and band width infrastructure required for the same, deployment of man power and service delivery in all these areas. It is also seen that it is engaged in legal process outsourcing. From Schedule-IV showing the fixed assets of the assessee, it is also seen that the said company owns goodwill/brand/IPRS (Intellectual Property Rights). From the notes to the accounts, it is also seen that a subsidiary of the company Asscent Infoserve Pvt. Ltd., has been amalgamated with the company consequent to which, assets and liabilities of the erstwhile company were transferred and vested in the company w.e.f. 1st April, 2008 and the scheme has been given effect to in the accounts of the year. Therefore, it is clear that there is an extraordinary even in the case of Accentia Technologies Ltd., during the relevant financial year particularly since the approval of amalgamation has been given by the Hon'ble High Court of Mumbai vide orders dated 21st August, 2009 and by the Hon'ble Karnataka High Court vide orders dated 6th February, 2010. This event would definitely have an effect on the profit margins of the said company and therefore, has to be excluded from the list of comparables as rightly done by the DRP. Therefore, we do not see any reason to interfere with the order of the DRP on this company also. Accordingly, ground no. 3 of the Revenue is dismissed.”

Since, the order of the Tribunal in the case of Hyundai Motors India Engg. (P) Ltd. (supra) for the same A.Y., we direct the AO/TPO to exclude this company from the final list of comparables.

11. TCS e-Serve International Ltd. As regards the comparability of this company with the assessee, the learned Counsel for the assessee submitted that the TCS international also provides software testing, verification and validation which are different from ITES services providers by the assessee. It is also submitted that the segmental information of TCS international are not available in the annual report. The exceptional circumstances of the company reported in annual report such as acquisition of India based captive business outsourcing arm,

resulting in acquisition of an aggregate amount of \$ 2.5 billion over a period of 9.5 years and its impact on the financial implications of the company also brought to our notice. It is submitted that these peculiar circumstances have been considered by the Coordinate Bench of this Tribunal in the case of Hyundai Motors India Engg. (P) Ltd. (supra) for exclusion of the list of comparables. Respectfully following the decision of the Bench, these two comparables TCS e-serve International Ltd. and TCS e-Serve Ltd. directed to be excluded.

In view of the aforesaid findings and judicial precedent relied upon, we hold that the comparable chosen by Ld. TPO i.e. Infinite Data Systems Pvt. Ltd. (Merged) is functionally not comparable with the assessee company.”

17. Following the aforesaid decision of the Tribunal we are of the view that E-Infochips Bangalore Ltd., should be excluded from the list of comparable companies while working out the arithmetic mean of the comparable companies.

18. As far as Inteq Software Limited is concerned, the plea of the ld. counsel for the assessee was that information regarding this company was not available in the public domain and the TPO had obtained the financial results by issuing of a notice u/s 133(6) of the Act. In the proceedings before DRP, on request by the assessee the TPO shared some of the details that he received from the aforesaid company. The details so obtained are at pages 613 to 617 of the paper book Vol.II filed by the assessee. The information shared shows that Inteq Software Limited is not purely software development service company and provides besides software development, consultancy services, data warehousing, EDI services besides Health Care BPO. The financial details of this company which was shared by the TPO in the course of proceedings before DRP, is at pages 269 to 297 of the assessee's paper book. Copy of profit and loss account was not given to the assessee. However schedule forming part of the profit and loss account has been furnished. The balance sheet has been furnished. The TPO in his order has worked out operating profit to operating cost of this company at 49.94%. On what basis this was worked out is not spelt out in the order of DRP except for a reference to the information received in response to the notice u/s 133(6) of the Act. It

is noticed from the information provided by the AO to the assessee in the form of schedule forming part of the profit and loss account that a sum of Rs.66,56,873/- being other income comprising of interest, foreign exchange gain etc has been considered part of the operating profit. As we have already seen that this company has different segments and no segmental data has been provided by the TPO to the assessee. In these circumstances we are of the view that it would be safe to exclude Inteq Software Pvt. Ltd from the list of comparables. The process of computation of arms length price involves comparability of profit margins of similar transactions by unrelated parties and therefore correct and reliable data should be the basis on which such comparability exercise should be carried out. When there is an element of doubt on a particular data based on which comparability analysis is carried out, it would be safe not to act on such data. We do not wish to go into the question whether the TPO can rely on secret comparables. On the facts available on record it transpires that no reliable data have been brought on record to substantiate the margin of 49.91% determined by the TPO for this company. In these circumstances we direct that Inteq Software Pvt. Limited be excluded from the final list of comparable companies to be adopted by the TPO for arriving at the average margin of comparable companies.

19. As far as Gr.No.7 challenging the inclusion of M/S.Infinite Data Systems Pvt.Ltd. (since merged) in the final set of comparables for the purpose of determining the Arithmetic mean of comparable companies, the plea of the Assessee is that this company is not functionally comparable with that of the Assessee and also for the reason that this company has earned supernormal operating margin. At the time of hearing the learned counsel for the Assessee brought to our notice a decision of the ITAT Kolkata Tribunal in the case of M/S.Labvantage Solution Pvt.Ltd., Vs. DCIT ITA No.617/Kol/2015 order dated 19.10.2016. The Assessee in that case was also a company engaged in the business of rendering software development services. The Tribunal held that Infinite Data Systems Pvt.Ltd., is not functionally comparable with a

company rendering software development services. The following were the relevant observations of the Tribunal.

“Infinite Data Systems Pvt Ltd (Merged)

The Id AR argued that this company is functionally not comparable to the assessee and it is having a different business model. The company is engaged in providing entire gamut of solutions comprising of technical consulting, design and development of software, maintenance, system integration, implementation, testing and infrastructure management services. Further it is stated from the records that the revenue is primarily driven from technical support and infrastructure in management services. Further, as per the Annual Report of 2009, at Page 1, it is stated that the Holding Company M/s Infinite Computer Solutions (India) Limited signed an agreement (Build, Operate and Transfer Model) with Fujitsu Services Limited to set up Global Delivery Centers in India to provide offshore delivery capabilities to Fujitsu & Fujitsu's associated companies. Infinite Data Systems commenced its operations on 1 st January 2009 and as per segment reporting disclosure. the company's operations predominantly relate to providing software technical consultancy services to its sole customer Fujitsu Services Limited. The Id AR argued that these facts have also been acknowledged by the ld. TPO at page 77 .of. his order. Also, it would be worthwhile to note that Infinite Data Systems Pvt Ltd completed i three years contract with Fujitsu, post which, the business was transferred to Fujitsu and thus the company has been merged with its Holding Company - Infinite Computer Solutions (India) ltd during the financial year 2011-12.

The Id AR argued that the assessee company is a service provider in area of software development whereas the comparable company Infinite Data Systems Pvt Ltd w created for purposes of transfer of business. The services and business model of assessee company and comparable company is entirely different. He also argued that there e abnormal circumstances in the said comparable. During the last 3 years, variation m margins earned shows an abnormal circumstances leading to huge fluctuation an supernormal profit, the margin earned by Infinite is 88.25% which is abnormally his . Such companies which are making more than twice the arithmetical mean margin computed by the Id TPO should not be considered as comparable. The ld AR referred t page 591 of the Paper Book where the details of the fluctuation in the revenue, profit an margins has been provided. Accordingly, he prayed for rejection of this comparable.”

20. The aforesaid reasoning of the Tribunal which decision was also rendered in a case relating to AY 2010-11 will equally apply to the case of the Assessee in this appeal

also as the functional profile of the Assessee and that of the Assessee in the decision cited by the learned counsel for the Assessee are one and the same. We therefore direct that M/S.Infinite Data Systems Pvt.Ltd., be excluded from the list of comparable chosen by the TPO. Gr.No.7 raised by the Assessee is accordingly allowed.

21. As far as Gr.No.8 raised by the Assessee seeking exclusion of Thirdware Solutions Ltd., and Com-U-Learn Tech India Ltd., in the final set of comparables chosen by the TPO is concerned, the plea of the Assessee is that these companies are not functionally comparable with that of the Assessee. It is the plea of the Assessee that this company is in software consultancy, application development services, application management support services, enterprise application space. Our attention was drawn to this companies website extract copies of which are at page 612 of Vol-II paper book filed by the Assessee. Our attention was also drawn to the extract of this companies financials at page 607 paper book-II wherein the fact that it is developing software products from July, 2009 and that the products will be available for sale to the customers during the financial year 2010-11 is clearly spelt out. Our attention was also drawn to the fact that in the profit and loss account there is reference to income from sale of licenses which is not the case normally in the case of companies providing software development services. Finally it was submitted that the segmental information of these companies is not available as the primary segment is based on geographical area. Our attention was also drawn to several cases decided by various benches of the Tribunal on the comparability of this company with a software development service provider such as the Assessee. We deem it appropriate to make mention of only one such decision rendered by the ITAT Ahmedabad Bench in the case of I-Many Software Private Ltd. IT (TP) 222/Ahd/2015 order dated 27.10.2016 which is in relation to AY 2010-11 and rendered in the context of a software development service provider such as the Assessee.

22. We have considered the submissions of the learned counsel for the Assessee as well as the learned DR who relied on the directions of the DRP. We find that in the case of I-Many Software Pvt.Ltd., (supra) comparability of this company with a software development services company such as the Assessee was considered and it was held that this company is not a good comparable. The following were the relevant observations of the Tribunal.

"10. We have heard the rival contentions and perused the material on record. Solitary" grievance of the assessee through this ground is against the order of Id. ORP for approving the selection of comparable namely Thirdware Solution Ltd. by TPO. We observe that assessee is engaged in the business of providing software development evolution and production of computer software. Assessee also has not outsourced its business activities to third party and operates on the instructions of its associate enterprise. We further observe that assessee has referred and relied on various decisions of Co-ordinate Bench wherein it has been held that Thirdware Solution is not a good comparable for the purpose of T.P. adjustment with regard to the assessee engaged in the business of software development. We observe that Co-ordinate Bench Delhi in the case of ION Trading India Private Ltd. vs. ITO in ITA No.1 035/0el/2015 for Asst. Year 2010-11 has held as under :-

"56. We have heard the rival submissions and perused and carefully considered the material on record. It is seen from the details on record that the functions of Thirdware are in account with the assessee which only provides software development in the finance domain as per the instruction of its AE. Also, Thirdware has incurred expenses towards import of software services, evidencing outsourcing of software services unlike the assessee. Since it is also engaged in outsourcing its activities as it has incurred expenses towards imports of software services, evidencing outsourcing of software services unlike the appellant company. Hence, it is functionally not comparable and cannot be treated as a comparable to assessee. We order accordingly. "

11. We further observe that the Co-ordinate Bench, Oeli in the case of Sun Life India Service Centre Pvt. Ltd. vs. DCIT (ITA NO.5799/0e1/2012 for AY 2008-09 has held as under :-

"21. We have perused the Annual report of this company which is available on pages 100 onwards of the paper book. The Profit & Loss Account of this company is at page 107, which shows 'Sales & Other

income'. Bifurcation of 'Sales ' is available as per Schedule 12, which comprises of 'Sale of licence' amounting to RS.39.16 lac, 'Software services' amounting to Rs.7.67 crore, 'Export from SEZ unit' amounting to Rs.26,39 crare, 'Export from STPI unit' amounting to RS.16.88 crare and 'Revenue from subscription' amounting to RS.92.93 lac. These tiqures indicate that apart from the revenue from 'Software services' which is only to the tune of Rs.7.67 crore, this company earned total gross revenue from 'Sales' to the tune of Rs.52,27 crore including from export from SEZISTPI units. When we consider the figures of this company on an entity level as have been adopted by the TPO for comparison, it becomes vivid that it ceases to be comparable with the assessee's 'Software development and maintenance support services' segment. The reason hardly needs any highlighting, being the income of this company also largely including, revenues from exports from SEZISTPI units apart from sale of licence. These distinguishing features make this company as non comparable. We, therefore, order for the removal of this company from the list of comparables. "

(emphasis supplied by us)

12. Further the Co-ordinate Bench Delhi in the case of Avaya India (P) Ltd vs. Addl.CIT (ITA No. 5528/0e1.12011) has observed that Thirdware Solutions has made income from sale of licence to the tune of more than RS.1 crore, which means the company is into production of software products and therefore, functionally different from contract software developer assessee. The relevant extract of the decision is reproduced below"-

"12. 1 ... (xxv) ... We have heard both the parties and perused the material available on record. A perusal of the annual report of Thirdware Solutions Ltd. reveals that the said company has made income from sale of licence to the tune of more than Rs. 1 crore, which means the company is into production of software products which apparently cannot be a comparable to assessee dealing with contract software development and not into sale of any product. Therefore, we direct TPO/AO to exclude this company from the list of comparables."

(emphasis supplied by us)

13. Respectfully following the decision of the Co-ordinate Bench referred above in para 10,11 & 12, we find that the same are squarely applicable to the facts of the assessee to the extent that assessee is also engaged in software development valuation of production works of computer software and operates mainly on the instructions of its associate enterprises whereas the impugned comparable Thirdware Solution is additionally also in the business of enterprises whereas the

impugned comparable Thirdware Solution is additionally also in the business of trading of software outsources its activities. We are, therefore, of the view that Thirdware Solution is not a fit comparable in the case of assessee for the purpose of making T.P. adjustment. We allow this ground of assessee.”

23. Respectfully following the aforesaid decision, we direct exclusion of Thirdware Solution as a comparable by the TPO for arriving at arithmetic mean of comparable companies.

24. As far as the company Comp U-Learn Tech India Ltd., is concerned, it was the plea of the Assessee that this company is more into software products as well as BPO services besides R & D activities in pharmaceutical sector and that no segmental details of this company are available. It was brought to our notice that the ITAT Hyderabad Bench in the case of Pegasystems Worldwide India Pvt.Ltd. Vs. ACIT ITA No.1758/Hyd/2014 in relation to AY 2010-11 by order dated 16.10.2015 held that this company is not comparable with a software development services company such as the Assessee.

25. We have considered the submission and we find that in the case of Pegasystems Worldwide India Pvt.Ltd. (supra), a company engaged in rendering software development services such as the Assessee, the Hyderabad Bench held that this company is not comparable with a software development services company. The following were the relevant observations:

“9.2. After considering the rival contentions, we are of the opinion that on the basis of information available, Comp-U-Learn Tech India Ltd., cannot be selected as a functionally comparable company as it has diversified activities. Only if there are segmental reports pertaining to software development services, then only the company can be taken as comparable company. In the absence of such information, it is very difficult to hold that the selected company is comparable to Assessee-company. There is no information about the segmental profits. What that company has reported in its annual report is 'Income from software development' which cannot be equated as 'Income from services'. The software development may include sale of products. In the absence of segmental information, this case cannot be selected as comparable. However, whether TPO could obtain any segmental

information is not known to us. we are of the opinion that TPO should examine whether there are any segmental information which can be obtained from the company or available in the public domain so as to compare Assessee's software development services with that of software development services of Comp-U-Learn Tech India Ltd. Therefore, we :- 10 -: I.T.A. Nos. 1758 & 1936/Hyd/14 Pegasystems Worldwide India Pvt. Ltd., are of the opinion that the issue of selection of this company is a comparable should be restored to the file of AO/TPO to examine the available data in public domain/or obtaining information U/s. 133(6) of the Act for segmental information pertaining to software development services and then decide after giving due opportunity to Assessee whether the said company can be selected as comparable. For the time being, Assessee's objections are considered valid and issue is restored to the file of AO for undertaking analysis afresh as far as this company is concerned."

26. Respectfully following the decision of the Tribunal, we direct the TPO to exclude this company from the list of comparables for the purpose of determining ALP.

27. As far as Gr.No.9 raised by the Assessee is concerned, the challenge to including Kuliza Technologies Pvt.Ltd. as a comparable company was not seriously contested and therefore the same is directed to be retained as a comparable. The Assessee has however pointed out that the OP/OC of this company has been wrongly calculated by the TPO by considering the Bad Debts of this company as part of the non-operating profit of the Assessee. In this regard, we have noticed that the TPO in his order at page-8 paragraph 5.2 has observed that certain items of income and expenses are non-operational income or expenditure and will not be considered for calculating OP/OC profit margin. One of the item of expenditure set out therein to be added to the income (because it is non-operational) is provisions Other than provision for bad debts. Therefore provision for bad debts was admitted by the TPO to be considered for arriving at the operating profit of the Assessee. Apart from the above, we find from the details of the provision for bad debts that the Assessee developed software for its client and the quality was not upto the mark owing to bugs in the software and therefore it was decided not to press for payment by the customer and the sum receivable was written

off. Thus it was very much part of the operating expense of the company which will go to reduce the operating profit of the Assessee. Besides the above, the ITAT Ahmedbad Bench in the case of I-Many Software Private Ltd. (supra) for AY 2010-11, who is also a software development service provider like the Assessee, has taken note of the view of the DRP in that case, wherein the DRP held that bad debts written off should go to reduce the operating income of that Assessee as it was more in the nature of regular business expenditure. The tribunal accordingly directed the TPO to include bad debts as expenditure while working operating income of the comparable company Kuliza Technologies Pvt.Ltd. Respectfully following the said decision, we hold that in computing the operating profit of Kuliza Technologies Pvt.Ltd., the AO should reduce the bad debts written off from the operating income. We hold and direct accordingly. Thus Gr.No.9 is partly allowed.

28. As far as Gr.No.10 is concerned, the plea of the Assessee is that CG-VAK Software Exports Ltd., is a good comparable company for the purpose of determining ALP of the Assessee and was wrongly excluded by the TPO and DRP on the ground that it was a consistently loss making company. In this regard, the TPO has given the following reasons for not regarding this company as comparable.

14.2. CG-VAK Software and Exports Limited

The objection of the assessee in respect of rejection of this entity is on account of the fact that this entity and made profits in the period corresponding to F.Y. 2008-09 and correspondingly it did not have persistent losses for the last three years; including the year under consideration. In this regard, it is seen that the analysis in respect of this comparable was made in the transfer pricing order for the assessee for last year, in respect of the margins of this entity and the same is reproduced below:

	Revenue in Lakhs	Profit in Lakhs	Profit Margin
Mar-05	397.86	14.15	3.56%
Mar-06	422.31	3.79	0.90%
Mar-07	425.92	20.5	4.81%
Mar-08	508.97	-10.22	-2.01%
Mar-09	637.29	-15	-2.35%
Mar-10	511.5	-73.44	-14.36%

Mar-11	569.89	-21.09	-3.70%
Mar-12	639.79	-114.73	-17.93%

From perusal of the above analysis, it can be seen that the company has stated making losses in the year ending March 2008, a trend which continues for subsequent years and is being continued till date. This clearly imply that in the period under consideration also the conditions were such that the entity may be on the verge of closure, under –utilization of assets or human resources which have been created/recruited earlier. Most of these exceptional circumstances are not quantifiable so as to see the effect on their profitability based on the date available in the public domain. As reasonable adjustments cannot be made to account for these differences in exceptional circumstances like gross under utilisation of assets/ resources and others, the entity with such a profile is required to be excluded. Consequently, it was not considered as comparable.

It can be seen that the difference is on account of loss calculated by the TPO for FY 2008-09 at profit calculated by the assessee. In this regard, the relevant segmental account, as available in the annual report is reproduced below:

12. Segment Analysis for the year ended 31st March 2010- Business Segment

Sl.No.	Particulars	Rs. in Lakhs	
		31-Mar-2010 (Audited)	31- Mar-2009 (Audited)
1	SEGMENT REVENUE		
	a) Software Services	511.50	637.29
	b) BPO Services	82.78	86.10
	Less : Inter Segment Revenue	---	---
	Net Sales/ Income from operations	594.28	723.39
2	SEGMENT RESULT (Profit before tax and Interest from each segment)		
	a) Software Services	(73.44)	(15.00)
	b) BPO Services	(2.21)	(3.43)
	Total	(75.65)	(18.43)
	Less : Interest	19.17	30.48
	Less : Other un-allocable expenditure	---	---
	Add : Other un-allocable Income	25.53	72.27
	Profit before tax & Extraordinary item	(69.29)	23.36
3	CAPITAL EMPLOYED		
	a) Software Services	709.38	789.78
	b) BPO Services	52.40	35.20
	Total	761.79	824.98

It is seen that the TPO has considered the data, as available in the segmental accounts provided in the Annual report. The calculation of the assessee is as follows:

ANSHIN SOFTWARE (P) LTD 10-11

Particulars	Software Services	BPO Services & Training	Total (Rs.)
Income			
Income as per segmental information	6,37,29,000	86,10,000	7,23,39,000
Operating Income (as per P&L)			7,80,87,817
Income to be allocated from P&L to segmental income (Allocation as a percent of sales)	50,64,576	6,84,241	57,48,817
Total operating income	6,87,93,576	92,94,241	7,80,87,817
Segmental revenue / Total operating revenue	88.10%	11.90%	
Segmental profit (Given)	(15,00,000)	(3,43,000)	(18,43,000)
Expenses			
Allocated expenses (segmental)	6,52,29,000	89,53,000	7,41,82,000
Operating expenses (as per P&L)			7,43,01,569
Expenses to be allocated from P&L to segmental expense (Allocation as a percent of sales)	1,05,338	14,231	1,19,569
Total operating expenses	6,53,34,338	89,67,231	7,43,01,569
Segment cost / Total operating cost	87.93%	12.07%	
Operating profit (A-B)	34,59,238	3,27,010	37,86,248
Operating Profit/Total operating cost	5.29%	3.65%	5.10%

It can be seen that the assessee has considered an amount of Rs. 50,64,576/- out of total amount of Rs. 57,48,817/- as allocable to this segment, which has led to the conversion of negative PLI to positive. The details of this expenditure, as extracted from the Annual report is as given below:

SCHEDULE TO ACCOUNTS

Schedule	31-Mar-2010 Rs	31-Mar-2009 Rs
12 Income from Software Development, Product & Services - Overseas:		
Onsite Software Services	54,34,341	2,32,41,620
Offshore Software Services	4,37,74,635	3,98,35,200
Business Process Outsourcing Services	82,78,611	86,10,268
	5,74,87,587	7,16,87,088
13 Income from Software Development, Product & Services - Domestic:		
Software Services	19,40,663	6,52,093
	19,40,663	6,52,093
14 Other Income:		
Interest Receipts	7,89,450	14,77,685
Foreign Exchange Gain	13,27,679	55,47,621
Dividend Receipts	0	400
Sundry Receipts	4,36,081	2,01,015
	25,53,210	72,26,721
15 Cost of Services:		
Cost of Services - Overseas	60,30,799	2,77,32,127

From the above it becomes clear that **the assessee has considered forex gain as part of operating income, which is incorrect, as detailed in the order below. Consequently, the margin of this company in FY 2008-09 is also negative and this company is therefore, a persistent loss maker. Since, it is a persistent loss maker, it has been rightly rejected by the TPO. Incidentally this filter is used by the assessee also.**

As far as the objection of the assessee in respect of the observations made by the TP in show cause notice is concerned, it is pertaining to note that the TPO has not made a definite statement that the entity is on the verge of closure. In view of the persistent nature of losses, there are abnormal circumstances in this company for which “reasonably accurate” adjustment can’t be made, as required under Rule 10B(3). The TPO merely identified many such factors which could have lead to such persistent losses in the company.

On the basis of the above, the rejection of this company by the TPO is correct.”

29. Before the DRP the principal contention of the Assessee was that the TPO accepted this company as functionally comparable but excluded only for the reason that it was consistently making losses. The Assessee had submitted before the TPO that this company earned operating margin of 5.29% in AY 2009-10 from its software services segment. Hence the basis assumption of the TPO that this company was consistently loss making company was incorrect. Another submission was that when the Assessee conducted the TP study the information available in the public domain was only financial information upto to FY 2009-10 relevant to AY 2010-11. The TPO in the impugned order has taken note of financial results for the subsequent years also, which was not correct. The case of the Assessee was that, if the results of the software development segment of this company, is considered and if foreign exchange gain/loss is considered as part of the operating profit than this company’s profit margin for FY 2008-09 would be 5.29%. The DRP however upheld the order of the TPO observing that this company was a consistent loss making company.

30. Before the Tribunal the submission of the learned counsel for the Assessee upon for reiterating submission made before DRP was that the DRP in page-29 of its direction while working out the margins of another comparable company Kuliza

Technologies Pvt. Ltd., has accepted foreign exchange gain to be part of the operating profits. It was submitted that foreign exchange gain arising out of transactions of rendering software development services should be considered as part of the operating profit and the law in this regard is well settled. Reference was made to several judicial pronouncements in this regard especially the decision of the Bangalore ITAT in the case of SAP Labs (P) Ltd. Vs. ACIT 44 SOT 156 (Bang.) wherein it was held that foreign exchange gain should be included while computing operating margin of comparables as well as that of the Assessee for the purpose of comparison of margins while determining ALP. The learned DR relied on the order of the TPO.

31. We have considered the rival contentions. From a perusal of the order of the TPO it is clear that the claim of the Assessee that this company's operating profit to operating cost of the software development services segment for AY 2009-10, if expenses are allocated on the basis of revenues, is 5.29%. This chart is extracted by the TPO in page-50 of his order (and also in paragraph 27 of this order) and even the TPO does not dispute this plea of the Assessee. The TPO has however proceeded on the basis that foreign exchange gain should not be regarded as part of the operating profit. Such approach of the TPO has not been accepted by the DRP in its order while dealing with the comparable company Kuliza Technologies Pvt.Ltd. Therefore it appears that the plea of the Assessee that the basis assumption of the TPO and DRP on the comparability of this company that it is a consistent loss making company is erroneous and therefore their orders are set aside. However, the question still remains as to whether the allocation of expenses and the attribution of the foreign exchange gain to the software development services segment of the comparable company CG-VAK software and Exports Ltd., has not been considered by the TPO or DRP. Further it has also to be seen as to what were the reasons for the losses in the case of this comparable company. If all these factors are considered and due adjustment can be given to the operating margins of this company, than the same should be considered as comparable

company and added to the list of comparables for determining Arithmetic mean of profits of comparable companies. The TPO is directed to consider the comparability of this company **afresh** in the light of the aforesaid observations and also taking note of decision rendered on this aspect by Tribunals and Hon'ble High Courts if any.

32. As far as Gr.No.11 raised by the Assessee is concerned, it projects the grievance of the Assessee in rejecting Goldstone Technologies Ltd., as a comparable company on the ground that it is functionally not comparable. On the comparability of this company with a software development services company such as the Assessee, we find that the TPO has rejected this company as a comparable company for the reason that this company was not a pure software development service provider as there were expenses relating to media and therefore this company was considered as also in the business of media services. The absence of segmental data was also given as a reason for not regarding this company as a company in software development service sector. The DRP also accepted the stand of the TPO.

33. Before us the learned counsel for the Assessee drew our attention to pages 754, 759, 763 and 764 of paper book Vol-II filed by the Assessee as also pages 159 and 209 of paper book Vol.-I filed by the Assessee. Perusal of these documents shows that the income as per the profit and loss account as on 31.3.2010 of this company was Rs.24,04,76,948 out of which income from rendering software services was 23,18,69,452/-. Out of the income from software services, income from export of software is Rs.20,75,99,979/-. Thus this company satisfies the test of being a predominant software service exporter such as the Assessee. The related party transaction of this company is 10.71% which is well below the 15% mark. If related party transactions are more than 15% than the company will be excluded from comparability for the reason that the operating profits might be impacted by reason of related party transactions. That is not the case with this company as the RPT is less than

15%. Therefore there appears to be no valid reason for not regarding this company as a comparable company. The TPO is directed to regard this company as comparable company in the final list of comparable companies for the purpose of arriving at the arithmetic mean of profit margins of comparable companies.

34. As far as Grd.No.12 raised by the Assessee is concerned, the same is in relation to the grievance of the Assessee in not considering R.S.Software (India) Ltd., and Zylog Systems Ltd., as comparable companies by the TPO and the DRP. The reason why these two companies were not regarded as comparable companies by the TPO (upheld by DRP) was that the ratio of expenditure on Advertising, Marketing and Sales promotion was more than 5% of the revenue. The rationale for applying this filter is set out by the TPO in his order as follows:

“7. Companies with the ratio of advertising spend being more than 5% of the revenues were rejected.

In the FAR analysis provided by you, it is submitted that the assessee did not market its services to the end customers as it only provide software development services to the associate enterprise. It is further stated that since it is a captive service provider and provides services only to the associate enterprise no market risk is being borne by it. Consequently, it is clear that the entities which are engaged in such additional function would be in comparable to you. Therefore, the TPO has rejected those entities whose advertising spend was more than 5% of the revenues. In order to determine the advertising spend the expenditure incurred and shown in Prowess database under advertising, marketing and distribution expenses were consolidated and the same was utilised. It must be mentioned that this filter was applied by you last year but the same has not been applied in this year.”

35. The DRP upheld the stand of the TPO. The submission of the Assessee before the DRP and the DRP’s decision on such submission was as follows:

“d) Rejecting companies with the ratio of sum of advertising, marketing & distribution expenses to sales more than 5%

The Assessee wishes to submit that the filter applied by the Id. TPO is not appropriate due to following reasons :

For difference in activities including advertising/marketing, the assessee has requested for necessary market risk adjustments (please refer to Ground No.10 below)

The TPO has not argued that comparable companies are functionally different. Hence, rejecting the comparable companies by putting additional filter is not justified. Additional filter reduces the number of comparables available which are otherwise functionally comparable.

The OECD Guidelines 2010 which acknowledges the need for broadening the search criteria to accommodate for the limitations in available comparables.

The relevant extract from the OECD Guidelines 2010 is as follows:

"3.38. The identification of potential comparables has to be made with the objective of finding the most reliable data, recognising that they will not always be perfect. For instance, independent transactions may be scarce in certain markets and industries. A pragmatic solution may need to be found, on a case-by-case basis, such as broadening the search and using information on uncontrolled transactions taking place in the same industry and a comparable geographical market, but, performed by third parties that may have different business strategies, business models or other slightly different economic circumstances; information on uncontrolled transactions taking place in the same industry but in other geographical markets; or information on uncontrolled transactions taking place in the same geographical market but in other industries, "

- The above recommendation under the OECD Guidelines 2010 is also supported by the Advance Pricing Agreement Program Training Manual of USA which recognizes the need to relax the comparability criteria in order to arrive at a wider set of companies:

- In the case of Actis Advisers Pvt Ltd (ITA No. 5277 /Del/2011) it was held that comparables, which are otherwise similar, shall not be rejected merely on the ground that comparables who had incurred high marketing and advertising expenditure are functionally different.

Given the above, we submit that Ld. TPO has wrongly rejected our comparables RS Software (India) Ltd and Zylog Systems Ltd by applying this filter.

Further, we submit that the clear breakup of marketing and selling expenses is not provided for these comparables in their annual reports. The Ld. TPO has considered the proportion of 5% on sales. It is pertinent to note that selling

expenses does not always mean advertising and marketing expenses, hence in the absence of required details, the filter cannot be applied in generality.

Decision :

5.2. Software industry is manpower intensive and significant part of their expenses relate to salaries and bonus. On an average, salary cost comprises 24% to 42% of the revenue in the case of software service providers. As per the data in Prowess database, the average employee cost works out to about 39% on sales. This being so, low expenditure on salary/ employee cost is an indication that the company is either into further outsourcing of work or is in product development / trading. Therefore, we are of the opinion that the filter of 25% of sales as minimum salary expenses used by the TPO is fair and appropriate. Persistently loss making companies or companies with declining revenue may have some exceptional circumstances and unique factors contributing to such results that make them not suitable for comparability analysis. Moreover, the financial results of comparable companies should be of the same period as that of the assessee i.e. April to March, as that only enable proper comparison between them. In respect of rejection of companies having ratio of advertising, marketing and distribution expenses to sales more than 5%. Normally a company having high ratio of these expenses would be engaged in selling of products on a substantial scale. Obviously such a company would not be functionally similar to a software services providing company like the Assessee. Therefore, the TPO was justified in applying this filter as well. The TPO was also justified in applying filter for rejecting companies where export earning was 75% of the sales as this criteria has been applied by the TPO resulting sufficient number of comparables therefore there was no reason for further relaxation. Therefore, the objection raised by the assessee in respect of these filters cannot be upheld. In view of the above discussion, the objections raised by the assessee against the rejection of its TP study by the TPO and use of new quantitative and qualitative filters used by the TPO do not stand the analysis of merits and therefore, rejected. Action of the TPO is upheld.”

36. The learned counsel for the Assessee did not dispute the proposition that the filter of rejecting companies with the ratio of advertising spend being more than 5% of the revenues by the TPO and DRP. His limited submission was the Assessee will not satisfy the test of its AMP being more than 5% of the revenues, if correct AMP expenses are taken. In this regard the learned counsel for the Assessee brought to our notice that the Special Bench of ITAT Delhi in the case of LG electronics India Pvt.Ltd., ITA No.5140/Del/2011 has taken the view that sales expenses are not part of

the Advertising, Marketing and sales promotion. Our attention was drawn to the following observations of the special Bench:

“18.3. Having heard the rival submissions on this issue, we find that the AMP expenses refer only to advertisement, marketing and publicity expenses. A divider needs to be placed between the expenses for the promotion of sales on one hand and expenses in connection with the sales on the other. Both these expenses are required to be kept in different compartments. While expenses for the promotion of sales directly lead to brand building, the expenses directly in connection with sales are only sales specific.

18.4. Sub-section (3A) of sec. 37, before its omission, provided that where the expenses incurred by the assessee on anyone or more of the items specified in sec. 37(3B) exceed one lac of rupees, then twenty percent of such excess shall not be allowed as deduction in computing the income chargeable under the head 'Profits and gains of business or profession'. Clause (i) of sub-sec. (3B) referred to "advertisement, publicity and sales promotion". The Hon'ble jurisdictional High Court in the case of CIT Vs. Khetu Ram Bishambar Dass [(2008) 166 Taxman 273 (Del.)], has held that bonus paid to dealers is not in the nature of sales promotion expenses and hence the provisions of sec. 37(3A) cannot be applied to it. The Hon'ble Calcutta High Court in CfT Vs. The Statesman Ltd. [(1992) 198 fTR 582 (Cal.)] has enunciated that the expenses incurred by way of commission paid to sales agent do not attract disallowance under sub-sections (3A) & (3B) of sec. 37. The Hon'ble M.P. High Court in the case of CfT Vs. Mohd. fshaque Gulam [(1998) 232 ITR 869 (MP)] has held that the dealer's commission and sales agent commission etc. cannot be brought within the purview of advertisement, publicity and sales promotion expenses, as referred to in sec. 37.

18.5. We do not find any force in the contention of the learned DR made in this regard. The logic in the exercise of finding out the AMP expenses towards creation of marketing intangibles for the foreign AE starts with the expenses which are otherwise in the nature of advertisement, marketing and promotion. If an expenditure itself is not in the nature of advertising, marketing or promotion, that ought to be excluded at the very outset. We, therefore, reject this contention raised by the learned DR.

18.6. As we are presently considering the term "advertisement marketing and promotion expenses', which is analogous to, if not lesser in scope than the term 'advertisement, publicity and sales promotion' as employed in the erstwhile sub-sec. (3B) of sec.37, all the judgments rendered in the context of sub-sec. (3A) & (3B) of sec. 37 will squarely apply to the interpretation of the scope of AMP expenses. We, therefore, hold that the expenses in connection with the sales

which do not lead to brand promotion cannot be within the ambit of 'advertisement, marketing and promotion expenses' for determining the cost/value of the internal transaction.

37. It was submitted that if sales expenses are excluded than the percentage of AMP expenses to revenue will be below 5% and there would be no reason to exclude this company as comparable company. It was submitted that the fact that this company is otherwise comparable functionally is not disputed by the TPO. It was prayed that the issue may be set aside for the purpose of ascertaining the quantum of AMP to revenue after excluding sales expenses and if the comparable companies pass the test, then they should be included in the list of comparable companies. The learned DR relied on the order of the TPO/DRP.

38. We have given a careful consideration to the rival submissions and are of the view that the prayer made by the learned counsel for the Assessee for a remand to the TPO/AO for the purpose of ascertaining the quantum of AMP to revenue after excluding sales expenses and if the comparable companies pass the test, then they should be included in the list of comparable companies, is acceptable. As rightly contended by him sales expenses should be excluded while arriving at the AMP expenses and only thereafter the same should be compared with the revenues before applying the filter of 5% AMP expenses to sales. We direct the TPO to ascertain this aspect after affording Assessee opportunity of being heard and decide the issue as per the directions given above.

39. As far as Gr.No.13 is concerned, the grievance of the Assessee is that Helios and Matheson Information Technology Ltd., ought not to have been excluded from the list of comparable companies by the TPO and DRP. The TPO and DRP rejected this company as not comparable because it had different financial year ending for preparation of their financial statements and the period of profit margins earned by these

two companies therefore cannot be compared with the Assessee's profit margin which would be for a different period. The argument of the revenue is that change of financial year will have effect because of the business cycle and market and other economic conditions. The argument of the Assessee is that if those factors are same for the period for which profit margins are compared than there should be no objection because otherwise these two companies are functionally comparable. We are of the view that the middle path to be adopted would be to cull out the results of the comparable companies for the financial year of the Assessee, if it is possible and then make a comparison of the profit margins. If such authentic data for culling out the profit margins are not available, then it would be safe to exclude this company from the list of comparable companies. With these observations the comparability of this company is set aside to the TPO/AO for adjudication afresh after affording opportunity of being heard to the Assessee.

40. As far as Gr.No.14 raised by the Assessee is concerned, the same projects the grievance of the Assessee in the action of the TPO and DRP in rejecting Mindtree Ltd., and Quintegra Solutions Ltd., from the list of comparable companies on the ground that there were exceptional circumstances that prevailed in the affairs of these two companies during the relevant financial year the results of which were taken up for comparison. It is undisputed that Mintree Ltd., amalgamated with Aztec Software Ltd., during the previous year and due to this factor accurate adjustment cannot be given to the operating margins by eliminating factors which would contribute to low or high profit margins. In the case of Quintegra Solutions Ltd., this company acquired some other companies and the real operating margins of these two companies could not be arrived at after giving appropriate adjustments. In such circumstances, we are of the view that it would be safe to exclude these two companies from the list of comparable companies. We therefore confirm the order of the DRP on this issue.

41. As far as Gr.No.15 and 16 are concerned, they project the grievance of the Assessee in the action of the TPO and DRP in not allowing adjustments to the arithmetic mean of profits of the final comparable companies towards working capital and other risks which according to the Assessee are required to be given under the provisions of Rule 10B(1)(e) of the Income Tax Rules, 1962 (Rules).

42. The DRP dealt with this issue as follows:

Decision:

10.2 The issue has been considered. The Assessee has objected to TPO not allowing working 'capital adjustment to the margins of the comparables as well as in its own case the- claim of working capital adjustment is not automatic the issue of working capital is relevant when there is a situation of inventory remaining tide up or receivables being held up or delay however this situations would not be very relevant to the service providers like the Assessee. While calculating the operating profit margin, the financial expenses and financial income is removed. Thus, the effect of working capital / loans are negated while calculating the OPM and the said balance sheet item does not have any effect on the profit and loss account. In view of the above the decision of the TPO in not allowing working capital adjustment is upheld.”

43. Before us the learned counsel for the Assessee has filed a decision of the ITAT Bangalore in the case of Unisys India (P) Ltd. Vs. DCIT (2015) 60 Taxmann.com26 (Bang.-Trib.). On the need for allowing working adjustment in determining ALP , the ITAT Mumbai in the case of Capgemini India P. Ltd. v. Assistant Commissioner of Income tax (2013)27ITR (Trib) 74 Mum., held as follows:

“35. The issue was taken before DRP before whom it was pointed out that the ITAT in its own case in 2007-08 has allowed the working capital Capgemini India Private Limited IT(TP) A 540/Mum/2014 adjustment. The DRP simply sustained the order of the AO on the issue, without referring to the decision of the ITAT in its own case.

36. Before us, on the issue of working capital adjustment, the AR submitted that the ITAT in its order had observed, "The assessee has also requested for working

capital adjustment. The case of the assessee is that working capital does have an impact on the profitability of the company and more accounts receivable in case of a company would mean relatively lower profit. Therefore, the companies could be considered as fully comparable if they hold the same level of account receivable and account payable. The TPO has, however, rejected the claim of working capital adjustment which has been upheld by the DRP. The reason given by the authorities below is that the assessee had not made any claim for working capital adjustment in its TP study and that it is not possible to make accurate adjustment on this account as it is difficult to find the account receivable/payable at different points of time during the year. The Id. Sr. Counsel has referred OECD D guidelines as per which if the account receivable/payable on the last date do not give a representative level of working capital for the whole year, average may be used if it reflects the better level of working capital over the year. In our view, working capital adjustments are required to be made because these do impact the profitability of the company. Rule 10B (2)(d) also provides that the comparability has to be judged with respect to various factors including the market conditions, geographical conditions, cost of labour and capital in the market. Accounts receivable/payable affect the cost of working capital. A company which has a substantial amount blocked with the debtors for a long period cannot be fully comparable to the case which is able to recover the debt promptly. In our view, the average of opening and closing balance in the account receivable/payable for the relevant year may be adopted which may broadly give the representative level of working capital over the year. Even if there is some difference with respect to the representative level, it will not affect the comparability as the same method will be applied to all cases. Working capital adjustment cannot be denied to the assessee only on the ground that the assessee had not made any claim in the TP study if it is possible to make such adjustment.”

44. Respectfully following the aforesaid ruling, we direct the TPO to make adjustments on account of working capital to the profit margin of the Assessee as well as the comparables and allow adjustments in accordance with law, after affording opportunity of being heard to the Assessee. We may also add that the DRP in Assessee's own case for AY 2012-13 in its order dated 22.9.2016 allowed claim of the Assessee for adjustment on account of working capital. A copy of the said order is also placed on record.

45. As far as the plea of the Assessee made in ground No.16 for allowing adjustment towards other risk is concerned, the claim of the Assessee in this regard was rejected by the TPO for the following reasons:

“18.10 The summary of risk analysis for the assessee can be made as follows:

- The assessee is totally dependent on the AE for business. Thus the assessee takes the risks associated with heavy dependence on a single customer. In common business parlance it is known as 'single customer risk'.
- The assessee is not compensated any amount for termination of agreement even if it is terminated without any cause. No independent enterprise would like to agree for a termination clause without compensation if it is terminated without any cause.
- The AE is exposed to the market risk and any fluctuation in the business conditions of the AE affect the contractual terms between the AE and the assessee. Thus even if independent comparables undertake some risk, the assessee also had to undertake risks like single customer risk, political risk, etc which are not incurred by the comparable companies and hence the risks are evened out.
- The independent entrepreneur has to incur expenditure on marketing, etc. which is debited to the profit and loss account. But, it is always not necessary that these risks reflected in the marketing, sales promotion expenses will automatically be compensated by Increase in sales or higher margins. For example, increased marketing efforts in some segments of export market may not yield results for an IT enabled service company and thereby there may be a loss on this marketing effort which may bring down the overall profitability rather than increase the profitability. Thus if undertaking the market risk etc. helps in earning any extra margin, the benefit is more than set off by the corresponding expenditure. The same applies to credit risk undertaken.
- There are many studies conducted on the risk reduction strategies followed by MNCs by shifting their production facilities to other countries based mainly on cost factors. By outsourcing to India, the overall cost of production of goods or services by the AE gets reduced which in turn increases the competitiveness of the AE in the market. Thus the assessee is not compensated for the reduction of risk attributable to the operations carried on by the assessee in India.

- The risk profile of the comparables selected by the assessee, acceptable to the assessee and those selected by the TPO but not acceptable to the assessee is similar.
- It is incorrect to say that higher the risk, the higher is the margin though it is true that higher risk expects a higher margin. Thus realization of risk is different from expected return based on risk undertaken.
- The assessee's single customer risk and political / country risk more than offsets any other risk differential between the assessee and the comparable companies.
- Different comparables can have different risk profiles and different profit margins. The proviso to Sec. 92C(2) of the Act provides for adopting arithmetical mean of the different prices. This provision neutralizes the effect of difference in the risk profile, if any between the assessee and the comparables as realized risk may pull down the profitability below the risk free return.
- It is not sufficient to merely spell out risks. But, it has to be shown which risk was actually undertaken by the comparables and to what extent it affected the profitability. The assessee has not done so.

18.11 In view of the above discussion there is no merit in the claim of assessee for risk adjustment and the same is rejected. It may not be out of place to mention here that it has been held, in different judicial decision that the risk adjustment can't be granted as a rule. Some of such judgments are:

- i. As the 'A' failed to bring any evidence of record to show that there was any difference in risk profiles of comparable companies and since the 'A' failed to file the details exhibiting risk borne by comparables, no risk adjustment can be given, even on ad hoc basis.- Marubeni India Pvt ltd (2011-TII-36-ITAT-Del-TP)
- ii. Unless it is shown that difference in function and risk leads to inflation or deflation of financial results, risk adjustments need not be granted as a rule. Assessee could not show how such risk difference affected the results of the comparables. Assessee could not quantify these differences for each comparable.- Symantec Software Solutions Pvt Ltd(2011-TII-60-ITAT-Mum-TP)
- iii. There are several factors such as market risks, which affect the results of the company. These factors make it impracticable to find out exact duplicate of the assessee as comparable. Some variation is bound to exist. The TPO had identified comparables whose functions were similar to the assessee by applying quantitative and qualitative filters to eliminate differences between the assessee and the

comparable to neutralize the risk factors. The assessee's argument that it is a "low end performer" operating in "risk-free environment" and that suitable adjustment should be made is not acceptable;- DCIT vs. Deloitte Consulting India Pvt. limited (ITAT Hyderabad)

18.12 Taking all these facts entirely into account, the assessee is not entitled for any risk adjustment.”

46. On objection of the Assessee on the above conclusion of the TPO in his order, the DRP upheld the action of the TPO, for the following reasons:

“Decision:

11.2. The claim of the Assessee for risk adjustment has been considered. While as per the Rules, adjustment should be provided for each function and difference of the risk identified. Needless to say as mentioned in OECD TP Guidelines, the exercise requires judgment and it is practically not possible to quantify the difference in exact numeric terms and would have to be based on most reliable methods/estimates. What is to be appreciated is whether an independent enterprise would agree for such adjustment to the price in the facts and circumstances surrounding the transaction. It has been held in Symantech software solutions Pvt. Ltd. 2011-TII-16-Mum-TP unless it has shown the difference in function leads to inflation and deflation of financial results, risk adjustment need not be granted as a rule. The A.O. has conducted the detailed analysis of the assessee in para 18.10 of his order therefore considering the same and the above it is held that the assessee is not entitled to any risk assessment nor has the Assessee given details or quantification of the risk Assessment its objections cannot be accepted and the action of the A.O. is upheld.”

47. The learned counsel for the Assessee has placed on reliance on several decisions rendered on the issue of risk adjustment to be given and the same are in CLPB vol-I.

48. We have considered the submissions and the decisions in this regard cited before us in which it has been held that appropriate adjustments have to be given for various risks, such as the one claimed by the Assessee in the present case. The following are the decisions in support of such proposition:

1. *Hyundai Motors India Engineering Pvt. Ltd. vs. The ITO, Ward-2(2), (I.T.A. No. 1850/Hyd/2012)*
2. *M/s 3DPLM Software Solutions Ltd. Vs. DCIT, Circle-11(1), Bangalore (I.T.(T.P.) A. No. 1303/Bang/2012)*
3. *M/s Hellosoft India Pvt. Ltd. vs. DCIT, Circle-2(2), (I.T.A. No. 645/Hyd/2009)*
4. *M/s Motorola Solutions India Pvt. Ltd. vs. ACIT (I.T.A. No. 5637/Del/2011)*
5. *M/s Sony India (P) Limited, Appellant vs. Deputy Commissioner of Income Tax, Respondent, and Vice Versa*
6. *Philips Software Center Private Limited vs. ACIT (119 TTJ 721)*

49. It cannot be said as a rule that no risk adjustment can be given. It can also not be said that the risk adjustment should be given in all cases. It depends on facts and circumstances of each case. As far as the present case is concerned the Assessee is a captive service provider and dependent on its associate enterprises and therefore there is a single customer risk. Besides the above the assessee has also highlighted several other risk factors. In the decisions cited by the Id. Counsel for the assessee, Tribunal has taken the view adjustment towards the risk factors should be given. We are of the view that it would be just and appropriate to set aside the order of the DRP on this issue and remand the question of allowing risk adjustment to the AO for fresh consideration. This ground no.16 is thus treated as allowed for statistical purposes.

50. As far as grounds of appeal raised by the revenue are concerned while dealing with the grounds of appeal of the assessee we have already held that foreign exchange loss or gain will be considered as part of the operating profits of the assessee. If they relate to and arise out of the business of the assessee and in particular the transactions in relation to which the arms length price is determined. In the present case the assessee is a captive service provider and software development is the only activity of the assessee and therefore income arising out of foreign exchange gain or loss has to be regarded as part of the operating income of the assessee.

51. As far as ground no.2 raised by the revenue is concerned in the present case as we have already seen that though the nomenclature used by the assessee was bad debts the reality is that the amount written off as bad debts is like sales return, where customers have not paid for software development because they did not find software due to existence of bugs. It has a direct nexus with the business and transaction for which the arms length price is to be determined, therefore the same has to be considered as part of operating expense for the purpose of determining the profit margin. We therefore do not find any merits in the grounds raised by the revenue.

52. Ground No.17 raised by the assessee reads as follows :-

“ 17. For that the Authorities below erred in disallowing a sum of Rs.2,99,979/- under section 14A of the Act read with Rule 8D(2)(iii) of the Rules. “

53. As far as ground no. 17 raised by the assessee is concerned, the issue is with regard to disallowance of expenses incurred earning exempt income. The disallowance was made by the AO by invoking the provision of section 14A of the Act. The claim of the assessee was that the assessee received as dividend of only a sum of Rs.33,79,674/- which was not chargeable to tax under the Act and exempt. The assessee computed the disallowance of expenses incurred for earning tax free income in terms of Sec.14A of the Act of a sum of Rs.1,12,895/- being 10% of salary and allowances to the finance and administrative staff. According to the assessee this was only expenditure which can be attributable for earning tax free income. The AO however invoked the provision of Rule 8D(2)(iii) of the Rules and made disallowance of Rs.4,12,874/- but restricted the disallowance of Rs.2,99,979/- (4,12,874 – 1,12,895) since the assessee has already disallowed Rs.1,12,895/-.

54. On objection by the assessee before DRP the DRP confirmed the action of the AO.

55. We have heard the rival submissions. The computation of disallowance u/s 14A of the Act was done by the assessee by attributing 10% of the salary and allowances of the finance and administrative staff. This disallowance was made having regard to the books of accounts of the assessee. This disallowance made by the assessee has taken care of the activities of the assessee and the probable time that needs to be spent for managing the investments which are likely to be tax free income. Neither the AO nor the DRP have found fault with this calculation made by the assessee. The provision of Rule 8D(1) as also the provision of section 14A(2) of the Act mandate disallowance in accordance with Rule 8D(2) of the Rules, only where having regard to the accounts of the assessee, the AO is not satisfied with the correctness of the claim of the assessee regarding expenditure incurred to earn tax free income. In the absence of any reason in given for rejecting the claim of the assessee, we hold that disallowance u/s 14A of the Act should be restricted only to the sum of Rs.1,12,895/- as disallowed by the assessee in its computation. Thus ground no. 17 raised by the assessee is allowed.

56. Ground No.18 raised by the assessee reads as follows :-

“ 18. For that the Assessing Officer erred in adding back depreciation of Rs.42,58,767 as per the Appellant’s books of account and in granting deduction of depreciation as per Rules of Rs.34,05,607/-.”

57. As far as ground no.18 raised by the assessee is concerned, while computing the book profits u/s 115JB of the Act, the AO is not empowered to make any adjustment which is not permitted by the explanation below section 115JB of the Act. The depreciation to be allowed while working the book profits is always as per the Companies Act and the depreciation should not be reduced as is done in the normal assessments by substituting the depreciation claimed under the Companies Act by the depreciation allowable under the Act. The action of the AO is per se unsustainable and the AO is directed to deduct depreciation only as per the Companies Act as done by the Assessee in its computation of book profits for the purpose of Sec.115JB of the Act.

58. Ground No.19 raised by the assessee reads as follows :-

“ 19. For that the Assessing Officer erred in adding back Rs.2,99,979 under section 14A of the Act read with rule 8D(2)(iii) of the Rules while computing book profits.”

59. As far as ground No.19 is concerned while deciding ground no.17 raised by the assessee we have also held that the computation of disallowance u/s 14A of the Act as made by the assessee has to be accepted. Therefore ground no.19 does not require any separate consideration.

60. In the result the appeal of the assessee is partly allowed and the appeal by the revenue is dismissed.

Order pronounced in the Court on 04.10.2017.

Sd/-
[M.Balaganesh]
Accountant Member

Sd/-
[N.V.Vasudevan]
Judicial Member

Dated : 04.10.2017.
[RG PS]

Copy of the order forwarded to:

1. M/s. Nomura Research Institute & Financial Technologies Pvt. Ltd,
2. D.C.I.T., Circle-2(2), Kolkata.
3. CIT(DR), Kolkata Benches, Kolkata.

True copy

By Order

Senior Private Secretary
Head of Office/ D.D.O., ITAT, Kolkata Benches

