

IN THE INCOME TAX APPELLATE TRIBUNAL  
"B" BENCH : BANGALORE

BEFORE SHRI ARUN KUMAR GARODIA, ACCOUNTANT MEMBER AND  
SHRI LALIT KUMAR, JUDICIAL MEMBER

IT(TP)A No. 588/Bang/2016
Assessment Year :2011-12

M/s. Marlabs Software Pvt. Ltd., 14 <sup>th</sup> Floor, Bagmane Citrine, Bagmane World Technology Center, KR Puram – Marathhalli Outer Ring Road, Mahadevapura Village, KrishnarajapuramHobli, Bangalore – 560 048.  <b>PAN: AACCM 6627Q</b>	Vs.	The Assistant Commissioner of Income Tax, Circle 4 (1) (2), Bangalore.
APPELLANT		RESPONDENT

IT(TP)A No. 424/Bang/2016
Assessment Year :2011-12

The Assistant Commissioner of Income Tax, Circle 4 (1) (2), Bangalore.	Vs.	M/s. Marlabs Software Pvt. Ltd., 14 <sup>th</sup> Floor, Bagmane Citrine, Bagmane World Technology Center, KR Puram – Marathhalli Outer Ring Road, Mahadevapura Village, KrishnarajapuramHobli, Bangalore – 560 048.  <b>PAN: AACCM 6627Q</b>
APPELLANT		RESPONDENT

Assessee by	:	Shri L. Bharath, CA
Revenue by	:	Ms. Neera Malhotra, CIT (DR)

Date of hearing	:	06.12.2017
Date of Pronouncement	:	08.12.2017

**ORDER**

*Per Shri A.K. Garodia, Accountant Member;*

These are cross appeals filed by the assessee and revenue and these are directed against the assessment order dated 27.01.2016 passed by the AO for Assessment Year 2011-12 u/s. 143(3) r.w.s 144C(13) of the IT Act, 1961 as per the directions of the DRP.

## 2. The grounds raised by the assessee are as under.

*“1. On the facts and in the circumstances of the case the order passed by the LAO based on the directions issued by the Hon'ble DRP is bad in law, to the extent the same are prejudicial to the Appellant.*

*2. The LAO, based on the directions of Hon'ble DRP, erred in confirming the order of the Learned TPO rejecting the transfer pricing documentation maintained by the Appellant on the basis that:*

*a. In respect of the comparable companies identified by the Appellant, current year data was not used;*

*b. The Appellant had considered comparables companies having related party transaction in excess of 25% of sales; and*

*c. The Appellant had identified comparable companies for which sufficient financial information is not available.*

*3. The Hon'ble DRP and the LAO erred in confirming the order of the Learned TPO in rejecting the following comparable companies identified by the Appellant:*

SWD segment

<b>Comparable Companies</b>	<b>Reason for rejection</b>
<i>Akshay Software Technologies Limited</i>	<i>Functionally different</i>
<i>Thirdware Solutions Limited</i>	
<i>Thinksoft Global Services Limited</i>	
<i>Ancent Software International Limited</i>	<i>Not available in the public domain</i>
<i>Caliber Point Business Solutions Limited</i>	
<i>LGS Global Limited</i>	<i>Employee cost data is not available</i>
<i>Cat Technologies Limited</i>	<i>Related party transactions ('RPT') information not available</i>
<i>CG VAK Software and Exports limited</i>	<i>Employee cost is less than 25% of total sales</i>
<i>R Systems International Limited</i>	<i>Different financial year ending</i>
<i>Saven Technologies Limited</i>	<i>RPT is more than 25% of sales</i>
<i>Zylog Systems Limited</i>	<i>Forex by sales &lt; 75%</i>
<i>Goldstone Technologies</i>	

IT-enabled Services

<b>Comparable Companies</b>	<b>Reason</b>
<i>Coral Hub Limited</i>	<i>Not found in the public database</i>
<i>Caliber Point Business Solutions Limited</i>	<i>Different financial year</i>
<i>R Systems International Limited</i>	
<i>Informed Technologies Limited</i>	<i>Functionally different</i>
<i>Microgenetics Systems Limited</i>	<i>No financial data is available</i>
<i>CG VAK Software and Exports Limited</i>	<i>Income from comparable functions is less than Rs. 1 crore</i>

4. The Hon'ble DRP and the LAO erred in confirming the order of the Learned TPO which involved adoption of the following inappropriate filters for selection of comparable companies thereby making the arm's length price determined by the Ld. TPO incorrect in law and in fact.

- a. Exclusion of companies with employee cost of less than 25% of sales;
- b. Exclusion of companies which have a financial year ending different from that of the taxpayer.

5. The Hon'ble DRP and the LAO erred in confirming the order of the Learned TPO which had selected the following comparable companies that are functionally different from the Appellant:

SWD Services

<b>Companies wrongly identified by DRP/TPO as comparable</b>
<i>E-Zest Solutions Limited</i>
<i>E-infochips Limited</i>
<i>ICRA Techno Analytics Limited</i>

IT-enables Services

<b>Companies wrongly identified by DRP/TPO as comparable</b>
<i>Acropetal Technologies Limited</i>
<i>ICRA Online Limited</i>
<i>Jeevan Scientific Technologies Limited</i>

6. *The Hon'ble DRP and the LAO erred in confirming the order of the Learned TPO that computed the operating profit margin of the comparable companies by considering provision for bad debts as non-operating in nature.*

7. *The Hon'ble DRP and the LAO erred in confirming the order of the Learned TPO which has considered incorrect value of receivables and payable in the case of the Appellant, while computing the working capital adjustment for determining the arm's length price.*

8. *The Hon'ble DRP and the LAO erred in confirming the order of the Learned TPO which contained an improper computation of the working capital adjustment while determining the arm's length price. The DRP, TPO and the LAO erred in:*

*a. Not considering the unbilled revenue, advances received from the associated enterprises towards provision of services, unearned revenue, prepaid expense, advance to suppliers, advance recoverable in cash or in kind and other payables/receivables while computing the adjustment for working capital deployed by the Appellant vis-a-vis the comparables.*

*b. Incorrectly computing the value of the accounts receivable and accounts payable of the comparable companies.*

*c. Arbitrarily restricting the working capital adjustment at 1.63% to the software development services and at 1.47% to the IT-enabled services segment.*

9. *The Hon'ble DRP and the LAO erred in confirming the order of the Learned TPO which had failed to provide adequate adjustment towards differences in risk as claimed by the Appellant to improve degree of comparability.*

10. *Without prejudice to the above grounds, the LAO erred, while giving effect to the directions of the DRP, in computing the transfer pricing adjustment at Rs 3,21,79,754 instead of Rs 2,91,86,154.*

*On the above and such other grounds as may be urged at the time*

*of hearing your appellant prays your Honour to consider the facts and circumstances of the case and render justice.”*

3. The grounds raised by the revenue are as under.

*“1. The directions of the Dispute Resolution Panel are opposed to law and facts of the case.*

*2. The Hon'ble DRP erred in directing the AO to reduced the expenses both from the Export Turnover as well as Total Turnover when there is no provision in section 10A which requires the said expenses to be reduced from the Total Turnover?*

*3. The Hon'ble DRP erred in holding that foreign exchange loss or gain is a part of operating expense or operating income, as the case may be, when the TPO has excluded this data from that of the comparables.*

*4. Whether the DRP is correct in foreign exchange fluctuation as operating in nature, while treating foreign exchange fluctuation non-operating in nature as applied by the TPO.*

*5. The Hon'ble DRP erred in granting 1% risk adjustment arbitrarily without appreciating the facts of the case and its comparables.*

*6. The appellant craves leave to add, alter, amend and / or delete any of the grounds mentioned above.”*

4. First we take up the appeal of the assessee. It was submitted by Id. AR of assessee that ground no. 1 is general and ground nos. 2, 3 and 4 are not pressed.
5. Regarding ground no. 5, he drawn our attention to page no. 9 of the DRP order. He submitted that as per the decision of DRP on this page, it was held by DRP that since some of these comparables will get excluded for the reason that the objection of assessee regarding turnover filter having been accepted, the objection regarding functional dissimilarity of remaining comparables is not accepted as for TNMM, only broad functional comparability is required and exact matching of functions is not required. He submitted that hence, it can be seen that noted DRP has decided the issue in a cryptic manner without

considering various specific contentions raised by the assessee regarding this aspect that several comparables are functionally dissimilar.

6. Regarding ground no. 6, he drawn our attention to page no. 11 of the DRP order and pointed out that in respect of assessee's claim for accepting provisions written back, provision for doubtful debts in operating nature also, the decision of DRP is very cryptic.
7. Regarding ground nos. 7, 8 and 10, our attention was drawn to page no. 12 of the order of DRP and pointed out that in respect of working capital adjustment claim also, the issue was decided by DRP in a cryptic manner by directing the AO / TPO to verify the claim and correct it if there is any inaccuracy in the same.
8. Regarding ground no. 9, our attention was drawn to page no. 15 of DRP order and it was pointed out that the issue regarding risk adjustment was also decided by DRP in a cryptic manner. The Id. DR of revenue also admitted that the order of DRP on several issues is cryptic and hence, the matter may be restored back to the file of DRP for fresh decision.
9. We have considered the rival submissions and gone through the order of DRP and in our considered opinion, the order of DRP are very cryptic in respect of the issues raised by the assessee as per ground nos. 5 to 10. We set aside the assessment order on these issues and restore this matter back to the file of DRP for fresh decision by way of a speaking and reasoned order after providing adequate opportunity of being heard to both sides.
10. In the result, the appeal filed by the assessee is partly allowed for statistical purposes.
11. Now, we take up the appeal of the revenue. The Id. DR of revenue submitted that ground no. 1 is general. Regarding ground no. 2, it was agreed by both sides that this issue is now covered in favour of the assessee by the judgement of Hon'ble Karnataka High Court rendered in the case of CIT Vs. Tata Elxsi Ltd. as reported in 349 ITR 98. Respectfully following this judgement, we hold that

there is no infirmity in the directions of DRP on this issue because the direction of DRP on this issue is in line with this judgment of Hon'ble Karnataka High Court wherein it was held by Hon'ble Karnataka High Court that total turnover is sum total of export turnover and domestic turnover and therefore, if an amount is reduced from export turnover then total turnover also goes down by the same amount. Hence on this issue, we decline to interfere in the assessment order. Accordingly, ground no. 2 of the revenue's appeal is rejected.

12. Regarding ground nos. 3, 4 and 5, it was submitted by Id. DR of revenue that the order of DRP is very cryptic and therefore, on both these issues, the matter may be restored back to the file of DRP for fresh decision by way of a speaking and reasoned order. The Id. AR of assessee supported the order of DRP.
13. We have considered the rival submissions and we find that the order of DRP is very cryptic in respect of both the issues i.e. regarding foreign exchange fluctuation and risk adjustment. Hence, we restore both these matters back to the file of DRP for fresh decision with the direction that in respect of foreign exchange fluctuation, it has to be seen that whether such foreign exchange fluctuation gain / loss is in respect of turnover of the present year or of the earlier year and if it is found that the same is in respect of the turnover of the present year then the same should be considered as operating gain / loss of the present year for the purpose of computing ALP. But if it is for earlier year's turnover then the same should not be considered in the present year for the purpose of computing ALP although its nature is admittedly of operating revenue/expenditure because for the purpose of computing ALP under TNMM, operating profit percentage is worked out by dividing operating profit by turnover and therefore, if the foreign exchange fluctuation gain / loss is in respect of earlier year's turnover, then the corresponding turnover is not getting included in the denominator and therefore, adding the foreign exchange fluctuation gain in the profit will give absurd result. Hence foreign exchange fluctuation gain / loss in respect of earlier year turnover should not be considered for ALP calculation of the tested party. Similarly for the comparable companies also, only those exchange fluctuation gain / loss should be

considered which are in respect of turnover of the present year and if the same is for earlier year's turnover, it should not be considered for the purpose of computing ALP. If this information is not available as to whether such gain / loss is relatable to the turnover of the present year or an earlier year, then it should be accepted that such gain / loss is in respect of earlier year's turnover and therefore, it should not be considered for the purpose of computing ALP because normally, any fluctuation gain / loss for current year is adjusted in turnover itself without showing it separately as foreign exchange fluctuation gain / loss. Similarly regarding risk adjustment also, the assessee should provide working of such claim and only thereafter, the DRP should adjudicate this issue after providing reasonable opportunity of being heard to both sides. The order of DRP on all the issues should be a speaking and reasoned order.

14. In the result, the appeal filed by the revenue is partly allowed for statistical purposes.
15. In the combined result, the appeal filed by the revenue and that of the assessee are partly allowed for statistical purposes.

Order pronounced in the open court on the date mentioned on the caption page.

Sd/-  
(LALIT KUMAR)  
Judicial Member  
Bangalore,  
Dated, the 08<sup>th</sup> December, 2017.  
/MS/

Sd/-  
(ARUN KUMAR GARODIA)  
Accountant Member

- Copy to:
1. Appellant
  2. Respondent
  3. CIT
  4. CIT(A)
  5. DR, ITAT, Bangalore.
  6. Guard file

By order

Senior Private Secretary,  
Income Tax Appellate Tribunal,  
Bangalore.