

**IN THE INCOME TAX APPELLATE TRIBUNAL  
(DELHI BENCH 'I-2' : NEW DELHI)**

**BEFORE SHRI N.K. SAINI, ACCOUNTANT MEMBER  
and  
SHRI KULDIP SINGH, JUDICIAL MEMBER**

**ITA No.1102/Del./2015  
(ASSESSMENT YEAR : 2010-11)**

M/s. NEC Technologies India Ltd., vs. DCIT,  
(formerly known as NEC HCL Systems Circle 18(1),  
Technologies Ltd.), New Delhi.  
Unit No.1, 2<sup>nd</sup> Floor, TDI Centre,  
Commercial Plot No.7, Jasola,  
New Delhi – 110 025.

**(PAN : AACCN2062Q)**

**(APPELLANT)**

**(RESPONDENT)**

ASSESSEE BY : Shri Ajay Vohra, Senior Advocate,  
S/Shri Neeraj Jain & Rami Katyal,  
Advocates

REVENUE BY : Shri H.K. Choudhary, CIT DR

Date of Hearing : 05.10.2017

Date of Order : 27.10.2017

**ORDER**

**PER KULDIP SINGH, JUDICIAL MEMBER :**

The Appellant, M/s. NEC Technologies India Ltd. (hereinafter referred to as 'the taxpayer') by filing the present appeal sought to set aside the impugned order dated 29.01.2015, passed by the AO in consonance with the orders passed by the ld. DRP/TPO under section 143 (3) read with section 144C of the

Income-tax Act, 1961 (for short 'the Act') qua the assessment year 2010-11 on the grounds inter alia that :-

**“General Ground:**

- 1. That the impugned order of assessment framed by the assessing officer in pursuance of the directions of the Dispute Resolution Panel (hereinafter referred to as 'DRP') under Section 143(3) read with Section 144C of the Income-tax Act, 1961 ('Act'), is bad in law, violative of principles of natural justice and void ab-initio.*
- 2. That assessing officer erred on facts and in law in determining income of the appellant at RS.16,67,38,442 against the total income returned by the appellant of RS.3,09,32,409.*

**Transfer Pricing Matters:**

*3. That the assessing' officer erred on facts and in law in making an addition of Rs. 4,11,03,650 to the income of the appellant, on account of the alleged difference in the arm's length price of the international transactions of rendering software services undertaken during the previous year, on the basis of the order passed under section 92C(3) of the Act by the TPO.*

*3.1 That the TPO / DRP erred on facts and in law by failing to appreciate the commercial expediencies surrounding the international transaction pertaining to provision of software development services,*

*3.2 That the TPO / DRP erred on facts and in law in rejecting the corroborative analysis performed using Comparable Uncontrolled Price ("CUP") Method to establish the arm's length price of international transaction of provision of software development services.*

**3.3 That the DRP erred on facts and in law in rejecting the use of CUP method holding that in the absence of one to one correspondence with the transactions being compared, CUP cannot be applied**

**3.4 That the TPO / DRP erred on facts and in law in not appreciating that outsourcing costs, being pass through items, ought to be excluded from the cost base of the of the Appellant for the purpose of benchmarking analysis.**

**3.5 That the DRP erred on facts and in law in holding that outsourcing cost cannot be excluded from the cost base as it constitutes part of the international transaction being benchmarked**

**3.6 That the TPO/ DRP erred on facts and in law by applying turnover filter of Rs 5 crores for selecting / rejecting the comparable companies.**

**3.7 That the TPO/DRP erred on facts and in law in considering Infosys Ltd, having turnover of Rs 21,140 crore, as comparable to the appellant**

**3.8 That the TPO / DRP erred on facts and in law in rejecting the following companies by applying filter of 75% export sales:**

- (i) Cigniti Technologies Ltd**
- (ii) Maveric Systems Ltd**
- (iii) Indus Networks limited**

**3.9 That the TPO/DRP erred on facts and in law in applying the filter of diminishing revenue for selection/rejection of comparable companies.**

**3.10 That the TPO/ DRP erred on facts and in law in rejecting companies having employee cost less than 25 percent of operating costs.**

**3.11 That the TPO/ORP erred on facts and in law in rejecting CG-VAK Software and Exports Limited**

*as comparable allegedly on the basis that its employee cost to operating cost ratio is 5.56% not appreciating that the correct employee cost ratio is 70.69%*

*3.12 That the TPO/DRP erred on facts and in law in rejecting the following companies allegedly on the ground that financial statements of these companies were not available for the year ending March 31, 2009 :*

- a) Helios & Matheson Information Technology Limited*
- b) Caliber Point business Solutions Limited*
- c) R Systems International Limited*
- d) Silverline Technologies Limited*

*3.13 That the TPO/DRP erred on facts and in law in rejecting Goldstone Technologies Ltd as comparable holding that this companies is not functionally comparable to the appellant.*

*3.14 That the TPO/DRP erred on facts and in law in considering the following companies in the final set of comparable companies not appreciating that such companies are not functionally comparable to the appellant:*

- (i) Tata Elxsi Limited*
- (ii) Infosys Technologies Limited*
- (iii) Thirdware Solutions Limited*

*3.15 That the TPO/DRP on facts and circumstances of the case, ought to have excluded Persistent Systems Limited and Evoke Technologies Limited from the final set of comparable companies as being functionally not comparable to the appellant*

*3.16 That the TPO / DRP erred on facts and in law in considering Infosys Technologies Limited in the final set of comparable companies without*

*appreciating that its scale of operations cannot be compared with that of the appellant.*

*3.17 That the TPO / DRP have erred on facts and in law in selecting companies earning super normal profits as comparable to the Appellant.*

*3.18 That the TPO / DRP erred on facts and in law in considering foreign exchange gains or loss as non operating item for the purpose of computing the operating profit margins.*

*3.19 That the TPO / DRP erred on facts and in law in considering provision for doubtful debts as non operating item for the purpose of computing the operating profit margins*

*3.20 That the TPO / DRP erred on facts and in law in considering bank charges as non operating item for the purpose of computing the operating profit margins*

*3.21 That the TPO erred on facts and in law in considering incorrect profit margin of following companies despite a direction from the DRP for taking the correct margin for determining the arm's length price:*

<i>Name of the company</i>	<i>Margin considered by TPO</i>	<i>Actual Margin</i>
<i>Larsen and Toubro Infotech Ltd</i>	<i>22.72%</i>	<i>21.59%</i>
<i>RS Software India Limited</i>	<i>12.41 %</i>	<i>11.52%</i>
<i>Mindtree Limited</i>	<i>19.12%</i>	<i>16.74%</i>
<i>Evoke Technologies Pvt Ltd</i>	<i>20.71%</i>	<i>20.32%</i>
<i>Thirdware Solutions Ltd</i>	<i>41.80%</i>	<i>28.29%</i>

**3.22 That the DRP/TPO erred on facts and in law in incorrectly excluding the following companies from the final list of comparables:**

- (i) Goldstone Technologies Ltd**
- (ii) Quintegra Solutions Ltd**
- (iii) Saven Technologies Ltd**

**3.23 That the TPO / DRP erred on facts and in law in not allowing appropriate risk adjustment for the purpose of benchmarking the international transaction of provision of software services undertaken by the appellant allegedly holding that in absence of robust and reliable data risk adjustment could not be considered.**

**Corporate Tax Matters:**

**4. That the assessing officer erred on facts and in law in making a disallowance of Rs. 9,34,91,383 under section 40(a)(i) of the Act in respect of payment made by the appellant's Japan Branch Office to HCL Japan Ltd, despite the directions of the DRP to delete the said disallowance.**

**5. That the assessing officer erred on facts and in law in not allowing deduction under section 10A of the Act to the extent of Rs.12,11,000 with respect to unbilled revenue recorded by the appellant on the ground that:**

**6. That the DRP erred on facts and in law in not allowing the deduction under section 10A of the Act holding that the change of accounting policy would result in the appellant claiming deduction in assessment year 2011-12 with respect to invoices to be raised in assessment year 2012-13, when no deduction under section 10A is available**

**7. That the assessing officer erred on facts and in law in levying interest under Section 234B and Section 234C of the Act.”**

2. Briefly stated the facts necessary for adjudication of the controversy at hand are : NEC Technologies India Limited (NEC HCL) has been set up at Noida which is availing tax exemption under section 10A of the Act and is also having branch office in Japan (NEC HCL BO). The main activity of the taxpayer is with NEC group companies with regard to the contract awarded to NEC HCL. During the year under assessment, the taxpayer has entered into international transaction qua software development services to the tune of Rs.56,76,10,033/- which are to the following effect :-

<i>No.</i>	<i>Nature of transaction</i>	<i>Approach of taxpayer</i>		<i>Value of transaction</i>
		<i>Method</i>	<i>PLI</i>	
<i>1</i>	<i>Provision of software development</i>	<i>TNMM</i>	<i>OP/TC</i>	<i>56,76,10,033</i>
<i>2</i>	<i>Payment of outsourcing costs</i>	<i>TNMM</i>	<i>OP/TC</i>	<i>9,34,91,383</i>
<i>3</i>	<i>Availing of management services</i>	<i>TNMM</i>	<i>OP/TC</i>	<i>46,32,003</i>
<i>4</i>	<i>Payment of lease rent</i>	<i>TNMM</i>	<i>OP/TC</i>	<i>57,43,348</i>
<i>5</i>	<i>Purchase of fixed assets</i>	<i>TNMM</i>	<i>OP/TC</i>	<i>50,95,718</i>
<i>6</i>	<i>Sale of mobile phones</i>	<i>CUP</i>	<i>WDV</i>	<i>17,533</i>
<i>7</i>	<i>Reimbursement of exp. To AEs</i>	<i>TNMM</i>	<i>OP/TC</i>	<i>53,74,233</i>
<i>8</i>	<i>Royalty payment for using brand</i>	<i>TNMM</i>	<i>OP/TC</i>	<i>7,93,915</i>

3. Assessee in order to benchmark its international transactions in the software development services segment chosen 21 comparables having OP/TC at 11.26% as against 9.63% of the tested parties (the taxpayer in this case) by adopting weighted

average for the current year and the immediately preceding two years. In the working of the margins, the taxpayer has not made any working capital or risk adjustment and consequently, the taxpayer was called upon to provide margins of comparable for current year and then he has provided updated margins of 23 comparable companies with arithmetic mean of 11.53% with no working capital or risk adjustment made in the margins of comparables. After applying and discussing various filters by the TPO, he has chosen 17 comparables having average mean of 26.93%. TPO also provided working capital adjustment to the comparables and with working capital adjustment OP/OC comparable is 27.11% and thereby computed the shortfall on account of adjustment of Arm's Length Price at Rs.7,47,70,768/-.

4. The taxpayer carried the matter before the Id. DRP by way of raising objections who has directed the TPO to exclude E-Infochips Bangalore Limited and Infinite Data Systems Pvt. Ltd. and to correct the margin of comparable companies, namely, Larsen and Toubro Infotech Ltd., Mindtree Ltd, RS Software India Ltd., Evoke Technologies Pvt. Ltd. and Thirdware Solutions Ltd. Consequently, TPO considered 15 comparables for benchmarking the international transactions having arithmetic mean of 20.50%. Pursuant to the directions issued by Id. DRP, AO/TPO computed

the adjustment on ALP to the tune of Rs.4,11,03,650/- on account of difference in the margin of comparable companies and the taxpayer. Feeling aggrieved, the taxpayer has come up before the Tribunal by way of filing the present appeal.

5. We have heard the Id. Authorized Representatives of the parties to the appeal, gone through the documents relied upon and orders passed by the revenue authorities below in the light of the facts and circumstances of the case.

**GROUND NO.1 & 2**

6. Grounds No.1 & 2 are general in nature and do not require any adjudication.

**GROUND NO.3 TO 3.23**

7. Undisputedly, Transactional Net Margin Method (TNMM) used by the taxpayer in its TP documentation for benchmarking the international transaction qua software development services as most appropriate method has been accepted by the Id. TPO. It is also not in dispute that benchmarking the international transaction, the taxpayer treated itself as a tested party by taking OP/OC as Profit Level Indicator (PLI) and by selecting 21 companies as comparables with OP/OC of 11.26% as against taxpayer's

operating profit margin at 9.63% and found its international transactions at arm's length.

8. TPO, after retaining some of the comparables chosen by the taxpayer, introduced its own comparables and finally selected the following companies as comparables for benchmarking the international transactions :-

<b>S.No.</b>	<b>Company Name</b>	<b>Working Capital Adjustment OP/OC</b>
<b>1.</b>	<b><i>Akshay Software</i></b>	<b>0.91%</b>
<b>2.</b>	<b><i>Cat Technologies Ltd</i></b>	<b>11.14%</b>
<b>3.</b>	<b><i>Evoke tech</i></b>	<b>20.71%</b>
<b>4.</b>	<b><i>E-zest Solutions</i></b>	<b>19.92%</b>
<b>5.</b>	<b><i>Infosys Ltd</i></b>	<b>45.65%</b>
<b>6.</b>	<b><i>Larsen and Toubro Infotech</i></b>	<b>22.72%</b>
<b>7.</b>	<b><i>Mindtree Ltd.</i></b>	<b>19.12%</b>
<b>8.</b>	<b><i>Persistent Systems &amp; Solutions Ltd</i></b>	<b>15.08%</b>
<b>9.</b>	<b><i>Persistent Systems Ltd</i></b>	<b>32.10%</b>
<b>10.</b>	<b><i>RS software India Ltd</i></b>	<b>12.41%</b>
<b>11.</b>	<b><i>Sasken Communication Technologies Ltd</i></b>	<b>19.39%</b>
<b>12.</b>	<b><i>Tata Elxsi</i></b>	<b>20.41%</b>
<b>13.</b>	<b><i>Thinksoft Global Services Ltd</i></b>	<b>16.22%</b>
<b>14.</b>	<b><i>Thirdware Solutions</i></b>	<b>41.80%</b>
<b>15.</b>	<b><i>Ybrant diqita] Ltd</i></b>	<b>9.98%</b>
<b>16.</b>	<b><i>E-Infochips Bangalore Limited</i></b>	<b>67.37%</b>
<b>17.</b>	<b><i>Infinite Data Systems Pvt Ltd</i></b>	<b>85.96%</b>
	<b><i>Arithmetic mean</i></b>	<b>27.11%</b>

9. TPO by taking arithmetic mean of 27.11% of the comparables companies computed TP adjustment for benchmarking the international transaction as under :-

<b>Particulars</b>	<b>Amount (Rs.)</b>
<b>Operating Cost</b>	<b>50,39,98,779</b>
<b>Arm's length margin</b>	<b>27.11% of Operating Cost</b>
<b>Arm's Length Price</b>	<b>64,06,32,848</b>
<b>Price shown in international transaction</b>	<b>56,58,62,080</b>
<b>Shortfall being adjustment u/s 92CA</b>	<b>7,47,70,768</b>

10. However, after order passed by the ld. DRP, TPO recomputed the margin of the comparable companies to the tune of 20.50% as against taxpayer's mean margin of 12.27% and proposed an adjustment of Rs.4,11,03,650/- on account of difference in the margin of the comparables vis-à-vis the taxpayer.

11. At the very outset, the ld. AR for the taxpayer challenging the impugned order contended that he only seeks exclusion of four comparables for benchmarking the international transaction for software development services, viz., Infosys Limited, Tata Elexi, Thirdware Solutions and Persistent Systems Ltd. So, we will examine suitability of all the aforesaid four comparable companies for purpose of benchmarking the international transaction of the taxpayer qua software development services.

### **INFOSYS LIMITED (INFOSYS)**

12. The taxpayer challenged the comparability of Infosys vis-à-vis the taxpayer before TPO as well as ld. DRP on the grounds

inter alia that it is having high turnover of Rs.21140 crores; that Infosys assumes entrepreneurial risk and having huge ownership of intangibles and brands and it also deals in software products and relied upon numerous decisions rendered by Hon'ble High Courts as well as coordinate Benches of the Tribunal.

13. However, Id. DR for the Revenue drew our attention towards para 2.1 of the joint venture agreement, available at page 890 of Vol.III of paper book, in order to highlight the profile of the taxpayer and to prove the fact that the taxpayer is a high end service provider and the comparable sought to be excluded are also high end service provider.

14. For ready perusal, para 2.1 of the joint venture agreement, available at page 890 of Vol.III of the paper book, is reproduced as under :-

***“2.1 The Parties hereby agree that the Company is being established for the purpose of providing offshore centric software engineering services and solutions primarily to NECC, NECST and their Subsidiaries and clients. It is contemplated that at the end of the Initial Term, the Parties shall discuss and review the business of the Company and unanimously agree on the future functioning of the Company including its further Business Plan. In no event, shall anything in this Agreement be construed as obligating NECC to place any order to the Company for purchasing the software services and solutions.”***

15. However, when Id. AR for the taxpayer drew our attention towards para 2.2 of the joint venture agreement, available at page 891 of Vol.III of the paper book, it has become clear that the taxpayer is a routine service provider. Moreover, the taxpayer being a captive software provider is providing the services to its AE for which it is being asked for. Moreover the fact that the taxpayer is a software development provider which is a fact accepted by TPO/DRP and the Id. DRP cannot travel beyond that. So, we are of the considered view that providing hardware design, as has been pointed out by the Id. AR for the taxpayer, to its AE is one such function amongst others as has been mentioned in para 2.2 of the joint venture agreement. Moreover, there is no difference in high end and low end services so far as KPO is concerned.

16. Suitability of Infosys as comparable has been examined by *Hon'ble Delhi High Court in CIT vs. Agnity India Technologies Pvt. Ltd. – (2013) 36 taxmann.com 289 (Delhi)*, available at pages 25 to 28 of the paper book, which is also a captive software services provider, by making following observations :-

*“5. The tribunal has observed that the assessee was not comparable with Infosys Technologies Ltd., as Infosys Technologies Ltd. was a large and bigger company in the area of development of software and, therefore, the profits earned cannot be a bench marked or equated with the respondent, to determine the results declared by the respondent-assessee. In paragraph 3.3*

*the tribunal has referred to the difference between the respondent-assessee and Infosys Technologies Ltd. For the sake of convenience, we are reproducing the same:-*

<b>“Basic Particular</b>	<b>Infosys Technologies Ltd.</b>	<b>Agnity India</b>
<b>Risk Profile</b>	<i>Operate as full-fledged risk taking entrepreneurs</i>	<i>Operate at minimal risks as the 100% services are provided to AEs</i>
<b>Nature of Services</b>	<i>Diversified-consulting, application design, development, re-engineering and maintenance system integration, package evaluation and implementation and business process management, etc. (refer page 117 of the paper book)</i>	<i>Contract Software Development Services.</i>
<b>Revenue</b>	<i>Rs.9, 028 Crores</i>	<i>Rs.16.09 Crores</i>
<b>Ownership of branded/proprietary products</b>	<i>Develops/owns proprietary products like Finacle, Infosys Actice Desk, Infosys iProwe, Infosys mConnect, Also, the company derives substantial portion of its proprietary products (including its flagship banking product suite ‘Finacle’)</i>	
<b>Onsite Vs. Offshore</b>	<i>- As much as half of the software development services rendered by Infosys are onsite (i.e., services performed at the customer’s location overseas). And offshore (50.20%) (Refer page 117 of the paper book) than half of its service, income from onsite services.</i>	<i>The appellant provides only offshore services (i.e., remotely from India)</i>
<b>Expenditure on</b>	<i>Rs.61 Crores</i>	<i>Rs. Nil (as the</i>

<i>Advertising/Sales promotion and brand building</i>		<i>100% services are provide to AEs)</i>
<i>Expenditure on Research &amp; Development</i>	<i>Rs. 102 crores</i>	<i>Rs. Nil</i>
<i>Other</i>		<i>100% offshore (from India)</i>

6. *Learned counsel for the Revenue has submitted that the tribunal after recording the aforesaid table has not affirmed or given any finding on the differences. This is partly correct as the tribunal has stated that Infosys Technologies Ltd. should be excluded from the list of comparables for the reason latter was a giant company in the area of development of software and it assumed all risks leading to higher profits, whereas the respondent-assessee was a captive unit of the parent company and assumed only a limited risk. It has also stated that Infosys Technologies Ltd. cannot be compared with the respondent-assessee as seen from the financial data etc. to the two companies mentioned earlier in the order i.e. the chart. In the grounds of appeal the Revenue has not been able to controvert or deny the data and differences mentioned in the tabulated form. The chart has not been controverted.*

7. *Learned counsel for the appellant Revenue during the course of hearing, drew our attention to the order passed by the TPO and it is pointed out that based upon the figures and data made available, the TPO had treated a third company as comparable when the wage and sale ratio was between 30% to 60%. By applying this filter, several companies were excluded. This is correct as it is recorded in para 3.1.2 of the order passed by the TPO. TPO, as noted above, however had taken three companies, namely, Satyam Computer Service Ltd., L&T Infotech Ltd. and Infosys Technologies as comparable to work out the mean.*

8. *It is a common case that Satyam Computer Services Ltd. should not be taken into consideration. The tribunal for valid and good reasons has pointed out that Infosys Technologies Ltd. cannot be taken as a comparable in the present case. This leaves L&T Infotech Ltd. which gives us the figure of 11.11 %, which is less than the figure of 17% margin as declared by the respondent-assessee. This is the finding recorded by the tribunal. The tribunal in the impugned order has also observed that the assessee had furnished details of workables in respect of 23 companies and the mean of the comparables worked out to 10%, as against the margin of 17% shown by the assessee. Details of*

*these companies are mentioned in para 5 of the impugned order.”*

17. Comparability of Infosys has also been examined by the coordinate Bench of the Tribunal in *Toluna India Pvt. Ltd. vs. ACIT in ITA No.5645/Del/2011 order dated 26.08.2014* which was rendering services to its own AE on cost plus basis without having any intangible assets or retaining any intellectual property in the work done by it. Coordinate Bench of the Tribunal held Infosys to be not comparable on the ground that it is a giant company having huge capacity to assume entrepreneurial risk, having huge turnover of Rs.21140 crores and having revenue ownership of branded / proprietary products.

18. Moreover, Infosys is engaged in significant R&D activities leading to creation of significant intellectual property during the year under assessment and has incurred substantial expenditure of R&D activities to the tune of Rs.267 crores i.e. 1.3%.

19. Keeping in view the fact that the taxpayer is a low end captive service provider to its AE having no intangibles or branded / proprietary products vis-à-vis Infosys and following the decision rendered by Hon'ble High Court in *CIT vs. Agnity India Technologies Pvt. Ltd.* (supra), we are of the considered view that

this company is not a suitable comparable for benchmarking the international transaction qua software development services.

**PERSISTENT SYSTEMS LTD. (PERSISTENT)**

20. Persistent is taxpayer's own comparable and retained by the TPO in the final set of comparables on the operating profit margin of 32.50%. However, now the taxpayer sought to exclude Persistent on ground of having different business model vis-à-vis taxpayer as Persistent is into the business of providing software product and relied upon *Taluna India Pvt. Ltd.* (supra), *Steria India Ltd. (ITA No.107/Del/2016) affirmed by Hon'ble Delhi High Court in ITA 762/2017, Agilis Technologies India Pvt. Ltd. vs. ACIT (ITA No.786/Del/2015) and Telcordia Technologies India Pvt. Ltd. vs. ACIT (ITA No.7821/Mum/2011).*

21. Comparability of Persistent has been examined by the coordinate Bench of the Tribunal in *Taluna India Pvt. Ltd.* (supra) wherein it has been ordered to be excluded on ground of merger by making following observations :-

***“33. After considering the rival submissions and perusing the relevant material on record, we hold that this company also cannot be considered as comparable because of merger of another company into it, which fact is evident from page 196 of the paper book. It can be seen that a subsidiary company was merged into this company pursuant to judgment of Hon'ble Bombay High Court w.e.f. 1.4.06. Because of the merger of***

*subsidiary into this company, we hold that the financial position of this company cannot be construed as normal capable of a good comparison. Following the Mumbai Bench decision in Petro Araldite (P) Ltd. (supra) , we direct the exclusion of this company from the list of comparables. The assessee succeeds.”*

22. Furthermore when we examine annual report of Persistent, available at pages 120 to 209 of the paper book, relevant pages 170 to 173, it is amply clear that Persistent deals in software products and earned its income both from software services and product whereas the taxpayer deals in software services and as such cannot be compared with Persistent for benchmarking the international transaction.

23. In view of what has been discussed above, we direct to exclude Persistent from final set of comparables for benchmarking the international transaction.

#### **TATA ELEXI (TATA)**

24. TPO has selected Tata as a comparable despite raising objection by the taxpayer that its operation predominantly relate to providing system integration and software development services in the information technology field; for FY 2007-08 & 2008-09 the company has revenue from two segments viz. systematic information & support and software development & services – the business constituting this segment are Product Design Services

(Design and Development of Hardware and Software), Innovation Design Engineering (Mechanical Design with a focus on Industrial Design) and Visual Computing Labs Division (Animation and Special Effects); that as per P&L Account for FY 2008-09, for FY 2007-08 and FY 2008-09, the revenues are from “Sales and Services: No further bifurcation given for revenues from software development and services”. However, TPO retained this company as comparable by observing that the company is engaged in providing software services by relying upon annual report of the company which is to the effect that, “*Visual Computing Labs : VCL delivers 3D computer graphics, animation and special effects in the pre-production, production and post-production of content for the film, television, gaming and advertising industry.*”

25. Comparability of this has been examined by the coordinate Bench of the Tribunal in *Toluna India Pvt. Ltd.* (supra) wherein it has been ordered to be excluded as a comparable with *Toluna India Pvt. Ltd.* (supra), a software development and service provider by making following observations :-

***“39.1. The TPO included this company in the list of comparables by noticing that its ‘Software development and services segment’ matched with the assessee. On being called upon to explain as to why this company be not included in the list of comparables, the assessee stated that the nature of activity done by this company was different inasmuch as it was engaged in R&D***

*activities also which resulted in creation of intellectual property. Not convinced with the assessee's submissions, the TPO included this segment of the company in the list of comparables."*

26. Tata come up for comparability before coordinate Bench of Mumbai of the Tribunal in case of *Telcordia Technologies India Pvt. Ltd. – ITA No.7821/Mum/2011 order dated 11.05.2012* and has been ordered to be excluded from the final set of comparables with *Telcordia Technologies India Pvt. Ltd* (supra) which is also engaged in the business of software development related services by making following observations :-

***“7.7 Tata Elxsi Limited.:***

*From the facts and material on record and submissions made by the learned AR, it is seen that the Tata Elxsi is engaged in development of niche product and development services, which is entirely different from the assessee company. We agree with the contention of the learned AR that the nature of product developed and services provided by this company are different from the assessee as have been narrated in para 6.6 above. Even the segmental details for revenue sales have not been provided by the TPO so as to consider it as a comparable party for comparing the profit ratio from product and services. Thus, on these facts, we are unable to treat this company fit for comparability analysis for determining the arms length price for the assessee, hence, should be excluded from the list of comparable parties.”*

27. So keeping in view the fact that Tata being engaged in product design services, innovation design engineering services and visual computing labs and has specialized and niche domain of

software products/services and by following the decision rendered by the Tribunal in *Toluna India Pvt. Ltd.* and *Telcordia Technologies India Pvt. Ltd* (supra), we find Tata as not a suitable comparable for benchmarking the international transaction.

**THIRDWARE SOLUTIONS LTD. (THIRDWARE)**

28. The taxpayer sought to exclude this company from the final set of comparables. The ld. TPO however retained this company on the ground that this is into development of software services and its annual report is available in public domain. The ld. DRP also retained this comparable on the ground that its income from IT and software services is more than 75% of the total operating revenue.

29. The ld. AR for the assessee sought exclusion of this company on the grounds inter alia that it has insufficient financial or description information to perform analyses; that it has functional dissimilarity because its revenue from subscription as well as sale of licence and relied upon *Egain Communication (P.) Ltd. vs. ITO – (2008) 23 SOT 385 (Pune)*, *3DPLM Software Solutions Ltd. vs. DCIT – ITA No.1303/Bang/2012* and *St. Ericson India Pvt. Ltd. vs. ACIT – ITA No.7821/Mum/2011*; that Thirdware also owns software/ proprietary products and is also into purchase and sale of licence to earn income.

30. The factum of earning of revenue subscription as well as of licence is proved from page 258 of the annual report of Thirdware of the paper book, schedule forming part of balance sheet and profit & loss account wherein the revenue from subscription as well as from purchase in licence is shown at Rs.74,26,721/- and Rs.1,35,24,304/- respectively and this income makes Thirdware incomparable to the taxpayer for benchmarking the international transaction.

31. Coordinate Bench of the Tribunal examined comparability of Thirdware in case of *St. Ericson India Pvt. Ltd. vs. ACIT – ITA No.1672/Del/2014* which is also a software development service provider and held the same to be incomparable for benchmarking the international transactions of software development services provider by returning following findings :-

***“47. This is again TPO’s own comparable and assessee sought to exclude this company from the list of comparables on the ground of non-comparable services i.e application implementation, management and development services. TPO rejected objections raised by the assessee by observing that software development, implementation and support services are various sub-segments of software development services only and require employment of software engineers and retained this company as a comparable for benchmarking international transactions.***

***48. However, perusal of the annual report of this company, available at page 1735 to 1782 of the Paper Book Vol.IV, goes to prove that the substantial revenue***

*of this company is from sales and operating sales of licence; software services, export from SEZ unit, export from STPI unit and revenue from subscription. It is also apparently clear that software services segment accounts for Rs.8.91 crores out of the total sales of Rs.77 crores whereas segmental results are not available. So, when this company's substantial revenue is from other various business segments like sale of licence, software services and segmental results are not available, this company cannot be a valid comparable for benchmarking the international transaction, hence ordered to be excluded.*

32. Coordinate Bench of the Tribunal in *Egain Communication (P.) Ltd. vs. ITO* (supra), available at pages 297 to 325 of the case laws compendium, examined its comparability vis-à-vis a software development service provider company and directed to exclude the same from the final set of comparables on the ground that this company is in the trading of software and was purchasing licence and clearing them and purchase and sale of licence business cannot be compared with software business by making following observations :-

*(i) Thirdware Solutions Ltd. which had shown PBTT of 67.65%. Copy of profit and loss account of above company collected from the public domain with its annual report is available in the paper book. The profit and loss account is available at page 201 of the paper book. On examination of above accounts, it is seen on the receipt side, under the head 'sales and other income' the taxpayer has shown 'other income' at Rs.1,41,55,687.*

*The detail given as per Schedule 13 is as under:*

**Schedule 13: Other Income**

<b><i>Interest on Deposit</i></b>	<b><i>2.953.027</i></b>
<b><i>Interest on Bank Deposit</i></b>	<b><i>7.600.902</i></b>
<b><i>Debtors written back</i></b>	<b><i>---</i></b>
<b><i>Other Income</i></b>	<b><i>---</i></b>
<b><i>Profit on sale of investment</i></b>	<b><i>(1.180,188)</i></b>
<b><i>Excess provision w/back</i></b>	<b><i>183,400</i></b>
<b><i>Interest on IT Refund</i></b>	<b><i>394,838</i></b>
<b><i>Deposit W/Back-Reed.</i></b>	<b><i>40,000</i></b>
<b><i>Dividend Income</i></b>	<b><i>4,163,708</i></b>
	<b><i>14,155,687</i></b>

***22. Schedule XIV of the balance sheet further shows that above company was in the trading of software in the relevant period. It was purchasing licenses and clearing them. Purchase and sale of license is not a business which can at all be compared with the software business. The balance sheet further makes it clear that the company has paid wealth tax advance and was not involved in development of technology. It did not have any income from development of software but had income from mutual lands.”***

33. So, we are of the considered view that because of functional dissimilarity the Thirdware is not a suitable comparable for benchmarking the international transactions qua software development services provided by the taxpayer, hence we direct to exclude the same from the final set of comparables.

34. The Id. AR for the assessee contended that with the exclusion of Infosys Limited, Tata Elexi, Thirdware Solutions and

Persistent Systems Ltd. from the final set of comparables, the average operating margin of remaining comparable companies finally selected by the TPO comes to 15.24% as compared to taxpayer's operating margin of 12.27% which is within +/- 5% range. However, this figure is subject to the verification by the AO.

35. Initially, Id. AR for the taxpayer sought inclusion of CG-Vak Software & Exports Ltd. and Quintegra Solutions in the final set of comparables, however during the course of arguments, he has not preferred to press inclusion of these companies. Hence, no findings are being returned for inclusion of CG-Vak Software & Exports Ltd. and Quintegra Solutions.

#### **GROUND NO.4**

36. Ground No.4 is not pressed.

#### **GROUNDS NO.5 & 6**

37. DRP/AO disallowed an amount of Rs.12,11,000/- on account of deduction claimed by the taxpayer u/s 10A of the Act on the ground that change of accounting policy would result in taxpayer claiming deduction in AY 2011-12 with regard to invoices to be raised in AY 2012-13 when no such deduction u/s 10A is available.

38. Ld. AR for the taxpayer contended that since the income pertaining to unbilled revenue profit is derived from export of software services, the same is eligible for deduction u/s 10A (4) of the Act and relied upon the decision rendered by the *coordinate Bench of Mumbai of the Tribunal in ACIT vs. Sonata Software Ltd. – 55 SOT 533*, available at pages 982 to 987 of the case laws compendium.

39. Section 10A (4) is categorical enough to explain that “*profits derived from export of articles or things or computer software shall be the amount which bears to the profits of the business of the undertaking, the same proportion as the export turnover in respect of such articles or things or computer software bears to the total turnover of the business carried on by the undertaking.*” This issue has been decided by the coordinate Bench of the Tribunal in *Sonata Software* (supra) in favour of the assessee.

40. The assessee has also proved before AO the date on which the invoices relating to such unbilled revenue is raised as well as date of realization of such invoices and this fact is not disputed by the AO and is otherwise in accordance with the Accounting Standard – 09. Moreover when assessee has produced relevant documents viz. copies of FIRC before the AO to prove the fact that the export proceeds were realized from the six months of the

export, disallowance of the deduction u/s 10A of the Act on unbilled revenue and relatable foreign exchange gain is not sustainable in the eyes of law. Consequently, we are of the considered view that the assessee is entitled for deduction of Rs.12,11,000/- u/s 10A of the Act. Hence, grounds no.5 & 6 are determined in favour of the assessee.

**GROUND NO.7**

41. The question of levying of interest u/s 234B of the Act by the AO is consequential. So far as question of levying interest u/s 234C is concerned, the same is to be levied in accordance with the provisions contained under the section itself by considering the tax on returned income and not on the assessed income. Consequently, ground no. 7 is determined in favour of the assessee.

42. Resultantly, the appeal of the assessee is allowed.

**Order pronounced in open court on this 27<sup>th</sup> day of October, 2017.**

**Sd/-  
(N.K. SAINI)  
ACCOUNTANT MEMBER**

**sd/-  
(KULDIP SINGH)  
JUDICIAL MEMBER**

**Dated the 27<sup>th</sup> day of October, 2017  
TS**

Copy forwarded to:

- 1.Appellant
- 2.Respondent
- 3.CIT
- 4.CIT (A)
- 5.CIT(ITAT), New Delhi.

AR, ITAT  
NEW DELHI.