

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

**BEFORE SHRI R.K. PANDA, ACCOUNTANT MEMBER
and
SHRI KULDIP SINGH, JUDICIAL MEMBER**

**ITA No.2788/Del./2017
(ASSESSMENT YEAR : 2011-12)**

M/s. Clear 2 Pay India Pvt. Ltd., vs. ITO, Ward 6 (2),
(Earlier known as New Delhi.
ISIS Infotech Solutions Pvt. Ltd.)
House No.WZ-4A, Nangli Jalib B – 1,
Janakpuri,
New Delhi – 110 002.
(PAN : AABCI3023R)

**ITA No.2744/Del./2017
(ASSESSMENT YEAR : 2011-12)**

ITO, Ward 6 (2), vs. M/s. Clear 2 Pay India Pvt. Ltd.,
New Delhi. (Earlier known as
ISIS Infotech Solutions Pvt. Ltd.)
House No.WZ-4A, Nangli Jalib B – 1,
Janakpuri,
New Delhi – 110 002.
(PAN : AABCI3023R)

**ITA No.594/Del./2017
(ASSESSMENT YEAR : 2012-13)**

M/s. Clear 2 Pay India Pvt. Ltd., vs. DCIT, Circle 10 (2),
(Earlier known as New Delhi.
ISIS Infotech Solutions Pvt. Ltd.)
House No.WZ-4A, Nangli Jalib B – 1,
Janakpuri,
New Delhi – 110 002.
(PAN : AABCI3023R)

(APPELLANT)

(RESPONDENT)

ASSESSEE BY : Shri Manoneet Dalal, AR
Shri Yishu Goel, AR
Shri Chirag Aggarwal, CA

REVENUE BY : Shri Sanjay Kumar Yadav, Senior DR

Date of Hearing : 29.05.2018

Date of Order : 22.06.2018

ORDER

PER KULDIP SINGH, JUDICIAL MEMBER :

Present cross appeals filed by the assessee as well as by the revenue are being disposed of by way of consolidated order to avoid repetition of discussion.

2. Appellant, M/s. Clear 2 Pay India Pvt. Ltd. (for short 'the taxpayer'), by filing the present appeal (ITA No.2788/Del/2017 AY 2011-12) sought to set aside the impugned order dated 08.04.2015, passed by the AO under section 144C read with section 143 (3) of the Income-tax Act, 1961 (for short 'the Act') qua the assessment year 2011-12 in consonance with the orders passed by the Id. CIT (A)/TPO on the grounds inter alia that :-

“1. That on the facts and in the circumstances of the case, the order passed by the Learned Assessing Officer ("Ld. AO") is bad in law and void ab-initio.

2. That on facts and circumstances of the case and in law, the reference made by the Ld. AO suffers from jurisdictional error as the Ld. AO did not record any reasons in assessment order based on which he reached the conclusion that it was "expedient and necessary" to refer the matter to the Ld. Transfer Pricing Officer ("Ld. TPO") for computation of the arm's length

price, as is required under section 92CA (1) of the Income Tax Act, 1961 ("Act").

3. That on facts and circumstances of the case and in law, the Ld. AO/ Ld. TPO/ Hon'ble Commissioner of Income Tax (Appeals) ("CIT(A)") erred in making an addition to the returned income of the Appellant by re-computing the arm's length price of the international transactions under section 92 of the Act.

4. The Ld. AO/ Ld. TPO/ CIT(A) erred in not accepting the quantitative filters selected by the Appellant in its Transfer Pricing Documentation/ fresh search and has instead applied his own additional/ quantitative filters which lacked valid and sufficient reasoning.

5. The Ld. AO/ Ld. TPO/ CIT(A) erred in rejecting the comparable companies set adopted by the Appellant in its Transfer Pricing Documentation/ fresh search.

6. The Ld. AO/ Ld. TPO/ CIT(A) erred in accepting companies which were functionally not comparable to the Appellant in terms of Functions, Assets and Risk profile.

7. The Ld. AO/ Ld. TPO/ CIT(A) erred in not providing the benefit of economic adjustment on account of difference in working capital position of Appellant vis-a-vis comparable companies, in arriving at the arm's length margin.

8. The Ld. AO/ Ld. TPO/ CIT(A) erred in not providing the benefit of economic adjustment on account of difference in risk profile of Appellant vis-a-vis the comparable companies, in arriving at the arm's length mean margin.

9. The Ld. AO/ Ld. TPO/ CIT(A) erred in computing the margins of comparable companies selected by him.

10. The Ld. AO / Ld. TPO/ CIT(A) erred in disregarding the multiple year data selected by the Appellant in the TP Documentation and in selecting the current year (i.e. Financial Year 2010-11) data for comparability despite the fact that at the time of comparison done by the Appellant, the complete data for financial year 2010-11 was not available within the public domain.

11. That on the facts and circumstances of the case and in law, the Ld. AO has erred in initiating penalty proceedings u/s

271(1) (c) of the Act mechanically and without recording any adequate satisfaction for such initiation.

12. The Ld. AO erred in facts and in law in charging and computing interest under section 2348 and 234C of the Act.”

3. Appellant, Income-tax Officer, Ward 6 (2), New Delhi (for short ‘the Revenue’), by filing the present appeal (ITA No.2744/Del/2017 AY 2011-12) sought to set aside the impugned order dated 08.04.2015, passed by the AO under section 144C read with section 143 (3) of the Income-tax Act, 1961 (for short ‘the Act’) qua the assessment year 2011-12 in consonance with the orders passed by the Id. CIT (A)/TPO on the grounds inter alia that:-

“1. Whether on the facts and in the circumstances of the case and in law, the Ld. CIT (A) has erred in rejecting the comparable viz. 1. Larsen Turbo InfoTech Ltd. 2. Persistent Systems Ltd, 3.Sasken Communication Technologies Ltd., 4. Zylog Systems Ltd., 5. Wipro Technologies Ltd., 6. Infosys Ltd. by ignoring the facts and without passing a speaking order.”

4. Appellant, M/s. Clear 2 Pay India Pvt. Ltd. (for short ‘the taxpayer’), by filing the present appeal (ITA No.594/Del/2017 AY 2012-13) sought to set aside the impugned order dated 30.11.2016, passed by the AO under section 144C read with section 143 (3) of the Income-tax Act, 1961 (for short ‘the Act’) qua the assessment year 2012-13 in consonance with the orders passed by the Id. CIT (A)/TPO on the grounds inter alia that :-

“1. That on the facts and in the circumstances of the case, the order passed by the Learned Assessing Officer ("Ld. AO") is bad in law and void ab-initio.

2. That on facts and circumstances of the case and in law, the reference made by the Ld. AO suffers from jurisdictional error as the Ld. AO did not record any reasons in assessment order based on which he reached the conclusion that it was "expedient and necessary" to refer the matter to the Ld. Transfer Pricing Officer ("Ld. TPO") for computation of the arm's length price, as is required under section 92CA(1) of the Income Tax Act, 1961 ("Act").

3. That on facts and circumstances of the case and in law, the Ld. AO/ Ld. TPO/ Ld. Dispute Resolution Panel ("Ld. DRP") erred in making an addition of INR 14,938,052 to the returned income of the Appellant by re-computing the arm's length price of the international transactions under section 92 of the Act.

4. The Ld. AO/ Ld. TPO/ Ld. DRP erred in not accepting the quantitative filters selected by the Appellant in its Transfer Pricing Documentation/ fresh search and has instead applied his own additional/ quantitative filters which lacked valid and sufficient reasoning.

5. The Ld. AO/ Ld. TPO/ Ld. DRP erred in rejecting the comparable companies set adopted by the Appellant in its Transfer Pricing Documentation / fresh search.

6. The Ld. AO/ Ld. TPO/ Ld. DRP erred in accepting companies which were functionally not comparable to the Appellant in terms of Functions, Assets and Risk profile.

7. The Ld. AO/ Ld. TPO/ Ld. DRP erred in not providing the benefit of economic adjustment on account of difference in risk profile in arriving at the arm's length mean margin.

8. The Ld. AO/ Ld. TPO erred in disregarding the multiple year data selected by the Appellant in the TP Documentation and in selecting the current year (i.e. financial year 2011-12) data for comparability despite the fact that at the time of comparison done by the Appellant, the complete data for financial year 2011-12 was not available within the public domain.

9. That on the facts and circumstances of the case and in law, the Ld. AO has erred in initiating penalty proceedings u/s 271(1)(c) of the Act mechanically and without recording any adequate satisfaction for such initiation.

10. The Ld. AO erred in facts and in law in charging and computing interest under section 234B and 234C of the Act.”

5. Briefly stated the facts necessary to adjudicate the issues in controversy are : M/s. Clear 2 Pay India (P) Ltd. is wholly owned subsidiary of ISTS Worldwide Inc., US (ISTS US), registered as Software Technology Park Unit (STPI) under Software Technologies Park Scheme of Government of India. The taxpayer is engaged in providing routine software development and getting services to ISTS and is also providing services to unrelated parties customers overseas. During the year under assessment, the taxpayer entered into international transactions with its Associated Enterprises (AE) as under :-

<i>Sl.No.</i>	<i>Nature of Transactions</i>	<i>Value Rs.</i>
<i>1</i>	<i>Provision of Software Development Services</i>	<i>150818592</i>

6. The taxpayer in its TP analysis applied Transactional Net Margin Method (TNMM) as Most Appropriate Method (MAM) with Operating Profit / Operating Cost (OP/OC) as Profit Level Indicator (PLI) and used multiple years data in order to benchmark its international transactions. The taxpayer computed its own

OP/OC at 8.30% as against 7.21% of the comparable company and found its international transactions at arm's length.

7. TPO rejected the TP analysis made by the taxpayer being based on multiple years data and comparable being not proper one. TPO finally selected 17 comparables with OP/OC at 20.28% and thereby proposed the TP adjustment at Rs.1,63,95,979/-.

8. The taxpayer carried the matter before the Id. CIT (A) by filing the appeal who has partly allowed the appeal filed by the taxpayer by rejecting the comparables viz. (i) Larsen & Toubro Infotech Ltd., (ii) Persistent Systems Ltd., (iii) Sasken Communication Technologies Ltd., (iv) Zylog Systems Ltd., (v) Wipro Technologies Ltd., and (vi) Infosys Ltd. selected by the TPO. Feeling aggrieved, both the taxpayer as well as the Revenue have come up with cross appeals qua AY 2011-12 challenging the comparables selected by the TPO as well as rejected by Id. CIT (A).

9. 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.

10. Out of 23 comparables chosen by the taxpayer for benchmarking its international transactions, the ld. TPO retained 9 comparables and introduced 8 new comparables and has finally selected the comparables as under :-

<i>Sl.No.</i>	<i>Company Long Name</i>	<i>OP/OC</i>
1.	<i>Akshay Software Technologies Ltd.</i>	<i>0.16%</i>
2.	<i>Celstream Technologies Pvt. Ltd.</i>	<i>12.26%</i>
3.	<i>Evoke Technologies Pvt. Ltd.</i>	<i>8.11%</i>
4.	<i>iGate Global Solutions Ltd.</i>	<i>23.71%</i>
5.	<i>Infosys Ltd.</i>	<i>43.53%</i>
6.	<i>Kirteeti Soft Technologies Ltd.</i>	<i>3.63%</i>
7.	<i>Larsen & Toubro Infotech Ltd.</i>	<i>18.40%</i>
8.	<i>Mindtree Ltd. (segment)</i>	<i>10.74%</i>
9.	<i>Persistent Systems & Solutions Ltd. (merged)</i>	<i>22.12%</i>
10.	<i>Persistent Systems Ltd.</i>	<i>23.08%</i>
11.	<i>R.S. Software (India) Ltd.</i>	<i>16.20%</i>
12.	<i>Sankhya Infotech Limited</i>	<i>26.20%</i>
13.	<i>Sasken Communication Technologies Ltd.</i>	<i>24.36%</i>
14.	<i>Tata Elxsi Ltd. (segment)</i>	<i>13.00%</i>
15.	<i>Thirdware Solutions</i>	<i>16.19%</i>
16.	<i>Wipro Technologies Ltd.</i>	<i>54.42%</i>
17.	<i>Zylog Systems Ltd.</i>	<i>28.74%</i>
	<i>Average</i>	<i>20.28%</i>

11. AO on the basis of his TP analysis computed the PLI of comparables at 20.28% as against 8.3% of the taxpayer and thereby proposed the TP adjustment of Rs.1,63,95,979/-.

12. Undisputedly, the taxpayer has entered into only one transaction relating to provision of software development services to its AE. TPO has also not disputed TNMM as the MAM with OP/OC as PLI adopted by the taxpayer. It is also not in dispute

that the Id. CIT (A) without disturbing the method has rejected 6 comparables viz. (i) Larsen & Toubro Infotech Ltd., (ii) Persistent Systems Ltd., (iii) Sasken Communication Technologies Ltd., (iv) Zylog Systems Ltd., (v) Wipro Technologies Ltd., and (vi) Infosys Ltd. as comparables.

13. Ld. AR for the taxpayer in order to cut short the controversy sought exclusion of Persistent Systems Ltd., Sankhya Infotech Ltd. and E-Zest Solutions. The taxpayer also sought working capital adjustment and correct computation of the margins. At the same time, Id. DR sought inclusion of 6 comparables viz. (i) Larsen & Toubro Infotech Ltd., (ii) Persistent Systems Ltd., (iii) Sasken Communication Technologies Ltd., (iv) Zylog Systems Ltd., (v) Wipro Technologies Ltd., and (vi) Infosys Ltd. rejected by the Id. CIT (A) in AY 2011-12. We would like to examine the comparability of each comparable sought to be excluded and included by the taxpayer as well as Revenue one by one.

TAXPAYER'S APPEAL
(ITA NO.2788/DEL/2017 FOR AY 2011-12)

GROUND NO.1, 2, 3, 4 & 5

14. Grounds No.1, 2, 3, 4 & are dismissed having not been pressed during the course of arguments.

GROUNDS NO.6 & 7**COMPARABLES SOUGHT TO BE
EXCLUDED BY THE TAXPAYER****PERSISTENT SYSTEMS AND
SOLUTIONS LTD. (PERSISTENT)**

15. The taxpayer raised objections before TPO as to the inclusion of Persistent as a comparable on ground of functional dissimilarity, it being engaged in development of new product for which Persistent carries out research and development activities. Perusal of annual report of Persistent, available at pages 472 & 473 of Paper Book-I, categorically proves that Persistent is a global company specializing in software product development services and have partnered closely with the world's largest technology brands, innovative enterprises and pioneering start-ups to provide end to end product development services.

16. Persistent is constantly innovating new technology solutions that are focused on the four key building blocks of their IP portfolio, Cloud Computing, BI & Analytics, Collaboration and mobility. Persistent has also customized end to end solutions as per their specific requirement. Perusal of Profit & Loss account, available at page 495 of Paper Book – I, shows that Persistent has

sale of software services and products with no segmental data. The Id. DR for the Revenue contended that the taxpayer has failed to point out as to which product has been developed. But this contention is not tenable in the face of the P&L account which shows the income jointly from sale of software services and product.

17. Coordinate Bench of the Tribunal in case of *Alcatel Lucent India Ltd. vs. DCIT in ITA No.6856/Del/2015 for AY 2011-12* ordered to exclude Persistent being a product company having huge intangibles as a comparable with routine software development services provider.

18. In view of the facts narrated above, we are of the considered view that Persistent being a product development company and into diversified services having no segmental information is not a valid comparable vis-à-vis the taxpayer which is a routine software development service provider, so we order to exclude the same from the final set of comparables.

SANKHYA INFOTECH LTD. (SANKHYA)

19. The taxpayer raised objections before the Id. CIT (A) for inclusion of Sankhya on ground of functional dissimilarity for the

year ending March 31, 2011, available at page 510 of the Paper Book – II, shows that Sankhya is a leading simulation and training solutions company. Sankhya provides end to end simulation solutions which are customized to the end user and the company has developed customizable products for imparting training which can cater to any industry. The annual report further shows that Sankhya has inhouse research and development centre involved in development activities for new products in the field of simulations and training and spend Rs.321.12 lakhs on research and development.

20. Moreover, segmental reporting of Sankhya , available at page 525, shows that it does not have complete segmental financials. So, when we examine the functional profile of Sankhya, it is incomparable to the taxpayer which is a routine software development services provider.

21. Coordinate Bench of the Tribunal examined the comparability of Sankhya in *Alcatel Lucent India Ltd.* (supra) has ordered to exclude the same as a comparable vis-à-vis routine software development service provider.

22. In view of what has been discussed above, we are of the considered view that Sankhya being into diversified services

providing customized services to end users and has developed customized products for imparting training and having its own research and development centre cannot be a valid comparable vis-à-vis the taxpayer which is a routine software development service provider.

E-ZEST SOLUTIONS (E-ZEST)

23. The taxpayer challenged E-Zest as a comparable before Id. CIT (A) on ground of functional incomparable. When we peruse annual report of E-Zest, available at page 737 of Paper Book-I, it is into diversified kind of activities viz. Product Engineering Services / Outsourced Product Development Services, Enterprise Application Development, IT Services, Industries Solutions and Technology Expertise. Furthermore, when we examine the segment reporting of E-Zest, available at page 781 of the Paper Book, it is mentioned that it has only one reportable segment. So, in the face of diversified kind of activities being carried out by E-Zest, it is not a valid comparable vis-à-vis the taxpayer which is a routine software development service provider.

24. Coordinate Bench of the Tribunal in *M/s. Symantec Software and Services India Pvt. Ltd. Vs. DCIT in ITA*

No.614/Del/2016 for AY 2011-12 examined comparability of the taxpayer with routine software service provider and ordered to exclude the same on the ground that it is providing high end technical services and as such, is a KPO and not a software development company. So, in view of the matter, we order to exclude E-Zest from final set of comparables.

WORKING CAPITAL ADJUSTMENT ISSUE

25. The TPO has denied the working capital adjustment to the taxpayer on the ground that the taxpayer has not specifically sought working capital adjustment but has stated that there are differences between itself and the comparables used by the TPO on the ground that the level of inventories, debtors and creditors varies as percentage of total cost. TPO also mentioned that the taxpayer has failed to discharge the primary onus to prove the need for such comparability exercise, hence rejected the claim of the taxpayer for working capital adjustment.

26. The taxpayer has filed detailed working capital computation, available at page 190 of the Paper Book, and has also filed submissions on working capital adjustment as per OECD Guidelines. It is also an uncontroverted fact that the working

capital adjustment has been allowed to the taxpayer by the TPO in AY 2012-13 and business model of the taxpayer has not undergone any change. In these circumstances, we are of the considered view that the issue is required to be sent back to AO/TPO to decide allowability of working capital adjustment in view of the settled principle of law applied by the Revenue itself in taxpayer's own case for AY 2012-13 after providing an opportunity of being heard to the taxpayer.

GROUND NO.8

27. Ground No.8 is dismissed having not been pressed during the course of arguments.

GROUND NO.9

28. The taxpayer by raising specific ground contended that AO/TPO/CIT(A) have erred in computing correct margins of the comparables. We are of the considered view that when the taxpayer has argued its case on the basis of facts and figures brought on record by way of evidence as well as submissions, AO/TPO is required to compute the correct margin. So, this issue is remanded back to the AO/TPO to compute the correct margin to be consistent with directions issued by the Id. DRP in taxpayer's

own case for AY 2012-13 as there is no change in the business model of the taxpayer. So, ground no.9 is determined in favour of the taxpayer for statistical purposes.

GROUND NO.10

29. Ground No.10 is dismissed having not been pressed during the course of arguments.

GROUNDS NO.11 & 12

30. Grounds No.11 & 12 being consequential in nature need no specific findings.

REVENUE'S APPEAL **(ITA NO.2744/DEL/2017 FOR AY 2011-12)**

31. The Revenue by filing cross appeal challenged rejection of comparables viz. (i) Larsen & Toubro Infotech Ltd., (ii) Persistent Systems Ltd., (iii) Sasken Communication Technologies Ltd., (iv) Zylog Systems Ltd., (v) Wipro Technologies Ltd., and (vi) Infosys Ltd. by the Id. CIT (A) for benchmarking the international transactions. We would discuss the comparability of aforesaid comparables by one by one.

INFOSYS LTD. (INFOSYS)

32. The Id. DR challenging the impugned order sought inclusion of Infosys, excluded by Id. CIT (A), on the ground that high turnover cannot be a ground for exclusion and relied upon *Chryscapital Investment Advisors (India) Pvt. Ltd. Versus DCIT – (2015) 376 ITR 183 (Del)*. Ld. DR also relied upon the order passed by the TPO.

33. However, the taxpayer had challenged inclusion of Infosys by the TPO on grounds of functional dissimilarity; non-availability of segmental information; Infosys is a giant company having high brand value; having its own research and development centre; and it is a full-fledged risk bearing company.

34. Perusal of profit & loss account of the taxpayer, available at page 393 of the paper book, shows that the taxpayer has never been into development of product rather a pure software development and other services provider as the entire income is from SDOS.

35. Suitability of Infosys vis-à-vis a captive software service provider has been examined by the Hon'ble Delhi High Court in case cited as *CIT vs. Agnity India Technologies Pvt. Ltd. – (2013)*

36 taxmann.com 289 (Delhi) and found to be an invalid

comparable by returning following findings :

“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:

<i>Basic Particular</i>	<i>Infosys Technologies Ltd.</i>	<i>Agnity India</i>
<i>Risk Profile</i>	<i>Operate as full-fledged risk taking entrepreneurs</i>	<i>Operate at minimal risks as the 100% services are provided to AEs</i>
<i>Nature of Services</i>	<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>
<i>Revenue</i>	<i>Rs.9, 028 Crores</i>	<i>Rs.16.09 Crores</i>
<i>Ownership of branded/proprietary products</i>	<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</i>	

	<i>flagship banking product suite "Finacle")</i>	
<i>Onsite Vs. Offshore</i>	<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>
<i>Expenditure on Advertising/Sales promotion and brand building</i>	<i>Rs.61 Crores</i>	<i>Rs. Nil (as the 100% services are provide to AEs)</i>
<i>Expenditure on Research & 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.”

36. So, we are of the considered view that keeping in view the functional dissimilarity, scale of operation, high brand value impacting profit, having own research and development centre with capital expenditure of Rs.5 to Rs.7 crores and revenue expenditure of Rs.570 crores, creating huge intangibles for the company and the fact that Infosys is a full-fledged risk bearing company, hence cannot be a valid comparable vis-à-vis the taxpayer which is a routine captive software service provider working on minimal risk having no brand value nor having any research and development

centre to produce its own intangibles. So, Id. CIT (A) has rightly excluded Infosys from the final set of comparables.

WIPRO TECHNOLOGIES LTD. (WIPRO)

37. The Id. DR challenged the inclusion of Wipro by Id. CIT (A) on the ground that abnormally high margin and assuming entrepreneurial risk and marketing risk cannot be a ground to exclude any comparable and in such circumstances, only captive subsidiaries can be used as comparables which is not possible and relied upon findings returned by TPO.

38. However, on the other hand, Id. AR for the taxpayer supported the order passed by the Id. CIT (A) on the ground that the Wipro is functionally not comparable being into technology infrastructure; support products; and software related support services activities; that Wipro has generated entire revenue pursuant to the master service agreement between Wipro and Citi Group services; that Wipro has huge scale of operation and without prejudice, correct margin at 52.09% instead of 54.42% be taken; and relied upon *Agilis Information Technologies Pvt. Ltd. vs. ITO – ITA No.1063/Del/2016*.

39. Coordinate Bench of the Tribunal in case cited as *Agilis Information Technologies Ltd.* (supra) examined the comparability of Wipro vis-à-vis Agilis, routine software service provider and ordered to exclude the same on ground of functional dissimilarity being a software product company having launched its product in the name of 'FLOW' for the retail sector users in 2012, which is outcome of research and development.

40. Keeping in view the functional dissimilarity of Wipro vis-à-vis taxpayer, and the fact that Wipro has generated its entire revenue pursuant to the master service agreement having its huge scale of operation as compared to taxpayer and the fact that the taxpayer is a routine captive service provider, the Id. CIT (A) has rightly excluded Wipro as a comparable from final set of comparables for benchmarking the international transactions.

SASKEN COMMUNICATION TECHNOLOGIES (SASKEN)

41. The Id.DR challenged exclusion of Sasken by Id. CIT (A) for the reason that the taxpayer has significant intangibles and research and development activities, Ld.DR contended that the Sasken is having no income from sale of licence and drew our attention towards page 324 of the paper book. However, when we examine

Director's report available at page 300 of the annual report of Sasken, the contention raised by Id. DR is not sustainable.

Operative part of the Director's report is extracted as under :-

“On the hardware side we will leverage our extensive understanding and knowledge of this OEMs ecosystem and capitalize on the delivery centers in European Union and China regions. This geographical spread enables a cost efficient service mix to service opportunities in RF / Antenna design. The combination of our hardware and software knowledge gives us a competitive edge.

Sasken key differentiators :

Some of the unique capabilities of Sasken include its abilities to take a leadership position in :

- *Android Software Platform Services*
- *Full Phone (device) Design Services*
- *Intellectual Property (IP) Led Services*
- *Operator Specific Services”*

42. So, on the basis of functional dissimilarity alone, Sasken is not a valid comparable vis-à-vis the taxpayer. Moreover, its segmental financials are not available and it is having significant intangibles and research and development activities. So, Id. CIT (A) has rightly excluded Sasken from the final set of comparables.

ZYLOG SYSTEMS LTD. (ZYLOG)

43. The Id. DR challenged the exclusion of Zylog by Id. CIT (A0) by relying upon the TP order and drew our attention to page 685 of

the annual report of the paper book – 1, wherein revenue recognition is given as under :-

“The company derives its revenues primarily from software development services / consultancy services, projects and e-governance projects.

Revenue from software services and projects comprise income from time-and-material contracts, fixed price/fixed time contracts, technical services and annual maintenance contracts. Revenue from time-and-material contracts is recognized on the basis of man hours spent and materials utilized for the development of software and billable in accordance with the terms of the contracts with clients. Revenue from fixed price/fixed time contracts are recognized as per the proportionate completion method. Revenue from technical service for software application is recognized on completion of the service.”

44. When we examine the aforesaid recognition in the light of the Profit & Loss account, available at page 649 of the paper book, Zylog is having income from software development services and product with no segmental financials available. Similarly, page 665 of the annual report shows that Zylog operates in IT services, there is no other business segment. However, around 98% of the revenue accrues in USA and consequently, there is no other reportable geographical segment.

45. Furthermore, when we examine strength of Zylog explained at page 625 of the paper book, it is given as under :-

“OUR STRENGTHS

We believe the following aspects of our business help our customers address the challenges posed by today's business and information technology environment.

> Solutions based customer entry approach

ZSL's forte is evolving IT Services and Consulting into business solutions to meet the needs and goals of clients, leveraging accumulated knowledge of subject matter experts and best practices in numerous fields. We empower the businesses in several domains by integrating our Best Practices in both-Business and Technology through our Rapid Application Frameworks and Latest Technologies to create real Solutions. When your business depends on leveraging the right technology at the right budget, ZSL's portfolio of proven applications can take you where you need to go, in budget and on time.

The Company offers value to our customers and market place through value-added research and development, product engineering, and product lifecycle management (PLM) solutions from conceptualization, prototyping, development, integration with enterprise applications, migration, porting, performance tuning, application upgrade, testing and maintenance.

The Company's business applications are created with leading industry experts and experienced developers to help propel legacy systems and processes to fully leverage the current market technology.

- *E-waste & compliance framework[Manufacturing]*
- *Vesalius - HIS [pharma]*
- *Phoenix, M-Banking , M- Wallet[BFSI]*
- *Smart card solutions (RTO, Healthcare, Agriculture) ,E-Police system (E-Governance]*
- *Wi5, Field force automation [Telecom]*
- *E-Enablement [Retail]”*

46. Zylog has been ordered to be excluded by the coordinate Bench of the Tribunal in *Alcatel Lucent India Ltd. vs. DCIT* (supra) wherein it is held that, “...in the case of *CIT II Hyderabad vs. Intoto Software India P. Ltd. (ITA No.233 of 2014)*, has held that software product companies owning

intangibles could not be compared with the software development services provider.”

47. So, all these facts go to prove that Zylog is into diversified business activities with no segmental financials and is also into research and development activities, product engineering and end to end product life scale management solutions, etc. and as such, cannot be a valid comparable vis-à-vis the taxpayer which is a routine captive software development service provider, hence Id. CIT (A) has rightly excluded Zylog as comparable.

LARSEN & TOUBRO INFOTECH LIMITED (L&T)

48. The Id. DR for the Revenue challenged the exclusion of L&T by the Id. CIT (A) on the ground that no income from licence of product has been shown rather 100% income is from the software export. However, when we examine profit & loss account of L&T at page 238 of the paper book-1, L&T has shown this entire income from software development services and products. However, complete segmental financials are not available. Furthermore, the taxpayer is having intangibles of Rs.37,78,99,720/- during the year under assessment as against nil intangibles with the taxpayer. So, in these circumstances, L&T

cannot be a valid comparable vis-à-vis the taxpayer which is a routine captive software development service provider and Id. CIT (A) has rightly excluded the same.

PERSISTENT SYSTEMS LTD. (PERSISTENT)

49. The Id. DR challenged the exclusion of Persistent by contending that no income from licence of product has been shown rather 100% income is from the software export. However, when we examine revenue recognition of Persistent, available at page 542 of the annual report of paper book – 1, revenue from licensing of product is recognised on delivery of product, revenue from royalty is recognised on sale of products, products in accordance with the terms of relevant agreements. So, in these circumstances, the contention of the Id. DR is not sustainable. Moreover, when the Persistent is engaged in software product development and development of end to end solution qua software services, its business profile is dissimilar, which cannot be taken as a comparable in the absence of segmental financials. Furthermore, Persistent owns significant intangibles as against the taxpayer which has nil intangibles. Keeping in view the aforesaid facts, the

ld. CIT (A) has rightly excluded Persistent from the final set of comparables.

TAXPAYER'S APPEAL
(ITA NO.594/DEL/2017 FOR AY 2012-13)

50. At the very outset, it is fairly conceded by ld. ARs for the parties to the present appeal that there is no change in the business model of the taxpayer since AY 2011-12 and during the year under assessment also, the taxpayer has been providing software development services to its AE. During the year under assessment, the taxpayer entered into international transactions with its AE as under :-

<i>Sl. No.</i>	<i>Nature of International transactions</i>	<i>Amount (Rs.)</i>
<i>1.</i>	<i>Provision of Software Development Services</i>	<i>263,580,063</i>
<i>2.</i>	<i>Reimbursement of expenses by AEs</i>	<i>491,117</i>

51. There is no dispute regarding reimbursement of expenses by the AEs. The only dispute is qua transactions relating to provisions of software development services. The taxpayer by applying Transactional Net Margin Method (TNMM) as the Most Appropriate Method (MAM) with OP/OC as Profit Level Indicator (PLI) selected 25 comparables with three years weighted average margin of the comparable company at 7.92% as against taxpayer's net margin at 9.59% for benchmarking the international

transactions and found the same at arm's length. During the assessment proceedings, the taxpayer filed fresh search and updated margin of comparable companies at 7.77% as against its own margin of 9.95% and again found its international transactions at arm's length.

52. TPO accepted the TNMM as the MAM with OP/OC as PLI to benchmark the international transaction but used current year data to compute the margin of comparables. TPO rejected 16 comparable companies out of 25 chosen by the taxpayer and identified six additional companies and finally selected 15 comparables for benchmarking the international transactions having adjusted margin of PLI of comparable at 16.53% which are as under :-

<i>Sl.No.</i>	<i>Company Long Name</i>	<i>WC adjusted OP/OC</i>
<i>1.</i>	<i>Akshay Software Technologies Ltd.</i>	<i>8.51%</i>
<i>2.</i>	<i>Cigniti Tech</i>	<i>6.68%</i>
<i>3.</i>	<i>Celstream Technologies Pvt. Ltd.</i>	<i>10.88%</i>
<i>4.</i>	<i>Evoke Tech</i>	<i>11.81%</i>
<i>5.</i>	<i>Infosys Ltd.</i>	<i>41.04%</i>
<i>6.</i>	<i>Thirdware Solution Ltd. (Overseas segment)</i>	<i>10.59%</i>
<i>7.</i>	<i>Tata Elxsi Ltd. (segment)</i>	<i>13.89%</i>
<i>8.</i>	<i>Zylog Systems Ltd.</i>	<i>28.84%</i>
<i>9.</i>	<i>Lucid Software Ltd.</i>	<i>10.54%</i>
<i>10.</i>	<i>Persistent Systems Ltd.</i>	<i>26.13%</i>
<i>11.</i>	<i>R.S. Software (India) Ltd.</i>	<i>15.61%</i>
<i>12.</i>	<i>Larsen & Toubro Infotech Ltd.</i>	<i>23.13%</i>
<i>13.</i>	<i>Sankhya Infotech Limited</i>	<i>3.79%</i>
<i>14.</i>	<i>Spry Resources Pvt. Ltd.</i>	<i>18.12%</i>
	<i>Average</i>	<i>16.53%</i>

53. On the basis of TP analysis, TPO computed the ALP of international transactions relating to provision of software development services as under :-

<i>Operational Cost</i>	<i>240,961,423</i>
<i>Arm's Length Price at a Margin of 16.53%</i>	<i>280,792,346</i>
<i>Price Received</i>	<i>264,071,180</i>
<i>105% of Price Received</i>	<i>277,272,739</i>
<i>Total Adjustment u/s 92CA</i>	<i>16,721,166</i>

54. The taxpayer carried the matter before the Id. CIT (A) by way of filing the appeal who has disposed of the objections. After directions of the Id. DRP, following comparables have been finally selected to benchmark the international transactions which are as under :-

<i>Sr.No.</i>	<i>Name of the Company</i>	<i>As per TPO Order</i>	<i>DRP Directions</i>
<i>1.</i>	<i>Akshay Software Technologies Ltd.</i>	<i>8.51%</i>	<i>8.87%</i>
<i>2.</i>	<i>Celstream Technologies Pvt. Ltd.</i>	<i>10.88%</i>	<i>10.68%</i>
<i>3.</i>	<i>Cigniti Technologies Ltd.</i>	<i>6.68%</i>	<i>5.97%</i>
<i>4.</i>	<i>Evoke Technologies Ltd.</i>	<i>11.81%</i>	<i>11.90%</i>
<i>5.</i>	<i>Infosys Ltd.</i>	<i>41.04%</i>	<i>40.55%</i>
<i>6.</i>	<i>Larsen & Toubro Infotech Ltd.</i>	<i>23.13%</i>	<i>22.45%</i>
<i>7.</i>	<i>Lucid Software Ltd.</i>	<i>10.54%</i>	<i>12.49%</i>
<i>8.</i>	<i>Mindtree Ltd. (Segment)</i>	<i>18.34%</i>	<i>13.66%</i>
<i>9.</i>	<i>Persistent Systems Ltd.</i>	<i>26.13%</i>	<i>24.88%</i>
<i>10.</i>	<i>Sankhya Infotech Limited</i>	<i>3.79%</i>	<i>-0.08%</i>
<i>11.</i>	<i>R.S. Software (India) Ltd.</i>	<i>15.61%</i>	<i>15.69%</i>
<i>12.</i>	<i>Spry Resources Pvt. Ltd.</i>	<i>18.12%</i>	<i>19.96%</i>
<i>13.</i>	<i>Thirdware Solution Ltd.</i>	<i>10.59%</i>	<i>9.84%</i>
	<i>(Segment)</i>		
<i>14.</i>	<i>Tata Elxsi Ltd.</i>	<i>13.89%</i>	<i>12.33%</i>
<i>15.</i>	<i>Zylog Systems Ltd.</i>	<i>28.84%</i>	<i>27.72%</i>
	<i>Average</i>	<i>16.53%</i>	<i>15.79%</i>

Pursuant to the directions issued by Id. DRP, ALP of the international transactions have been computed as under :-

<i>Particular</i>	<i>Amount</i>
<i>Operating Cost</i>	<i>24,09,61,423</i>
<i>Arm's Length Price at a Margin of 15.79%</i>	<i>27,90,09,232</i>
<i>Price Received</i>	<i>26,40,71,180</i>
<i>105% of Price Received</i>	<i>27,72,74,739</i>
<i>Adjustment u/s 92CA</i>	<i>1,49,38,052</i>

Feeling aggrieved, the taxpayer has come up before the Tribunal by way of filing the present appeal.

55. 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.

56. Ld. AR for the taxpayer in order to cut short the controversy sought exclusion of (i) Infosys Ltd., (ii) Zylog Systems Ltd., (iii) Persistent Systems Ltd., and (iv) Larsen & Toubro Infotech Ltd.. We would like to examine the comparability of each comparable sought to be excluded by the taxpayer one by one.

INFOSYS LTD. (INFOSYS)

57. The taxpayer had challenged inclusion of Infosys by the TPO on grounds of functional dissimilarity; non-availability of segmental information; Infosys is a giant company having high

brand value; having its own research and development centre; and it is a full-fledged risk bearing company.

58. When we examine the contentions raised by the taxpayer suitability of Infosys vis-à-vis a captive software service provider has been examined by the Hon'ble Delhi High Court in case cited as *CIT vs. Agnity India Technologies Pvt. Ltd. – (2013) 36 taxmann.com 289 (Delhi)* and found to be an invalid comparable by returning the findings, which are reproduced in the preceding para 35 of this order.

59. Perusal of profit & loss account of the taxpayer shows that the taxpayer has never been into development of product rather a pure software development and other services provider as the entire income is from SDOS.

60. So, we are of the considered view that keeping in view the functional dissimilarity, scale of operation, high brand value impacting profit, having own research and development centre with capital expenditure of Rs.5 to Rs.7 crores and revenue expenditure of Rs.570 crores, creating huge intangibles for the company and the fact that Infosys is a full-fledged risk bearing company, hence cannot be a valid comparable vis-à-vis the taxpayer which is a routine captive software service provider working on minimal risk

having no brand value nor having any research and development centre to produce its own intangibles. So we order to exclude Infosys from the final set of comparables.

ZYLOG SYSTEMS LIMITED (ZYLOG)

61. Zylog is engaged in product development along with software development services of which it has revenue of 38%. At the same time, segmental information is not available. Furthermore, Zylog fails the export sales filter applied by the TPO as it has merely 18.87% revenue from the export sales as against export sales/total sales benchmark of 75% determined by the TPO.

62. The Id. DR for the Revenue challenging the exclusion of Zylog drew our attention to revenue recognition given in annual report of the Zylog, available at page 57 to 578 of the paper book.

63. When we examine the revenue recognition in the light of the Profit & Loss account, Zylog is having income from software development services and product with no segmental financials available. Similarly, annual report shows that Zylog operates in IT services, there is no other business segment. However, around 98% of the revenue accrues in USA and consequently, there is no

other reportable geographical segment. Furthermore, we have examined strength of Zylog as explained in the annual report.

64. Zylog has been ordered to be excluded by the coordinate Bench of the Tribunal in *Alcatel Lucent India Ltd. vs. DCIT* (supra) by relying upon the case of *CIT II Hyderabad vs. Intoto Software India P. Ltd. (ITA No.233 of 2014)* wherein Zylog was excluded as invalid comparable vis-à-vis software routine development service provider by observing that, “*software product companies owning intangibles could not be compared with the software development services provider.*”

65. So, all these facts go to prove that Zylog is into diversified business activities with no segmental financials and is also into research and development activities, product engineering and end to end product life scale management solutions, etc. and as such, cannot be a valid comparable vis-à-vis the taxpayer which is a routine captive software development service provider. So, w order to exclude Zylog from the final set of comparables.

PERSISTENT SYSTEMS LTD. (PERSISTENT)

66. Persistent is functionally not comparable being engaged in product development along with software development services.

Persistent has undergone extra ordinary events during the year under assessment as it has amalgamated with Persistent eBusiness Solutions Ltd. and Persistent Systems and Solutions Ltd. w.e.f. 01.04.2011, as per detail given at page 212 of the paper book. So, due to merger and demerger financial results of the company have certainly been impacted.

67. Persistent has significant intangibles of Rs.385 crores comprising of software and acquired rights which is 14% of the net fixed assets whereas the taxpayer does not own any intangibles. Persistent is also incurring significant expenditure on research and development to the tune of Rs.44.72 crores as against nil expenses of the taxpayer on such research and development activities.

68. Persistent has been ordered to be excluded in *Alcatel Lucent India Ltd. vs. DCIT* (supra) on the aforesaid ground that it is a product company having no segmental financials and has undergone extra ordinary events impacting profit. So, in view of the matter, we order to exclude Persistent from the final set of comparables for benchmarking the international transactions.

LARSEN & TOUBRO INFOTECH LTD. (L&T)

69. is functionally dissimilar being product development company. Perusal of the annual report, available at pages 561 to

564 of the paper book, shows that L&T is into sale of software product, such as, Unitrax and Accurusi which fact has been brought to the notice of the TPO as well as DRP by the taxpayer in its TP study, available at page 206 of the paper book.

70. L&T is also developing new technology especially the cloud, mobility, social and big data analytics are impacting service providers who are renewing how industry verticals and customer segments will adjust themselves to the changing technology landscape. Furthermore, L&T is having a huge brand value impacting its profit vis-à-vis the taxpayer which is a routine software development service provider.

71. Larsen has been ordered to be excluded by the coordinate Bench of the Tribunal in *Alcatel Lucent India Ltd. vs. DCIT* (supra) by holding as under :-

“(iv) Larsen and Turbro Infotech Ltd. –The Ld. AR has submitted that L&T operates in software development services and earns revenue from licensing of products and hence is functionally dissimilar. The ITAT Delhi Bench in Saxo India P. Ltd. (ITA No.6148/Del/2015), has held that L&T cannot be taken as a comparable to a software development company. The Hon’ble High Court of Andhra Pradesh in the case of CIT II Hyderabad vs. Intoto Software India P. Ltd. (ITA No. 233 of 2014), has held that software product companies owning intangibles could not be compared with the software development services provider. Respectfully following the ratio of these decisions, we direct the TPO to exclude this company from the final list of comparable.”

72. So, in view of the matter, we order to exclude Larsen from the final set of comparables for benchmarking the international transactions.

73. Resultantly, the appeal filed by the assessee (ITA No.2788/Del./2017 for AY 2011-12) is partly allowed for statistical purposes and the appeal filed by the Revenue (ITA No.2744/Del./2017 for AY 2011-12) is dismissed. The appeal filed by the assessee for AY 2012-13 being ITA No.594/Del./2017 is allowed.

Order pronounced in open court on this day 22nd of June, 2018.

**Sd/-
(R.K. PANDA)
ACCOUNTANT MEMBER**

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

**Dated the 22nd day of June, 2018
TS**

Copy forwarded to:

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

**AR, ITAT
NEW DELHI.**