

आयकर अपीलीय अधिकरण, पुणे न्यायपीठ “ए” पुणे में
IN THE INCOME TAX APPELLATE TRIBUNAL
PUNE BENCH “A”, PUNE

श्री डी. करुणाकरा राव , लेखा सदस्य
एवं श्री विकास अवस्थी, न्यायिक सदस्य के समक्ष

**BEFORE SHRI D.KARUNAKARA RAO, AM
AND SHRI VIKAS AWASTHY, JM**

आयकर अपील सं. / ITA No.1802/PUN/2013
निर्धारण वर्ष / Assessment Year : 2008-09

ITO, Ward-11(1),
Pune

.... अपीलार्थी/Appellant

Vs.

Magic Software Enterprises
India Pvt. Ltd.,
9/12, Tara Icon,
Mumbai Pune Road,
Wakadewadi, Pune – 411 003
PAN : AABCM2443B

.... प्रत्यर्थी / Respondent

C.O.No.98/PUN/2014
(Arising out of ITA No.1802/PUN/2013
A.Y. 2008-09

Magic Software Enterprises
India Pvt. Ltd.,
9/12, Tara Icon,
Mumbai Pune Road,
Wakadewadi, Pune – 411 003
PAN : AABCM2443B

.... Cross Objector

Vs.

ITO, Ward-11(1),
Pune

.... Appellant in the
Appeal

Assessee by : Shri Arun Chhabra & Ms. Shilpa S.

Revenue by : Shri Achal Sharma

सुनवाई की तारीख / Date of Hearing : 29.05.2018	घोषणा की तारीख / Date of Pronouncement: 18.07.2018
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आदेश / ORDER**PER D. KARUNAKARA RAO, AM :**

The Revenue filed the appeal against the order of CIT(A)-IT/TP, Pune dated 31-07-2013 for the Assessment Year 2008-09. Assessee also filed the Cross Objection in connection with the said appeal of the Revenue.

2. Briefly stated relevant facts of the case are that the assessee is a company and is engaged in the business of Software Development. Assessee filed the return of income declaring income of NIL. On finding the international transactions with the Associated Enterprises, the case was referred u/s.92CA(1) of the Act to the TPO. The TPO passed the order dated 31-10-2011 u/s.92CA(3) of the Act and the adjustments on account of ALP of the international transactions amounts to Rs.1,64,23,243/-.

3. As per the TPO's order, assessee reported the international transactions amounting to Rs.5,22,96,342/- and the same were subjected to TP study by the assessee using Cost Price Method (CPM) as most appropriate method. During the proceedings before the TPO, certain comparables were identified from the database and TPO issued a show cause notice proposing to finalize the set of 11 comparables with the OP/OC ratio with the Arithmetic Mean 31.95% (Para 13 of the TPO's order). After considering the objections raised by the assessee, the TPO excluded few of the comparables and determined the final set of 8 comparables as per the table given in Para No.15 of his order. It reflects the Arithmetic Mean of 31.95% OP/OC. Eventually; the TPO quantified the adjustment as per the details in Para

No.19 of his order. The details of the comparables, OP/OC ratio and the manner of arriving at adjustment of Rs.1.64 crores are given in Para No.15 and the same is extracted as under :

Sr.No.	Name of the comparables	OP/OC (%)
1	Bodhtree Consulting Ltd.	19.14
2	E-Infochip Ltd.	30.32
3	eZest Solutions Ltd.	28.58
4	F.C.S. Software Solution Ltd.	57.02
5	Goldstone Technologies Ltd.	27.06
6	Hellos & Matheson Information Technology Ltd.	36.05
7	KALS Information Systems Ltd. (application software seg.)	41.94
8	L.G.S. Global Ltd.	26.33
	Arithmetic Mean	31.93

AO incorporated the same in his order dated 29-02-2012 and completed the assessment determining the assessed income at Nil after giving set off of brought forward losses.

4. Aggrieved with the same, assessee filed the appeal before the CIT(A) and raised various objections with regard to comparables introduced by the TPO in the final list of comparables. Assessee is also aggrieved for rejecting the arguments of the assessee with regard to couple of comparables namely (1) Thinksoft Global Services Ltd.; and (2) R. Systems International Ltd., Eventually, the CIT(A) partly allowed the appeal of the assessee.

5. Aggrieved with the relief granted by the CIT(A), the Revenue is in appeal with the grounds that revolve around the relief granted by the CIT(A). Further, aggrieved with confirming of certain issues and on certain directions of the CIT(A), the assessee filed the Cross Objection.

We shall take the Revenue's appeal first.

ITA No.1802/PUN/2013 – By Revenue
A.Y. 2008-09

6. In this regard, Ld. Counsel for the assessee submitted that the CIT(A) passed composite order involving both the assessment years 2007-08 and 2008-09. The appeal for A.Y. 2007-08 was already heard and adjudicated by the Tribunal.

For the A.Y.2007-08, in connection with technical ground raised by the assessee relating to validity of reopening of the assessment without notice u/s.143(2) of the Act, the Cross Objection raised by the assessee in this regard was allowed and the appeal of the Revenue was dismissed. In effect, there is no adjudication on merits relating to the grounds by the Revenue in the said appeal ITA No.1801/PUN/2013 dated 31-01-2017 which is on record.

7. Further, in connection with the appeal of the Revenue for the A.Y. 2008-09, Ld. Counsel for the assessee filed a chart mentioning the relief granted by the CIT(A) with reference to 4 of the comparables, i.e. (1) KALS Information Systems Ltd.; (2) E-Infochip Solutions Ltd.; (3) F.C.S. Software Solution Ltd.; and (4) L.G.S. Global Ltd. As per the CIT(A) these 4 comparables do not constitute good comparables. In this regard, defending the decision of CIT(A), Ld. Counsel for the assessee justified the reasons given by the CIT(A) in granting the relief. Further, bringing our attention to the arguments, details filed by the assessee in support of the arguments of CIT(A), who granted relief, Ld. Counsel read out the said reasons. He also mentioned various reasons supporting the arguments of the Ld. Counsel.

8. On hearing the Ld. DR for the Revenue as well as on perusal of the order of CIT(A), we shall now take up the each comparable-wise adjudication of the issues raised in the appeal of the Revenue.

(1) **KALS Information Systems Ltd.:** In this regard, CIT(A)'s finding is that the said company is engaged in the development of products and is also into the provisions of ITES and this comparable cannot constitute a good comparable considering the FAR analysis of the assessee under consideration. In this regard, we have also considered the contentions raised by the assessee and the same are extracted as under:

Findings of CIT(A) :

"1. Respondent has raised detailed contentions before the Ld.CIT(A) in respect of rejection of comparable on ground of functional non compatibility.

2. Ld. CIT(A) has ruled after analysing detailed contentions raised by the Respondent

3. The Ld. TPO has accepted the 'application software' segment of KALS as comparable to the Respondent. However, on perusal of the annual report (refer para 1 and 2(b), page 824 and para 7 on page 825 of paper book page 18 and 19 of annual report for F.Y 2007-08), it is observed that the segment also includes revenue from software products. Furthermore, the company also holds inventories of such software products as evident from page 822 and 823 of paper book- Page 13 and 16 of the annual report.)

Assessee's contentions :

The contention of the Appellant is devoid of merit since the powers of CIT(A) have been held to be coterminous with that of the assessing officer, thus, it was well within the powers of CIT(A) to consider those objections in relation to exclusion of KALS from the final set of comparable companies which were not raised before the Assessing Officer.

In the light of the judicial precedents relied, it can be considered that it was well within the powers of CIT(A) to consider the objections raised by the respondent before the CIT(A), hence the ground of objection raised by the appellant cannot be maintained.

Without prejudice to the above, the Respondent would like to humbly submit that it had raised arguments against inclusion of KALS as a comparable company before Ld. TPO as well Thus, the contention raised by the appellant

under Ground No.3 above is not just devoid of merit but is also factually incorrect and thus should not be entertained.

Furthermore, without prejudice to the above the Hon'ble High Court of Punjab and Haryana in the case of CIT Vs. Quark Systems India (P) Ltd. (ITA No.594/2010) (Refer page 590 of the Paper book) has upheld the view taken by the Special Bench of tribunal that the taxpayer cannot be stopped from raising objections to reject a company which was selected by the taxpayer itself in the transfer pricing study. Considering the ratio of the said decision, in the present case the taxpayer cannot be stopped from raising objections to reject a company at the CIT(A) or Tribunal level even if no objection was raised at the assessment level.

CIT(A) relied on series of decisions to hold that the case of M/s. KALS Information Systems Ltd. with product development and ITes services, is not a good comparable to the assessee, who is engaged in the Software Development activities. Assessee is neither a product- oriented company nor a ITes Company.

9. In the First Appellate proceedings, the CIT(A) directed TPO to exclude KALS as not good comparable and the same is engaged in product development activities and also engaged in ITes services(Para 2.3.2.3 of the order of CIT(A)). The CIT(A) relied on the decision of Pune Bench of Tribunal in the case of Bind View India Private Limited Vs. DCIT reported in ITA No. 1386/PUN/2010 for the assessment year 2006-07.

10. Aggrieved with the same, the Revenue is in appeal before us on the decision of CIT(A).

Findings of the Tribunal with regard to KALS Information System Pvt. Ltd:

11. Before us, the case of the Revenue is that the CIT(A) did not examine merits of the case of Bind View India Private Limited Vs. DCIT (supra.) before applying the same in the present case and also before concluding that the

KALS is not a good comparable. Further, the Revenue is of the opinion that KALS was included as good comparable with the consent of the assessee during TP proceedings. The assessee has no objection for such inclusion. The assessee now argued for exclusion of the same. The Revenue also argued that the KALS is a functionally comparable so far as ITes services are concerned.

12. Per contra, the case of the assessee is that function of product development and ITes services, KALS is not a functionally good comparable with the assessee. The assessee also objected to the allegation of consent given by assessee before TP proceedings. Justifying the decision of the CIT(A), assessee contends before us that the CIT(A) has co-terminus power and therefore, CIT(A) is justified in considering the claim of assessee for exclusion of the KALS from list of comparables and ordered for exclusion. In this regard, the assessee relied on the various decisions. Further, on the functional incomparability, the assessee referred to the contents of various decisions of Tribunal justifying the decision of exclusion by the CIT(A). The assessee made elaborate submissions and for the sake of completeness, the same are reproduced here as under:

- *In relation to the contention raised by the Appellant under Ground 2, the Respondent would like to humbly submit that the Ld. CIT(A) has not merely relied on the decision of Bindview India Pvt, Ltd. (vide order in ITA No.1386/PN/2010 for AY 2006-07) but has also considered the functional differences of Kals vis-a-vis the Respondent before rejecting Kals.*

Same can also be verified from the order of the Ld. CIT(A) (para 2.3.2.1-2.3.2.4, page 8 of the CIT(A)'s order, page 250 - 251 of the paper book and para 3.4.4.2, page 31 of the CIT(A)'s order, page 273 of the paper book). The Ld. CIT(A) has not merely relied on the aforementioned decision but has also considered the evidences presented before him (refer pages 231 and 309-311 of the paper book) in the form of annual report extracts and extracts from the website of the company to conclude that Kals is also engaged in product development and is thus, not functionally comparable to the Respondent.

- *In relation to the contention raised by the Appellant under Ground No.4, the Respondent respectfully submits that for Kals, Ld. TPO has accepted the 'application software' segment of Kals as comparable to the Respondent. However, on perusal of the annual report (refer para 1 and*

2(b), page 824 and para 7 on page 825 of Paper book - Page 18 and 19 of annual report for FY 2007-08), it is observed that the segment also includes revenue from software products.

Further, the company also holds inventories of such software products as is evident from the pages 822 and 823 of paper book-pages 13 and 16 of the annual report.

- *Since the Respondent is not engaged in selling any software products, the Respondent humbly requests that the action of the Ld. CIT(A) ordering exclusion of the said company from the final set of comparable companies should be sustained. In this regard, the Respondent would like to draw your Honours' kind attention to the ruling given by Hon'ble High Court of Bombay in the case of CIT VS. PTC Software (I) Pvt. Ltd. (ITA No. 732 OF 2014) [para 10, page 594-596 of paper book] and Pr CIT VS. PTC Software (I) Pvt. Ltd. (ITA No. 598 of 2016) [para 3, page 599-600 of paper book], wherein the exclusion of Kals was upheld."*

From the above, it is evident that the function of KALS is undisputedly a product development on one side and ITes services on the other side. These functions are no way comparable with that of the assessee, which, otherwise, is engaged in the software development services (Page 52 of the paper book). This functional test was approved by various Benches of the Tribunal including the Hon'ble Bombay High Court in the case of CIT Vs. PTC Software (I) Pvt. Ltd., in ITA No.337 of 2014 dated 10.10.2016.

13. Considering the above discussions as well as submissions made by the Ld. AR for the assessee, we are of the opinion that the order of CIT(A) is fair and reasonable on the exclusion of KALS and does not call for any interference. We also approve the arguments relating to co-terminus power of the CIT(A) considering the settled nature of this issue. Accordingly, **relevant ground raised by the Revenue in this regard is dismissed.**

(2) **E-Infochip Solutions Ltd.:** CIT(A) while granting relief to the assessee has attached certain conditions ignoring the fact that CIT(A) powers are co-terminus with that of the AO. Aggrieved with the conditions attached, assessee filed the Cross Objection. Revenue is in appeal against deletion of

this comparable as a good comparable. Relevant finding of the CIT(A) in this regard as well as the contentions of the assessee's Counsel before the Tribunal are extracted as follows :

Findings of CIT(A) :

Respondent 1. Annual Report for FY 2007-08 not available in public domain.

2. Company is in declining phase-turnover in FY 2008-09 is INR 148,674,474 as compared to INR 240,278,099 in FY 2007-08.

Held by CIT(A) :1 Company to be excluded if contention of non availability of annual report was raised before TPO.

2. Rejected argument of diminishing revenue since it pertains to use of future year data which is not permitted under Rule 10B(4) of the Income Tax Rules, 1962 ("the Rules")

3.Upheld application of 25% RPT filter applied by the TPO

Assessee's contentions :

1. CIT(A) had also excluded a comparable selected by Respondent (Thinksoft) on the basis of non availability of data.

2. The condition imposed by CIT(A) that the comparable will be excluded only if such contention had been taken before TPO is devoid of any merit as powers of CIT(A) have been held to be coterminous with that of the assessing officer, thus, it was well within the powers of CIT(A) to consider those objections which were not raised before the Assessing Officer.

3. E-infochips has been held as not being comparable to a software development services provider. The matter may accordingly be sent back for verification and exclusion. Also, inclusion of Thinksoft may also kindly directed, post verification.

Findings of the Tribunal with regard to E-Infochip Solutions Ltd :

14. From the above, it is submitted by the assessee that E-infochips stands excluded by the Revenue on the ground of non-availability of data at the relevant point of time. This issue is directly connected with the cross objection No.3 raised by the assessee. The said cross objection of the assessee stands remanded to the file of CIT(A) for want of speaking order and after considering the decisions cited by the assessee before us as per discussion given in para 27 & 28 of this order. Hence, ground No.5 raised by

Revenue stands remanded to the file of CIT(A) with the direction to adjudicate the issue after giving reasonable opportunity of being heard to the assessee and the objection, if any, in accordance with set principles of natural justice. Accordingly, **ground No. 5 raised in appeal by assessee is allowed for statistical purpose.**

(3) **F.C.S. Software Solutions Ltd. ('FCS' in short)** : CIT(A) granted relief to the assessee with regard to this comparable holding that the F.C.S. is predominantly ITES company and not a Software Development Company. Relevant finding of the CIT(A) as well as the contentions of Ld. Counsel before us are extracted as under :

Findings of CIT(A) :

Respondent : 1 The company is into provision of various services namely,

- *IT Consulting Services*
- *E-learning and digital consultation*
- *Application support 24/7*
- *Infrastructure management services*

None of the above comparable to the software development services and are in the nature of ITes. Furthermore, the company is not reporting any relevant segmental data for different services and is only providing geographical segments.

2. Company has earned super-normal profits.

Held by CIT(A) : To be excluded based on provision of ITes services.

Assessee's contentions :

- 1. FCS is engaged in diverse services and it a product company and not in software development.*
- 2. Due to diverse nature of services, being a software product company, and lack of relevant segmental financial data, the company is ought to be rejected. It ha also been held to be a product company in a coordinate Pune bench ruling.*
- 3. None of the above are comparable to the software development services and are in the nature of ITes. Furthermore, the company is not reporting any relevant segmental data for different services and is only providing geographical segments.*

It fails the filter of 75% income from software development services.”

Findings of the Tribunal with regard to FCS Software Solutions Ltd :

15. The TPO included FCS as comparable for benchmarking the international transactions. The CIT(A) ordered for exclusion on finding the FCS as again a software development as well as ITes services Company and is not a good comparable. The relevant contentions of the Ld. AR for the assessee in this regard are extracted as follows:

“(ii) Contentions in relation to exclusion of FCS Software Solutions Limited ("FCS Software")

In relation to the contention of the Appellant under Ground No.6, wherein the Appellant contends that the Ld. CIT(A) erred in holding that FCS Software is not comparable to the Respondent, the Respondent would like to humbly submit as under:

- *The Ld. CIT(A) has given a very detailed reasoning in his order, while accepting the Respondent's plea that FCS Software is into ITeS, and is not comparable to the Respondent (as is evident from page 27-29 of the CIT(A)'s order - page 269-271 of the paper book).*
- *As per the relevant extract of annual report of FCS Software (refer page 236 - 239 of the paper book and Page 827 of the paper book), the company is engaged in ITeS and not in software development services. The business of the company comprises of application support, e-learning, digital consulting and IT consulting. All these services are in the nature of ITeS, and cannot thus be compared with the software development services provided by the Respondent to its Associated Enterprise ("AE").*
- *Based on the above extracts submitted by the Respondent, it is clearly evident that the company does not clear the quantitative filter of at least 75% income from software development services applied by the Ld. TPO (for details of filters applied by the Ld. TPO, refer page 75 of the paper book).*
- *Furthermore, FCS Software has been held to be functionally non-comparable to a software development service provider in the following decisions:*
 - *TIBCO Software India Pvt. Ltd. vs. DCIT (ITA No. 2536/PN/2012) (Refer para 23, page 463-465 of the paper book)*
 - *John Deere India Pvt. Ltd. vs. ACIT (ITA No. 2236/PN/2012) (Refer para 20.6, page 630-634 of the paper book)*

- *Further, FCS Software has been held to be a product company and thereby incomparable by the Hon'ble Pune Bench of ITAT in case of Synechron Technologies Pvt. Ltd (ITA No. 5361Pun12015 & 622/Pun/2015) (Refer para 12, page 683-684 of the paper book).*
- *The above contentions of the Respondent are also supported by the ruling given by the Hon'ble Pune Bench of the Tribunal in the case of TIBCO Software India Pvt. Ltd vs. DCIT (ITA No. 94/Pn/2014) (Refer para 14-16, page 574-576 of the paper book).*
- *Based on the above, the respondent would like to submit that the Ld. CIT(A)'s action was correct in excluding FCS software from the final set of comparables.”*

16. The Ld. DR for the Revenue did not bring any other decision to support FCS as solely engaged in the software development activities and not in the product development as well as ITes services.

17. On hearing both the sides, we are of the opinion that the order of CIT(A) is fair and reasonable and does not call for any interference. Accordingly, **relevant ground raised by the Revenue in this regard is dismissed.**

(4) **L.G.S. Ltd.** : CIT(A) granted relief with regard to this comparable as it failed in Export Turnover Filter. TPO considered only total export of 14% of the total turnover filter. With 91.76% L.G.S. Global Ltd. fails to meet the said filter requirement set by the TPO. Therefore, CIT(A) granted relief. Relevant finding of the CIT(A) as well as the contentions of the Ld. Counsel before the Tribunal are extracted as under :

Findings of CIT(A) :

1. *Company's wages to total cost ratio is of 91.76% which is abnormal and cannot be compared with the Respondent, placing reliance on the ruling given by Hon'ble ITAT in the case of Avaya India P. Ltd. (ITA No.5150/Del/2010).*

2. *Company fails the export turnover filter as applied by the Ld. TPO (total exports are only 14% of the total turnover).*
3. *Company is engaged into provisions of ITes.*

Held by CIT(A): Company is to be excluded as it fails export turnover filter.

Assessee's contentions :

Company is failing the export turnover filter applied by the Ld. TPO and therefore, ought to be rejected.

Findings of the Tribunal with regard to Lanco Global Systems Ltd:

18. The Ld. AR for the assessee argued vehemently stating that the said comparable fails to meet the requirement of export turnover of 14%. Ld. AR has filed written submission and contents of the same read as under:

“ (iii) Contentions in relation to exclusion of Lanco Global Systems Ltd.

In relation to exclusion of Lanco from the final set of comparables, the Respondent would like to humbly submit that the said company does not clear the 75% export turnover filter as applied by the Ld. TPO (for details of filters applied by the Ld. TPO, refer page 75 of the paper book). Calculations in this regard for this filter were submitted before the Ld. CIT(A) (refer page 242 of the paper book) and the Ld. CIT(A) after factoring in such calculations, excluded Lanco for failing the export filter applied by the Ld. TPO (refer para 3.4.5.1 and 3.4.5.2, page 32 of the CIT(A)'s order- page 274 of the paper book). Based on the aforesaid, the Respondent prays that the said company ought to be excluded as it did not meet the comparability criteria applied by the Ld. TPO.”

19. Considering the above, we are of the considered view that the Lanco fails in meeting threshold requirement of export turnover filter. Therefore, in our view, LGS failed to be a good comparable in this regard. Therefore, we are of the opinion that the order of CIT(A) is fair and reasonable and does not call for any interference. **Accordingly, relevant ground raised by the Revenue is dismissed.**

20. In the result, appeal of the Revenue is dismissed as above.

CO.No.98/PUN/2014 – By Assessee

21. The assessee filed cross objection in connection with the impugned order of CIT(A) dated 31.07.2013.

22. At the outset, bringing our attention to the Cross Objections, Ld. Counsel for the assessee submitted that barring the Cross Objections at Sl.No.1,3 & 6 all other cross objections are not pressed. We accordingly dismiss the same. The rest of the Cross Objections, i.e. 1, 3 & 6 raised by the assessee are extracted as under:

“1. Accepting adjustment on the entire operating cost of Magic Software Enterprises India Pvt. Ltd. (“Magic India”) which includes cost incurred for providing services to third party (Non Associated Enterprise) (“AE”) and trading of licenses.

3. Accepting to reject E-infochips Limited, only if the argument of non-availability of Annual Report in the public domain was raised before the learned Transfer Pricing Officer (“TPO”).

6. Considering Carpro Netherlands (a third party) as an associated enterprise of the tested party, resulting into correct interpretation of the provisions of the Act.”

Ground wise adjudication of the cross objection are taken up in the following paragraphs.

Cross objection No. 1 :

23. Referring to the cross objection No. 1, the Ld. Counsel for the assessee submitted that the TPO/AO quantified the adjustment on the entire operating cost which also includes the cost incurred in providing services to the third parties i.e. non-AEs and the trading license. In this regard, he brought our attention to the contents of Page 15 of the paper book where computation of Arm’s Length Price is given showing the working quantifying adjustment considering total operating cost of Rs.6,11,70,289/-. The CIT(A) did not disturb the above manner of quantifying the adjustment. The CIT(A) is of the opinion that the adjustment made by TPO is sustainable as the

assessee used the entity level net margin while preparing his TP study. However, he did not refer or distinguished the case laws cited by the assessee before him. Therefore, the assessee raised cross objection asking for relief in this regard.

24. Before us, assessee filed written submissions and relied on various decisions of the Tribunal as well as judgment of Hon'ble High Court to make out the case for restricting quantification adjustment to the portion of international transaction with AEs. For the sake of completeness, the contents of the written submissions are extracted as under:

Assessee's contentions with regard to Ground No.1 :

While computing the transfer pricing adjustment, the TPO has considered the total cost incurred by Magic India for the purpose of computing the arm's length price. The total cost incurred by Respondent consists of cost incurred for provision of software development services to independent third parties as well as cost for trading of licenses which are not in any way related to the international transactions of the Respondent.

*The Respondent would like to place its reliance on judgments of Mumbai High Court in case of CIT vs. Bhansali & co. (ITA 1066 of 2014) (refer para 3 and 5, page 719-720 of the paper book) and Ratilal Becharlal & Sons ([2016J 65 taxmann.com 155 (Bombay)) (refer para 3(d) and 3(e), page 724 of the paper book) and Delhi High Court in case of CIT vs. Keihin Panalfa Ltd (ITA No. 11 of 2015) (refer para 12, page 734-735 of the paper book) stating that while determination of arm's length price under TNMM, **adjustment can be made only on transactions undertaken with the AE not with the third party.** Accordingly, in respondent's case, cost incurred for rendering services to third party should be excluded for determination of arm's length pricing.*

The Respondent would like to place reliance on the following cases in support of the above argument:

- *CIT vs. Tara Jewels Exports Pvt. Ltd [ITA No. 1814/2013]*
- *Huntsman Advanced Materials (I) Pvt. Ltd vs. DCIT [ITA No. 8237/Mum/2010]*
- *M/s Starlite vs DCIT [2010] 40 SOT 421 (MUM)*
- *ACIT v/s Ms Tej Diam [I.TA. No. 5034/Mum/2007]*
- *IL Jin Electronics (I) (P) Ltd v/s ACIT [(2010) 36 SOT 227 (DELHI)]*
- *Chiron Behring Vaccines Pvt Ltd Vs Asst CIT, Mumbai ITAT 2011*

*The Ld. CIT(A) was principally in favor of the above argument raised by the Respondent that the **transfer pricing adjustment should be made only in relation to the international transaction** (refer para 2.2.3 page 247 of the paper book). However, he rejected the above ground of the Respondent on account of two reasons. First of all, the Ld. CIT(A) has opined that making*

transfer pricing adjustment to the value of international transactions alone would constitute as further adjustment to an adjustment which is opposed to the provisions of law. Furthermore, the Ld. CIT(A) was of the opinion that the Respondent had used the entity level net margins while preparation of transfer pricing study which was accepted by the TPO at the assessment level. Thus, the same should not be covered by the CIT(A).

In relation to the above contentions of the CIT(A), the Respondent would like to humbly submit as under:

The Respondent is not proposing to make adjustments to the transfer pricing adjustment made. The Respondent is proposing to use the segment cost and revenue for computing the amount of adjustment.

Making an adjustment to the value of international transaction by using the segmental cost incurred by the entity in relation to the international transaction would not amount to making further adjustment to the transfer pricing adjustment.

Furthermore, in relation to the contention that the Respondent had selected entity level net margins at the time of transfer pricing study and the same was accepted by the TPO, the Respondent would like to humbly submit as under:

Ld. CIT(A) has himself opined that conduct or error on part of the TPO cannot stop operation of law that net margin has to be worked out On international transaction (para 2.2.7, page 249 of the paper book)

Ld. CIT(A) has himself agreed to the fact that an error on part of the tax payer which is not in accordance with legal provisions cannot become legally valid because the TPO accepted it. (para 2.2.8, page 249 of the paper book)

The powers of CIT(A) are co terminus with the powers of the AO, thus, even if the Respondent failed to raise the ground before the TPO or the AO, the same cannot be considered as the basis for not allowing the objection raised by the Respondent if it is acceptable as legally sound.

The Hon'ble High Court of Punjab and Haryana in the case of CIT vs. Quark Systems India (P) Ltd. (ITA No. 594/2010) (refer page 590 of the paper book) has upheld the view taken by the Special bench of tribunal that the taxpayer cannot be estopped from raising objections to reject a company which was selected by the taxpayer itself in the transfer pricing study. The same principle applied in the present case.

Without prejudice to the above, the Respondent would like to humbly submit that the Respondent had also submitted detailed segmental profitability to the TPO vide submissions dated 26th October 2010 and 14th October 2011 (page 57 and 103 of paper book). Thus, the above contention of Ld. CIT(A) is devoid of any factual or legal support.

From the above it is evident, the assessee summed up the objection of the CIT(A) and contended that it is not a case of making adjustment to the adjustment in opposition to the provisions of law. Further, assessee adopted entity level net margin in his TP study and there is no entity segregating the operating cost relatable to the international transactions and then quantified

the adjustment. In this regard, assessee submitted that the CIT(A) is empowered and is free to make correction and remove errors in the manner of determining ALP. Referring the schedule of co-terminus power of CIT(A), Ld. Counsel relied on the judgment of Punjab & Haryana High Court in the case of CIT Vs. Quark Systems India (P) Ltd. (supra.) which upheld the Special Bench decision of the Tribunal holding that the taxpayer cannot be stopped from raising objection.

25. Ld. DR for the Revenue relied heavily on the order of CIT(A).

26. On hearing both the parties on this issue, we are of the opinion that the issue of restricting the adjustment, if any, to the international transactions undertaken with AEs only and not with the third party, is already decided in favour of the assessee. The judgment in the case of Ratilal Becharlal & Sons (supra.) and the Delhi High Court's judgment in the case of CIT Vs. Keihin Panalfa Ltd. (supra.) are relevant in this regard. Revenue has not filed any case law in support of their decisions. Therefore, we are of the opinion that the issue under consideration needs, to be remanded back to the file of CIT(A) to adjudicate the issue fresh after considering the cited decisions (supra.). The CIT(A) shall grant reasonable opportunity of being heard to the assessee in accordance with the set principles of natural justice. Accordingly, **cross objection No.1 raised by assessee is allowed for statistical purpose.**

Cross objection Nos. 3 & 6

27. Other cross objections i.e cross objection No. 3 and 6 extracted in Para 21 of this order relates to rejection of E-infochips Limited on one side and considering Carpro Netherlands as an AE of the tested party on the other.

Ld. AR for the assessee filed the following written submissions. Cross objection wise write up is extracted as under:

Assessee's contentions with regard to Ground No.3 :

The order of Ld. CIT(A) so far as it related to the condition imposed for rejection of E-Infochips Limited is devoid of any merit. The powers of CIT(A) have been held to be co-terminus with that of the assessing officer, thus, it was well within the powers of CIT(A) to consider those objections which were not raised before the Assessing Officer. The Respondent would like reiterate the decisions on which it would like to place reliance on in support of this contention:

- *Commissioner of Income Tax vs. Nirbheram Daluram [(1997)139 CTR (SC) 484]*
- *Jute of Corporation of India Ltd. vs. Commissioner of Income Tax and another [(1990)88CTR(SC)66]*
- *Inventors Industrial Corp. Ltd. vs. Commissioner of Income Tax (1992)194 ITR 548 (Bom.)]*
- *CIT vs. Kanpur Coal Syndicate [(1964) 53 ITR 225 (SC)]*
- *CIT vs. Motor Industries Co. Ltd. (1998] 97 Taxman 7 (Karnataka))*
- *Indu Arts vs. ACIT ([2017] 88 taxmann.com 182 (Delhi - Trib.))*

In the light of above judicial precedents, the Respondent humbly requests the Hon'ble bench to reject E- Infochips Limited from the final set of comparable companies without the condition imposed by the Ld. CIT(A).

Furthermore, without prejudice to the above, the Respondent would like to humbly submit that the Hon'ble High Court of Punjab and Haryana in the case of CIT vs. Quark Systems India (P) Ltd. (ITA No. 594/2010) (Refer page 590 of the paper book) has upheld the view taken by the Special bench of tribunal that the taxpayer cannot be estopped from raising objections to reject a company which was selected by the taxpayer itself in the transfer pricing study. Considering the ratio of the said decision, in the present case the taxpayer cannot be estopped from raising objections to reject a company at the CIT(A) or tribunal level even if no objection was raised at the assessment level.

Further, the write up relating to the Carpro Netherlands wrongly considered as AE:-

Assessee's contentions with regard to Ground No.6 :

The Respondent is a subsidiary of Magic Software Enterprises Limited, Israel (,MSE Israel'). Carpro Systems Limited, Israel ('Carpro Israel') was a subsidiary of MSE lsarel. Carpro Israel developed a software solution "Carpro" for leasing, renting, fleet control and garage management functions of car rental companies. This solution was sold in various parts of the world including Europe and Middle East. Rental Technologies Benelux BV, Netherlands was an

independent third party distributor for selling and supporting the said software solution, especially in the Middle East.

Carpro Israel sold its whole business, including the rights of Carpro Software and its access to the existing customer base, to Rental Technologies Benelux BV ("Rental Netherlands"), and independent entity owned by Mr. Rob Terpstra and Mrs. Maria Terperstra, in year December 2006.

Rental Technologies Benelux BV incorporated a new company i.e., Carpro Systems International B.V, Netherlands ('Carpro Netherlands'), owned by Mr. Rob Terperstra, for development and distribution of Carpro product. Carpro Netherlands is an independent entity and MSE Israel or its subsidiary Carpro Israel do not directly or indirectly own manage or control Carpro Netherlands.

The Respondent provided services to Carpro Netherlands during the FY 2007-08 in pursuance of the service agreement which was entered between the Respondent and Carpro Netherlands in December 2006 (refer page 352-355 of the paper book) i.e, after the business was transferred by Carpro Israel to Rental Technologies Benelux BV Ld. CIT(A) has contended that Carpro Netherlands is an AE of espondent under section 92A(2)(g) of the Act (refer para 2.5.5, page 256 of the paper book). As per said section, an enterprise can be considered to be the AE of the taxpayer if the business of the tax payer is wholly dependent upon the use of know-how, patents, copyrights trademarks etc. owned by the other. Ld. CIT(A) has opined that the software for Carpro Netherlands is developed on the platforms which are owned by Carpro Netherlands and without the platforms, the software cannot be developed. Thus, the business of Respondent is dependent on the software owned by Carpro Netherlands which makes Carpro Netherlands as its AE. The rationale given by the Ld. CIT(A) is devoid of merit for all the following reasons:

Export of Software development services to Carpro Netherlands is not the only business of Respondent. It is engaged in providing software development services to Magic Israel as well as trading of software licenses in local market. Thus, the business of the Respondent is not "wholly" dependent on the know-how owned by Carpro Netherlands. The export of software development services to Carpro Netherlands constitutes only 20% the revenue of the Respondent for FY 2007-08. In this regard, the Respondent would like to place reliance on the ruling given by Authority for Advance Ruling in the case of Speciality Magazines (P) Ltd. (2005) 274 ITR 310 (AAR); wherein it was held that "The word wholly" means entirely, completely, fully, totally' 'almost wholly' would mean very near to wholly, a little less than whole. In terms of percentage 'almost wholly' would mean anything less than 90 per cent."

Furthermore, the Respondent would like to place its reliance on the judgment of Hon'ble Mumbai Bench of the tribunal in the case of M/s.Page Industries Ltd. vs. DCIT (IT(TP)A No. 1631/Bang/2015) (refer para 10,11 and 11.1, page 710-715 of the paper book) wherein the Tribunal while analyzing the existence of AE relationship within the meaning of section 92A of the Act, held that the assessee-company and foreign company were not "AEs" due to absence of de-facto control in the business of the assessee company, even though assessee was a license of the "brand-name" of the foreign company for exclusive manufacture and marketing of goods under said licensing arrangement.

Based on the above, the Respondent would like to submit that there is no allegation that Carpro Netherlands is controlling the Respondent, either through participation in capital or management or through the business transacted between them and considering the fact that the business of the Respondent was not "wholly dependent" on Carpro Netherlands, it could not be alleged that Respondent and Carpro Netherlands are AEs within the meaning of section 92A(2)(g) of the Act.

Apart from the above, it is pertinent to note that the respondent's business is

that of providing software services. The mere fact that in provision of such services, it uses the platform provided by the customer does not lead to an inference that the business of the Respondent is dependent on the know-how of the customer. It is a general industry practice to share the platforms on which software is to be developed with the parties who have been appointed to develop software. Accordingly, the Respondent's business is not dependent on the exploitation of the platforms of Carpro Netherlands.

Ld. CIT(A) has observed that the TPO held Carpro Netherlands to be an AE of the respondent (refer para 2.5.3, page 255 of the paper book) - the said observation is factually incorrect as the TPO had only held that the transactions between Appellant and Carpro Netherlands are not controlled - however, no AE relationship within the meaning of section 92A of the Act was established/ identified by the TPO.

Thus, on the basis of above reasons, it can be contended that Carpro Netherlands is not an AE of the Respondent under section 92A(2)(g) of the Act.

On the basis of above contentions, the Respondent humbly submits that the transaction with Carpro Netherlands should be considered as an independent third party transaction.”

28. After hearing both the parties on this issue and on perusal of the order of CIT(A) on one side and the written submissions made by the assessee before us on the other side, we find the order of CIT(A) in this regard falls short of the legal requirements of the definition of speaking order. We find the Revenue Authorities failed to consider certain relevant facts with respect to the ALP determination. It is settled law that every judicial order passed by the CIT(A) is required to be speaking order in accordance with principles laid down sub section (6) of section 250 of the Act. CIT(A) should note that the Carpro cannot be considered as AE for the ALP purpose. Therefore, we are of the opinion that the issue under consideration needs to be remanded back to the file of CIT(A) to adjudicate the issue after considering the cited decisions (supra.). The CIT(A) shall grant reasonable opportunity of being heard to the assessee in accordance with the set principles of natural justice. Accordingly, **cross objections No. 3 and 6 raised by assessee are allowed for statistical purpose.**

29. In the result, cross objection filed by assessee is partly allowed for statistical purpose.

30. To sum up, the appeal of the Revenue is dismissed and cross objection of the Assessee is partly allowed for statistical purpose.

Order pronounced in the open court on this 18th day of July, 2018.

Sd/-

Sd/-

(VIKAS AWASTHY)

(D. KARUNAKARA RAO)

न्यायिक सदस्य / JUDICIAL MEMBER

लेखा सदस्य / ACCOUNTANT MEMBER

पुणे Pune; दिनांक Dated : 18th July, 2018

सतीश /SB

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent
3. The CIT(A)IT/TP, Pune
4. The CIT(A)-13, Pune
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, "A Bench" Pune;
6. गार्ड फाईल / Guard file.

// True Copy //

आदेशानुसार/ BY ORDER,

Senior Private Secretary
आयकर अपीलीय अधिकरण ,पुणे / ITAT, Pune