

**IN THE INCOME TAX APPELLATE TRIBUNAL  
HYDERABAD BENCHES "A", HYDERABAD**

**BEFORE SMT. P. MADHAVI DEVI, JUDICIAL MEMBER  
AND  
SHRI B. RAMAKOTAIAH, ACCOUNTANT MEMBER**

**I.T.A. No. 464/HYD/2016**

Assessment Year: 2011-12

Conexant Systems Private Limited, HYDERABAD <b>[PAN: AAACF2723N]</b>	Vs	Deputy Commissioner of Income Tax, Circle-1(2), HYDERABAD
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**(Appellant)**

**(Respondent)**

For Assessee	:	Shri Dhanesh Bafna, AR
For Revenue	:	Shri J. Siri Kumar, DR

Date of Hearing : 10-01-2018

Date of Pronouncement : 24-01-2018

**ORDER**

**PER B. RAMAKOTAIAH, A.M. :**

This is an appeal by Assessee against the order of the Assessing Officer (AO) u/s. 143(3) r.w.s. 144C(1) of the Income Tax Act [Act]. The issues in this appeal are with reference to Transfer Pricing adjustments made by the Transfer Pricing Officer [TPO] as modified by the Dispute Resolution Panel [DRP].

2. Brief facts of the case are that assessee is engaged in the business of developing software design, development and modification services related to semi-conductors and also provides marketing and technical support services which are generally

categorized as 'software development services'. During the year, assessee has provided services to Associated Enterprise [AE] in the form of software design and development services and reimbursement of expenses etc. The appellant has disclosed OP/OC at 12.78 and has provided a TP report, wherein 12 comparable companies were short listed, whose PLI (operating profit/operating cost) was at 12%. While arriving the PLI at 12.78%, assessee has *suo motto* made an adjustment of Rs. 46,87,630/- and arrived at the above PLI. AO has modified the computation of PLI and arrived at 5.5%, on which at present there is no dispute. With reference to revised PLI it was explained that this was arrived at after excluding *suo motto* adjustment and foreign exchange loss etc., due to which there was variation in the PLI. Since it is not in dispute, assessee accepts the PLI at 5.5%. TPO in the TP study, rejected some of the comparable companies of assessee and selected final set of 17 comparable companies, whose PLI arrived was at 18.34% leading to an adjustment of Rs. 2,21,03,914/-.

3. Assessee has objected the selection of comparables on various parameters before the DRP and DRP has accepted some objections in which DRP excluded ten companies objected by assessee and also excluding *suo motto* four other comparables, thereby enhancing the adjustment to Rs. 2,92,71,639/- (after excluding *suo motto* adjustment of Rs. 46,87,630/-). The original 17 comparables selected by the TPO are as under:

Sl.No	Name of the comparable company
1	Acropetal Technologies Limited (Seg)
2	Akshay Software Technologies Ltd
3	CTIL Ltd
4	Evoke Technologies Pvt. Ltd
5	E-Zest Solutions Ltd
6	ICRA Techno Analytics Ltd
7	Igate Global Solutions Ltd
8	Kals Information Systems Ltd (Seg)
9	Larsen & Toubro Infotech Ltd
10	Mindtree Ltd
11	Persistent Systems & Solutions Ltd
12	Persistent Systems Ltd
13	R S Software (India) Ltd
14	Sankhya Infotech Ltd
15	Sasken Communication Technologies Ltd
16	Tata Elxsi Ltd
17	Zylog Systems Ltd

4. After exclusion by the DRP, the following three comparables only survived:

- i. Persistent Systems Ltd.,
- ii. Persistent Systems and Solutions Ltd.,
- iii. Sasken Communication Technologies Ltd.,

5. The AO consequent to the direction of the DRP, passed the impugned assessment order thereby making the adjustment. There was one more adjustment of Rs. 93,303/- as interest paid on the external commercial borrowings, on which issue in earlier years the issue was restored to the file of AO for verification, but due to smallness of the amount involved, assessee did not press for the ground (Gr. No.3).

6. Ld. Counsel appearing for assessee submitted that even though various sub-grounds are raised in Gr.No. 2, assessee is interested in grounds 2.6 and 2.7, i.e., exclusion of two companies approved by the DRP and inclusion of one company i.e., Evoke Technologies Ltd. excluded by the DRP in its order. The other companies which were excluded by the DRP were accepted or rejected by various orders of ITAT. Hence, assessee is not pressing for the same. The submissions of Ld. Counsel on the three comparables are as under:

To be excluded:

i. Persistent Systems Ltd:

6.1. The above company is engaged in product development which is different from software development services. The company is engaged in development of products. It earns revenue from licensing of products, royalty on sale of products as well as income from maintenance contracts. However, no segmental details are available. Ld. Counsel placed reliance on the following decisions where in this company was excluded as functionally not similar:

- i. *Saxo India (P) Ltd. Vs. ACIT – ITA No. 6148/Del/2015 (Pg. 16; para 15.1 – 15.2) affirmed by Hon'ble Delhi High Court in ITA No. 682/2016 (pg.4; para 10);*
- ii. *PCIT Vs. Cashedge India P. Ltd., - ITA No. 279/2016 (Hon'ble Delhi High Court);*
- iii. *Assessee's own case for AY. 2010-11 in ITA No. 264/Hyd/2015 – (Pg. Nos. 6-10);*

- iv. *Electronic Imaging India (P) Ltd., Vs. DCIT – AY. 2011-12 – ITA No. 1506/Bang/2015 (Pg. 9-10; para 8);*
- v. *Symantec Software & Services India (P) Ltd., Vs. DCIT – AY. 2011-12 – ITA No. 614/Mds/2016 (Pg. 6-7; para 9-10);*
- vi. *ACIT Vs. Broadcom India Research (P) Ltd., - AY. 2010-11 – ITA No. 348/Bang/2015 (Pg.10; para 13.4);*

ii. Sasken Communication Technologies Ltd:

6.2. The above company earns revenue from software services as well as software products. Though the breakup of revenue between the services and products is available, the breakup of operating costs and the net profitability between the two segments is not available. Ld. Counsel placed reliance on the following decisions:

- i. *Saxo India (P) Ltd. Vs. ACIT – ITA No. 6148/Del/2015 (Pg. 15-16; para 14.1 – 14.2) affirmed by Hon'ble Delhi High Court in ITA No. 682/2016 (pg.4; para 10);*
- ii. *Electronic Imaging India (P) Ltd., Vs. DCIT – AY. 2011-12 – ITA No. 1506/Bang/2015 (Pg. 13; para 9);*
- iii. *Symantec Software & Services India (P) Ltd., Vs. DCIT – AY. 2011-12 – ITA No. 614/Mds/2016 (Pg. 8; para 11-12);*
- iv. *ACIT Vs. Broadcom India Research (P) Ltd., - AY. 2010-11 – ITA No. 348/Bang/2015 (Pg.9-10; para 13.3);*

To be included:iii. Evoke Technologies Pvt. Ltd:

6.3. Ld. Counsel for assessee submitted that firstly, the functional comparability of the company has not been doubted by the TPO or the Hon'ble DRP. The total revenue of the company has increased by 33% during the current year from 10.86 Crores to 14.48 Crores as against increase in total expenses from 9.03 Crores to 13.13 Crores. The increase in expenditure has to be seen vis-à-vis its effect on the turnover, which is significant in the case of Evoke Technologies P. Ltd. Increase in expenses is a normal incidence of every business cycle. The annual report of the company nowhere indicates existence of any peculiar business circumstances. It was submitted that, unless the high/low margin is on account of abnormal/peculiar economic circumstances, the company cannot be excluded as a comparable. Ld. Counsel placed reliance on the decision of Hon'ble Delhi High Court in the case of Chyrscapital Investment Advisors (India) Pvt. Ltd., Vs. DCIT – ITA No. 417/2014.

6.4. Ld. Counsel also submitted that in the recent order of 'B' Bench of ITAT, Hyderabad in the case of Electronic Arts Games (India) Private Ltd., Vs. Dy.CIT in ITA No. 325/Hyd/2016 dt. 29-12-2017 also these two comparables mentioned above were excluded and with reference to Evoke Technologies Pvt. Ltd., the same was not accepted by the Bench only on the reason that assessee has accepted the exclusion in a later year. Ld. Counsel, however, referred to the detailed annual report of Evoke

Technologies Pvt. Ltd., Pg. No. 436 to 464 of paper book, to submit that this company satisfies all the parameters as that of assessee.

7. The DRP has excluded the said company by stating as under:

*“Evoke Technologies Pvt. Ltd – (“Evoke”)*

*Assessee is in agreement with Ld. TPO but Correct margin to be considered it is a well established principle that for transfer pricing analysis, a company which has significant high or low margins should not be retained as comparables unless on probe it is found that there are no abnormalities/peculiar circumstances due to which the margin has been influenced. The Hon'ble Delhi High Court in the case of Rampgreen Solutions pvt Ltd (ITA No.102/2015) observed that ‘..... A wide deviation in the PLI amongst selected comparables could be indicative that the comparables selected are either materially dissimilar or the data used is not reliable..... This exercise would fail, if a factor, which has a material bearing on the value of profitability, as the case may be depending on method used is ignore.’ Applying this principle, it is noticed by us that after exclusion of the comparables, the margin of the above company is abnormally low at 8.11% as compared to all other comparables selected by the TPO. It is noticed by us from the Annual Report that even though the revenue has been increased by 33% as compared to last year, the expenses on consultancy charges debited are increased from Rs. 9,57,480/- to Rs. 1,07,17,363/- i.e. by 1.118%, which clearly indicates that the low margin during the year were due to the peculiar economic circumstances and therefore, it will not be appropriate to retain the above company as comparable, accordingly we direct the assessing officer to exclude this company from the comparables. In view of the exclusion of the company from the comparables, the issue of margin computation becomes academic in nature and therefore, we do not find any necessity to issue the separate direction on this issue”.*

7.1. It was submitted that the consultancy charges increased was part of administrative expenditure and is comparable with the increase in turnover of assessee-company that does not indicate peculiar economic circumstances. It was submitted that the company which can be compared not only on functional basis but also on economic basis. Therefore, the same

is to be included. It was the submission that by excluding the above two companies and including the company as requested, assessee PLI is still less and require some adjustment. Since assessee-company has closed its operations in India and wanted to settle the matters, Ld. Counsel submitted for adjudication as requested.

8. Ld.DR, however, relied on the orders of DRP and submitted that DRP has correctly included the above companies and excluded Evoke Technologies Pvt. Ltd.

9. We have considered the rival contentions. As seen from the orders placed on record and also consistent stand taken by the Tribunal in various such cases, we have no hesitation in excluding two companies, Persistent Systems Ltd., and Sasken Communication Technologies Ltd on functionality basis. As far as Evoke Technologies Pvt. Ltd., is concerned, this company was also argued to be included in the case of Electronic Arts Games (India) Private Ltd., Vs. Dy.CIT (supra). But the Bench did not accept on the reason that assessee has accepted the exclusion in a later year. However, as pointed out by the Ld. Counsel, this company is functionally similar to assessee-company and the annual report does not disclose any peculiar economic circumstances as stated by the DRP. Moreover, the said consultancy charges were shown under the head administrative expenditure and the increase in administrative expenditure is proportionate to increase in turnover. Therefore, we are of the opinion that Evoke Technologies Pvt. Ltd., can be included as a comparable company.

10. Therefore, allowing the assessee grounds, we direct AO to re-workout the adjustment by considering only two companies i.e., Persistent Systems Ltd., and Evoke Technologies Pvt. Ltd. AO is also advised that in case the addition is coming less than the *suo motto* adjustment already made by assessee at Rs. 46,87,630/-, the *suo motto* adjustment should be accepted. Subject to above direction/verification, assessee's grounds on TP adjustment are considered allowed.

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

*Order pronounced in the open Court on 24<sup>th</sup> January, 2018*

Sd/-  
**(P. MADHAVI DEVI)**  
**JUDICIAL MEMBER**

Sd/-  
**(B. RAMAKOTIAH)**  
**ACCOUNTANT MEMBER**

Hyderabad, Dated 24<sup>th</sup> January, 2018

TNMM

*Copy to :*

- 1. Conexant Systems Private Limited, 5<sup>th</sup> Floor, Pioneer Towers, Plot No. 16, Survey No. 64/2, Software Units Layout, Madhapur, Hyderabad.*
- 2. The Deputy Commissioner of Income Tax, Circle-1(2), Hyderabad.*
- 3. Dispute Resolution Panel (DRP)*
- 4. Director of Income Tax (IT & TP), Hyderabad.*
- 5. Addl. Commissioner of Income Tax (Transfer Pricing), Hyderabad.*
- 6. D.R. ITAT, Hyderabad.*