

**IN THE INCOME TAX APPELLATE TRIBUNAL “C”, BENCH KOLKATA**

**BEFORE SHRI A.T. VARKEY, JM & DR. A. L. SAINI, AM**

**ITA No.741/Kol/2017**

**(Assessment Year: 2012-13)**

<b>M/s. R.S. Software (India) Ltd.</b> A-2, FMC Fortuna, 234/3A, A.J.C. Bose Road, Kol-20.	<b>Vs.</b>	<b>ACIT/Cir-2(2), Kolkata</b>
<b>PAN/GIR No.: AABCR 7813 G</b>		
<b>(Appellant)</b>	<b>..</b>	<b>(Respondent)</b>

Appellant by : Shri K.R. Sriram, FCA  
Respondent by : Shri G. Mallikarjuna, CIT(DR)

**Date of Hearing : 29/08/2018**  
**Date of Pronouncement : 25/10/2018**

**ORDER**

**Per Dr. A. L. Saini:**

The captioned appeal filed by the assessee, pertaining to Assessment Year 2012-13, is directed against a fair assessment order passed by the Assessing Officer under section 144C (5) r.w.s. 143(3) of the Income Tax Act, 1961 (hereinafter referred to as the ‘Act’), dated 30.01.2017, which incorporates the directions given by the Dispute Resolution Panel (‘DRP’) u/s 144C(5) of the Act, dated 14.12.2016.

2. The grievances raised by the assessee are as follows:

1. Grounds of appeal raised by the assessee relating to transfer pricing.

Ground No.2 raised by the assessee relates to upward adjustment on arm’s length price to the tune of Rs.1,45,89,355/- wherein the assessee objected that method adopted by ld. Commissioner are not in sync with reality.

3. Other grounds raised by the assessee are as follows:

(1) Ground No.1 raised by the assessee relates to disallowance under section 14A, other than what the assessee had suo-moto disallowed.

(2) Ground No.3 raised by the assessee relates to additions made with respect to unbilled revenue to the tune of Rs. 17,44,27,000/-, which is already included in the revenue/income of the company.

4. We shall first take-up additions challenged on account of Transfer Pricing Adjustment as has been raised vide ground No. 2, which is reproduced below for ready reference:

Ground No.2 raised by the assessee relates to upward adjustment on arm's length price to the tune of Rs.1,45,89,355/- wherein the assessee objected that method adopted by Id. Commissioner are not in sync with reality.

5. The brief facts qua the issue of transfer pricing adjustments of Rs.1,45,89,355/- are that M/s. R.S. Software (India) Ltd. was incorporated on 02.12.1987, as a private limited company and subsequently converted into a public limited company in 1992. The company is in the software industry and engaged in developing customized commercial application software as per specific needs and requirements of customers. In the year 2009, the assessee company set up 100% subsidiary in US named, Responsive Solutions Inc (RSI) to cater to the US market needs and to ensure that there was a physical presence of the company in the US market, which is key market for most of the companies in the Software industry. In the same year, the company also set up another 100% subsidiary in Singapore which is the prime hub of South East Asia in the name of RS Software (Asia) Pte Ltd. During the year under consideration, the assessee had undertaken international transaction regarding sale and purchase of services with its Associate Enterprises (AEs) viz: responsive solutions Inc. USA and RS Software (Asia) Pte. Ltd. The details of international transactions for the F.Y 2011-12, relevant to Assessment Year, 2013-14, are as follows:

Nature of transaction	Amount involved	Arm/s length price as per F.No.3CEB	Method adopted
Sale of services	Rs.3,73,96,168	Rs.3,73,96,178	TNMM
Purchase of services	Rs.12,74,27,928	Rs.12,74,27,928	TNMM
Reimbursement of expenses	Rs.1,39,43,115	Rs.1,39,43,115	Actual cost

6. During the assessment proceedings, the assessing officer referred the matter to Transfer pricing officer to determine the arm's length price of the international transactions undertaken by the assessee with its associated enterprises (AEs). During the TPO proceedings, the Transfer Pricing Officer noted that assessee had selected cost plus method in its Transfer Pricing Study Report ( TP Study Report) which requires identification of direct cost and indirect cost of production. The Id TPO has analysed and examined the following benchmarking exercise done by the assessee in its Transfer Pricing Study Report ( TP Study Report), which is given below for ready reference:

“13.0 – Application of CPM

*13.1 – The application of the CPM involves the following steps:*

*1. Identification of Direct and indirect costs for providing the service.*

*2. Calculating the amount of a normal gross profit mark-up to such costs (computed according to the same accounting norms) arising from the transfer or provision of the same or similar property or services by the enterprise, or by an unrelated enterprise in a comparable uncontrolled transaction, or a number of such transactions, is determined;*

*3. Calculating any adjustment to take into account the functional and other differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect such profit mark-up in the open market;*

*4. Arriving at the arm's length price in relation to the supply of the property or provision of services by the enterprise which is the sum arrived at by adding the adjusted mark up to the costs as in 1 above.*

*13.1 Identification of costs:*

*The cost identification is done internally, and it includes all costs directly associated with the work, which is in terms of the manpower cost and other identified direct costs for the manpower involved in the project. No part of indirect costs are considered neither appropriations nor allocations.*

*This step is not very critical as the mark up is applied on such costs and it is thus important to state whether the mark up adopted meets the arm's length pricing.*

### 13.2 Identifying the mark up:

**13.2.1 For identifying the mark up, the CPM guidelines state that the same has to be computed as the GP mark- up arising from the transfer or provision of the same or similar property or services by the enterprise, or by an unrelated enterprise in a comparable uncontrolled transaction, or a number of such transactions,**

13.2.2 In this regard it is to be noted that RSSL is engaged in the provision of software services to other entities also as well as RSI. Even though the nature and complexities of services may vary, fundamentally RSSL is a service organisation.

13.2.3 In terms of para 13.2.2 above, the operating results of RSSL as a whole can also act as a yard stick for determining the GP margin.

13.2.4 If we take the operations of RSSL, as a whole the breakup of Revenue is categorized below:

Description	Year 2011-12 (in Rs. Lacs)	%age	Year 2010-11 (in Rs. Lacs)	%age	year 2009-10 (in Rs. Lacs)	%age
Export of services	24496.76	99	18556.25	98.5%	15872.32	98.0%
Domestic income	217.20	1%	270.13	1.5%	311.39	2%
Total	24713.96		18826.38		16183.71	

13.2.5 Based on the table above we can conclude that RSSL is primarily an export -oriented service company. In terms of the export of services, the component of RSI billing in the export is also minimum as can be seen from the table below:

Description	Year 2011-12 (in Rs. Lacs)	%age	Year 2010-11 (in Rs. Lacs)	%age	year 2009-10 (in Rs. Lacs)	%age
Exports of services	24496.76		18556.25		15872.32	
RSI billing	373.96	1.5%	351.38	1.9%	53.12	0.33%

**13.2.6 Based on the above, the margins earned by RSSL in respect of its entire business operations can itself as a parameter for ascertaining the GP margin. In this regard, we take the average of the last three years margin from the audited accounts of RSSL. The same is calculated as below:**

Description	Year 2011-12 (in Rs. Lacs)	Year 2010-11 (in Rs. Lacs)	Year 2009-10 (in Rs. Lacs)
Revenue from operations	24713.96	18826.38	16128.96
Other income	95.76	3.75	58.55
Total income	24809.72	18830.13	16187.50
Total expenses	21477.47	16294.48	15008.09
Profit before tax	3332.25	2535.65	1179.41
PBIT/Revenue from Op	13.48%	13.46%	7.3%
Average Net profit for three years			11.43%

13.2.7 The above table reflects the average profit of the company at 11.43% which is less than the mark up of 12% considered in the inter-company transactions.”

**13.2.8 For the purpose of further evaluation of the mark-up factor used, we will also consider the mark up for transactions taken by other enterprises in the same line of business with comparable features.**

Having gone through the main provisions of Transfer Pricing Study Report ( TP Study Report) of the assessee, as noted above, the ld TPO came on conclusion that assessee, in fact, has selected Transactional Net Margin (TNMM) method for benchmarking exercise instead of Comparable Uncontrolled Price Method (CUP Method). The ld TPO observed that the assessee under consideration had considered profit before interest and tax (PBIT) instead of gross profit (GP) and taken PBIT/Sales as the profit ratio. The assessee arrived at average three years PBIT/Sales ratio of 11.43% in respect of its own business. It was stated by the assessee that average net profit of the company at 11.43%, which was less than the mark up of 12% considered in intercompany transaction. In this connection, it may be mentioned that mark-up term was used to indicate profit element on cost, which is actually gross profit (GP). By stating mark up of 12%, the assessee apparently indicates that cost plus method (CPM) in respect of intercompany transaction (i.e. transactions with AE is considered as intercompany transaction) was 12%. Obviously, any transaction that results in gross profit @12% against net profit margin 11.43% on entity level is much lesser profitable transaction. Therefore, the ld. TPO noted that assessee at its own admission, the profit at gross level of the company was higher than gross profit margin derived from transactions with Associate Enterprises (AEs). **The ld. TPO observed that the profit ratio of comparable taken was PBIT/Sales, that is, operating profit/sales therefore, the assessee had deviated from the principle of Comparable Uncontrolled Price Method (CPM), which requires comparison of gross profit and not operating profit ratio. Therefore, the assessee, evidently employed TNMM, and not CPM in its benchmarking exercise.** On examination of Transfer Pricing Study Report (TPSR) and faulty benchmarking undertaken by the assessee, the ld. TPO noted that assessee`s Bench marking exercise is not correct, therefore, ld TPO issued show cause notice, seeking rejection of TP-Study Report and informing selection of new comparable employing TNMM for benchmarking in an appropriate manner.

7. In response, the assessee submitted its reply on 18.01.2015 and defended the use of Cost Plus Method (CPM). However, the TPO noted that in the name of using CPM, the assessee has actually employed TNMM in the TP Study Report. Therefore, the question of applicability of CPM in TP Study Report, does not arise, when the assessee itself taken PBIT/sales, as profit indicator, which is the NPI used in TNMM. Therefore, the TPO rejected Cost Plus Method (CPM) adopted by the assessee and used the TNMM and selected the list of comparable of arm's length margins as follows:

Sl. No.	Name of company	Operating revenue	Operating expenditure (O.E) or TC	Operating profit (O.P)	O.P/O.R(%)	OP/OE(%)
1	CTIL Ltd.	15.35	13.77	1.58	10.29%	11.47%
2	Datamatics Global Solutions	163.88	143.64	20.24	12.35%	14.09%
3	Infosys Consulting (India) Ltd.	17.98	15.36	2.62	14.57%	17.05%
4	PreludeSys (India) Ltd.	16.67	10.66	6.01	36.05%	56.38%
5	ASM Technologies Ltd.	71.14	61.11	10.03	14.1%	16.41%
6	e-Infochips Ltd.	103.41	59.10	44.31	42.85%	74.97%
7	Onward Technologies Ltd.	61.59	54.21	7.38	19.45%	13.61%
8	Thirdware Solutions P ltd.	105.68	84.38	21.30	20.15%	25.24%
9	Persistent Systems (India) Ltd.	810.36	652.64	157.72	19.46%	24.17%
10	Indium Software (India) Ltd.	13.66	11.10	2.56	18.74%	23.06%
11	e-Zest Solutions Pvt. Ltd.	18.64	16.06	2.58	13.84%	16.06%
12	Subex Ltd.	329.01	245.67	83.34	25.33%	33.92%
	Simple A.M				20.59%	27.21%

PLI of the assessee:

Operating revenue		247,13,96,000
Total expenses	Rs.214,77,00,000/-	
Less: Finance Cost	Rs.44,00,000/-	
Operating expenses (total cost)		214,33,00,000/-
Operating profit		Rs.32,80,00,000/-
OP/OR	(Rs.32,80,00,000/- / 247,13,96,000)	13.28%
OP/TC	(Rs.32,80,00,000/- / 214,33,00,000/-)	15.30%

Thus, PLI of assessee OP/OR was 13.28% and OP/TC was at 15.30%. However, ld. TPO computed OP/OR at 20.59% and OP/TC at 27.21% and treated arm's length margin of the assessee company.

8. The ld. TPO computed the arm's length price of purchase as follows:

Purchase of services:

Sl. No.	Particulars	Amount (in Rs.)
1	Operating Revenue	247,13,96,000/-
2	Arm's length PLI (OP/OR)	20.59%
3	ALP of OE (79.41% of Rs. 247,13,96,000/-)	196,25,35,564/-
4	Operating Expenses (OE or TC)	214,33,00,000/-
5	Difference being excess (4-3)	18,07,64,436/-
6	Value of international transaction (purchase)	12,74,27,928/-
7	Percentage of value of international transaction to TC	5.94%
8	Arm's length adjustment (5.94% of Rs.18,07,64,436/-)	107,37,407/-

9. The TPO computed the arm's length price of sale of services as follows:

Sale of services:

Sl. No.	Particulars	Amount (in Rs.)
1	Operating Revenue	214,33,00,000/-
2	Arm's length PLI (OP/OR)	27.21%
3	ALP of OE (127.21% of Rs. 214,33,00,000/-)	272,64,91,930/-

4	Operating Expenses (OE or TC)	247,13,96,000/-
5	Difference being shortfall (3-4)	25,50,95,930/-
6	Value of international transaction (purchase)	373,96,178/-
7	Percentage of value of international transaction to TC (373,96,178/- / 247,13,96,000/- × 100%)	1.51%
8	Arm's length adjustment (1.51% of Rs. 25,50,95,930/-)	38,51,948/-

Summary of total ALP adjustments in respect of purchase of services and sale of services are given below:

Purchase of services	Rs.107,37,407/-
Sale of services	Rs.38,51,948/-
Total adjustment	Rs.145,89,355/-

This way, the TPO made the arm's length price addition on account of sale and purchase of software to the tune of Rs.145,89,355/-.

6. Aggrieved by the stand so taken by TPO/Assessing Officer, the assessee carried the matter, by filing an application, before Id DRP, but without any success. The Ld DRP examined the comparable companies selected by the TPO, and reached on the conclusion that all the comparable companies so selected by the TPO should be retained. The Id DRP, examined the company wise comparable selected by the Id. TPO and held that functions of the comparable companies were comparable broadly to the assessee company, and Id DRP also furnished its findings, company-wise, which is given on Page No.5 to 10 of the DRP order. Having analysed the comparable companies, the Id. DRP confirmed the order passed by the Id. TPO/Assessing Officer.

7. Aggrieved by the order of the Id. DRP/ Assessing Officer, the assessee is in appeal before us.

8. Learned counsel for the assessee begins by pointing out that the assessee has adopted the Cost Plus Method for calculating the arm's length margin (ALM) in

respect of its international transactions. The counsel explained the steps involved in application of the Cost Plus Method(CPM) as follows:

- (1). Identification of Direct and Indirect Costs for providing the Service.
2. Calculating the amount of a normal gross profit mark-up to such costs (computed according to the same accounting norms) arising from the transfer or provision of the same or similar property or services by the enterprise, or by an unrelated enterprise, in a comparable uncontrolled transaction, or a number of such transactions, is determined.
- (3). Calculating any adjustment to take into account the functional and other differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect such profit mark-up in the open market.
- (4). Arriving at the arms length price in relation to the supply of the property or provision of services by the enterprise which is the sum arrived at by adding the adjusted Mark up to the costs as in 1 above.

In terms of the above methodology, the company had identified the Direct and Indirect costs attributable to that specific job relating to the Associate Enterprise (AE). After the above, the company had to ascertain the Gross Profit Mark up, for which it had used the company's own profit ratio indicators as the same is allowed in terms of the above methodology for CPM. In terms of the company's own profit indicators and as mentioned **in Para 13.2.1 to 13.2.6 in the TP Report,( mentioned para 6 of this order)**, the company has used its own profit indicators being the PBIT/ Revenue from operations as calculated which stands at 11.43%, being less than the 12% margin used.

In respect of the use of NP margin, it is to be noted that for a service organization, the difference between NP and GP are marginal in nature and the same would have no major bearing on the ratio. Further, the assessee being a near Zero-Debt Company, the interest component is only Rs. 44.31 Lakhs and even without the same the margins calculated on PBIT (profit before interest and Taxes) would be as follows:

Description	Year 2011-12 (in Rs. Lacs)	Year 2010-11 (in Rs. Lacs)	Year 2009-10 (in Rs. Lacs)
Revenue from operations	24713.96	18826.38	16128.96
Other income	95.76	3.75	58.55
<b>Total income</b>	<b>24809.72</b>	<b>18830.13</b>	<b>16187.50</b>
Total expenses	21477.47	16294.48	15008.09
Profit before tax (PBT)	3332.25	2535.65	1179.41
Interest component	44.31	84.90	231.54
Profit before interest and taxes(PBIT)	3376.56	2620.55	1410.95
PBT/Revenue from Op (3332.25/24713.96)	13.48	13.46	7.3%
PBIT/Revenue from Op (3376.56/24713.96)	13.66	13.91	8.75%
Average PBT% age for three years (13.48+13.46+7.30)/3			11.43%
Average PBIT% age for three years(13.66+13.91+8.75)/3			12.10%

From the above table, Id Counsel explained the Bench that even after considering the PBIT (which in effect is the gross margin), the average margin %age is 12.10% instead of 11.43%. A small change of 0.6% only. Again, this compares to the 12% that the company has used, as the GP Benchmark, used for the CPM Method.

It has also been mentioned in Para 13.2.8 of the TP-Study Report of the assessee,(mentioned in para 6 of this order), that the mark-ups used by other enterprises in the same line of business with comparable features is taken only as a “further evaluation” of the mark-up factor used. This is no way can be taken as the assessee resorting to Transactional Net Margin Method (TNMM) for arriving at arm’s length price, (ALP).

9. On the other hand, the Id. DR for the Revenue submitted before us that assessee has himself selected Transactional Net Margin (TNMM) method for benchmarking exercise instead of Comparable Uncontrolled Price Method (CUP Method). The Id TPO observed that the assessee under consideration had considered profit before interest and tax (PBIT) instead of gross profit (GP) and taken PBIT/Sales as the profit ratio. The assessee arrived at average three years PBIT/Sales ratio of 11.43% in

respect of its own business. It was stated by the assessee that average net profit of the company at 11.43%, which was less than the mark up of 12%, was considered in intercompany transaction. In this connection, it may be mentioned that mark-up term was used to indicate profit element on cost, which is actually gross profit (GP). By stating mark up of 12%, the assessee apparently indicates that cost plus method (CPM) in respect of intercompany transaction (i.e. transactions with AE is considered as intercompany transaction) was 12%. Obviously, any transaction that results in gross profit @12% against net profit margin 11.43% on entity level is much lesser profitable transaction. Therefore, the Id. DR stated that assessee at its own admission, the profit at gross level of the company was higher than gross profit margin derived from transactions with Associate Enterprises (AEs). The Id. DR stated that the profit ratio of comparable taken was PBIT/Sales, that is, operating profit/sales, therefore, the assessee had deviated from the principle of Comparable Uncontrolled Price Method (CPM), which requires comparison of gross profit and not operating profit ratio. Therefore, the assessee, evidently employed TNMM, and not CPM in its benchmarking exercise, hence only the TNMM method is most appropriate method for the assessee.

10. We have given a careful consideration to the rival submissions and perused the materials available on record, we note that the main dispute in the assessee's case under consideration is the selection of method. The assessee differs in his TP-study Report about the use of cost plus method (CPM) whereas the Ld TPO and the Id. DRP recommended the Transactional Net Margin Method (TNMM) as the most appropriate. We note that so far the transfer pricing methods are concerned, the section 92C of the Act prescribes methods for computation of arm's length price. The provisions of section 92C, to the extent relevant for our analysis, is given below for ready reference:

***“Section 92C: Computation of arm's length price.***

*(1) The arm's length price in relation to an international transaction or specified domestic transaction, shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of*

*transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely:—*

- (a) comparable uncontrolled price method;*
- (b) resale price method;*
- (c) cost plus method;*
- (d) profit split method;*
- (e) transactional net margin method;*
- (f) such other method as may be prescribed by the Board.*

We note that any other method may be prescribed by the CBDT, but no other method has been prescribed by the CBDT, so far the assessee is concerned. The most appropriate method referred to in sub-section (1) shall be applied, for determination of arm's length price, in the manner as may be prescribed.

First of all, in the assessee's case under consideration, we would like to examine the applicability of the transfer pricing method, to determine the arm's length price (ALP) of the sale of services and purchase of services, by using a most appropriate method (MAM). We note that the arm's length price of an international transaction has to be determined by any of the following methods, being the most appropriate method as mentioned above in section 92C (1) of the Act. Further, section 92C(2) mentions that the most appropriate method shall be applied in the manner as may be prescribed. The prescription, accordingly, has been provided in Rule 10B of IT Rules, 1962. In general, the CPM is used when a product is sold by a manufacturer or service provider, the RPM is used in case of a product or service being sold by a distributor, the TNMM is generally used when data is difficult to find in case of comparables at a gross profit level or where a less stricter approach to functional similarity is to be taken. The PSM is used where the income arising out of any particular transaction or class of transactions is to be split between the parties to the transaction, - generally

PSM method is applied where intangibles are concerned and both the parties to the transaction contribute to the creation of the intangible(s).

We note that in the case of manufacturing organisations and in case of purchase and sales of services, the CPM is the most appropriate method. Rule 10B(1)(c) provides for the CPM which are given below:

*“10B. Determination of arm’s length price under section 92C.*

*(1). For the purposes of sub-section (2) of section 92C, the arm’s length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, in the following manner, namely:*

*(c) cost plus method, by which,—*

*(i) the direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an associated enterprise, are determined;*

*(ii) the amount of a normal gross profit mark-up to such costs (computed according to the same accounting norms) arising from the transfer or provision of the same or similar property or services by the enterprise, or by an unrelated enterprise, in a comparable uncontrolled transaction, or a number of such transactions, is determined;*

*(iii) the normal gross profit mark-up referred to in sub-clause (ii) is adjusted to take into account the functional and other differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect such profit mark-up in the open market;*

*(iv) the costs referred to in sub-clause (i) are increased by the adjusted profit mark-up arrived at under sub-clause (iii);*

*(v) the sum so arrived at is taken to be an arm’s length price in relation to the supply of the property or provision of services by the enterprise;”*

We note that assessee in his TP-Study Report determined the direct and indirect costs of production incurred by the company for purchase and sale of services and computed the PBIT as gross profit. Thus, assessee has fulfilled all the conditions of the Cost Plus Method (CPM) except using a terminology by mistake as ‘profit before interest and tax’(PBIT) instead of gross profit (GP).

11. We note that so far the assessee is concerned, he is selling of services and purchasing of services, therefore, Cost plus method (CPM) would be the appropriate method considering the functions, assets, risks, other factors and circumstances of the assessee's business. We note that by mistake, the assessee has mentioned in his TP-Study report, the wrong nomenclature/terminology as PBIT/Sales as the profit ratio instead of using Gross Profit terminology. This does not mean that the assessee is not eligible to use Cost Plus Method (CPM). The Id TPO held that assessee by its own admission, instead of using Gross Profit used the PBIT/Sales. That is, the Id. TPO observed that the profit ratio of comparable taken was PBIT/Sales, that is, operating profit/sales therefore, the assessee had deviated from the principle of Cost Plus Method (CPM), which requires comparison of gross profit and not operating profit ratio. Therefore, the assessee, evidently employed TNMM, and not CPM in its benchmarking exercise.

We note that in respect of the use of NP margin, it is to be noted that for a service organization, the difference between NP and GP are marginal in nature and the same would have no major bearing on the ratio. Further, the assessee being a near Zero-Debt Company, the interest component is only Rs. 44.31 Lakhs and even without the same the margins calculated on PBIT (profit before interest and Taxes) would be

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Total expenses	21477.47	16294.48	15008.09
Profit before tax (PBT)	3332.25	2535.65	1179.41
Interest component	44.31	84.90	231.54
Profit before interest and taxes(PBIT)	3376.56	2620.55	1410.95
PBT/Revenue from Op (3332.25/24713.96)	13.48	13.46	7.3%
PBIT/Revenue from Op (3376.56/24713.96)	13.66	13.91	8.75%
Average PBT% age for three years (13.48+13.46+7.30)/3			11.43%
Average PBIT% age for three years(13.66+13.91+8.75)/3			12.10%

We draw the conclusion from the above table, which is taken from the TP-Study Report of the assessee, that 'Profit Before Tax (PBT) is at 11.43%, which is Gross profit ratio of the assessee and Profit Before Interest and Tax (PBIT) is at 12.10%. The difference between PBT and PBIT is at 0.67% (11.43% - 12.10%). Again, the 12.10% compares to 12%, that the company has used as the Gross profit Benchmark used for the CPM method.

We note that the said difference of 0.67% may be nullified by the tolerance limit. We note that tolerance limit, that is, +/- 5% variation allowed in determining arm's length price has been capped to a limit of +/- 3% from April 1, 2013, and in the assessee's case the assessment year 2012-13, is under consideration therefore +/- 5% tolerance limit would be applicable. We note that if tolerance limit of +/-5% is applied then there would not be any arm's length price adjustment. Hence, after applying tolerance limit of +/-5%, we do not suggest any transfer pricing adjustment in the assessee's case under consideration.

12. The object of the transfer pricing is to ascertain the correct arm's length price by applying most appropriate method. We note that in the assessee's case under consideration, the information was on record of the TPO in respect of sales of services and purchase of services and hence, the TPO cannot say by any stretch of logic that the CPM is not a suitable method considering the business circumstances of the assessee. As we stated earlier that normally for manufacturing and sale of services/purchase of services CPM is suitable to compute arm's length price of the services.

We note that the stand of the Ld DR that the assessee has selected TNMM as a most appropriate method (MAM) by using terminology, in his TP-Study Report, as PBIT/Sales to compute the ALP and the assessee cannot resort to change his method at the appellate stage, is not acceptable for the reasons given above. We are of the view that such a contention cannot be upheld because it is found on the facts of the case that if a particular method will not result into proper determination of ALP, the TPO or the Appellate Authorities can very well hold that why a particular method can be applied for getting proper determination of ALP, or the assessee can demonstrate

the particular method to justify its ALP. Thus, even after the assessee has adopted TNMM as the MAM in the TP study report by mistake, then also he is not precluded from raising the contention before the TPO or appellate court that such a method was not a proper method and does not result into proper determination of the ALP and some other method should be resorted. The ultimate aim of the TPO to examine whether the price or the margin arising from an international transaction with a related party is at ALP or not. The determination of the ALP is the key factor for which the MAM is to be followed. Therefore, if at any stage of the proceedings, it is found that by adopting one of the prescribed method other than the one chosen earlier, the ALP can be determined, the TPO as well as the CIT(A) should take into consideration such a plea before them, provided, it is demonstrated as to why the change in the method will produce better or more appropriate ALP on facts of the case. Therefore, we reject the contention of the Id. DR and also the observation of the TPO that the assessee cannot resort to adopt the Cost Plus Method (CPM) instead of TNMM for its purchase and sale of services. Therefore, we find no any infirmity in choosing the Cost Plus Method (CPM) by the assessee to determine the arm's length price (ALP) of sale of services and purchase of services, hence we delete the transfer pricing adjustment to the tune of Rs.1,45,89,355/-

13. Now we shall take other grounds raised by the assessee, which are given below for ready reference:

(1) Ground No.1 raised by the assessee relates to disallowance under section 14A, other than what the assessee had suo-moto disallowed.

(2) Ground No.3 raised by the assessee relates to additions made with respect to unbilled revenue to the tune of Rs. 17,44,27,000/-, which is already included in the revenue/income of the company.

14. Ground No.1 raised by the assessee relates to disallowance under section 14A, other than what the assessee had suo-moto disallowed.

15. The brief facts qua the issue are that on the basis of the direction of the Hon'ble DRP-2, New Delhi, necessary verification was carried out by Id AO with the detail

documentary evidence furnished by the assessee and disallowance u/s 14A was re-calculated by excluding investments having taxable yields as following:

Dividend income           Rs.54.04 lakh

Finance cost                Rs.44.31 lakh

Average Investment :  $\frac{(\text{Rs.700.00 lakh} + \text{Rs.2421.9 lakh}) + 0}{2}$  = Rs.1560.95 lakh

Average Asset:  $\frac{(\text{Rs.11782.49 lakh} + \text{Rs.7090.89 lakh})}{2}$  = Rs.9436.69 lakh

(1).As per Rule 8D(2)(i):        Nil

(2).As per Rule 8D(2)(ii):       Rs.44.31 lakh  $\times$   $\frac{\text{Rs.1560.95 lakh}}{\text{Rs.9436.69 lakh}}$   
Rs.7.329 lakh

(3). As per Rule 8D(2)(iii):     0.5% of Rs.1560.95 lakh = Rs.7.805 lakh

Total disallowance u/s 14A r.w.r 8D:

= Nil + Rs.7.329 lakh + Rs.7.805 lakh = Rs.15.134 lakh

The assessee has already added Rs.1.2 lakh to the total income on account of expenditure disallowed u/s 14A. In view of the above, further disallowance of expenditure u/s 14A r.w.r. 8D was made by ld AO at [ Rs.15.134 lakh – Rs.1.2 lakh] = Rs.13.934 lakh.

16. The ld. Counsel for the assessee submitted before us that the disallowance of section 14A read with rule 8D, which can be done as per the books of accounts of the assessee company. The ld Counsel submitted before us the computation of disallowance under section 14 A read with Rule 8D as follows:

Particulars	Amounts(Rs.in lacs)	Amount
Rule 8D(ii)		2547973 A
Interest cost (in Rs.)		
Average investment		
-Opening investment	Nil	
-Closing Investment (Rs. In Lakhs)	1021.9	
(considering only investments that Have the potential to earn tax free Income)		
Average investment (Rs.in lakhs)		510.95 B

Average Assets		
-Opening assets (Rs. In Lakhs)	11782.49	
-Closing assets(Rs. In Lakhs)	7090.88	
-Average assets (Rs. In Lakhs)		9436.685 C
8D(ii) disallowance		
(interest × (Average investment/average assets) = A × (B/C)		137960
Rule 8D(iii)		
0.5% of Average investment	=0.5% of B	<u>255475</u>
<b>Total disallowance (in Rs.)</b>		<b><u>393435</u></b>

17. On the other hand, the ld. DR of the Revenue has primarily reiterated the stand taken by the Assessing Officer/DRP.

18. After giving our thoughtful consideration to the submission of the parties and perusing the judicial decisions relied upon by the Ld. AR, we find that the issue involved in the present appeal is no longer res integra. We note that coordinate bench of ITAT Kolkata in the case of REI Agro Ltd. Vs. DCIT 144 ITD 141 (Kol-Trib) has held that it is only the investments which yields dividend during the previous year that has to be considered while adopting the average value of investments for the purpose of Rule 8D(2)(ii) & (iii) of the Rules. The aforesaid view of the Tribunal has since been affirmed as correct by the Hon'ble Calcutta High Court in G.A.No.3581 of 2013 in the appeal against the order of the Tribunal in the case of REI Agro Ltd. (supra).

In the light of the aforesaid settled position, we direct the assessing officer to compute the disallowance under rule 8D(2)(ii) and under rule 8D(2)(iii), by taking into account the dividend bearing securities/investments. Therefore, we allow this ground of appeal raised by the assessee for statistical purposes.

19. Ground No.3 raised by the assessee relates to additions made with respect to unbilled revenue to the tune of Rs. 17,44,27,000/-, which is already included in the revenue/income of the company.

20. After hearing both the parties on this issue, we note that assessee being aggrieved by the order of the Id. Assessing Officer, filed objection before the Hon'ble DRP, who in turn, has directed the Assessing Officer to examine with documentary evidence whether Revenue has been included in the books of accounts during the Assessment Year under consideration or not. The Assessing Officer after considering the directions of the Id. DRP passed the order and made the disallowance to the tune of Rs.17,44,27,000/-.Aggrieved by the order of the DRP/Assessing Officer the assessee is in appeal before us.

The Id. Counsel for the assessee submitted before us that assessee has included the billed revenue as per accrual concept of accounting in the books of accounts. The Id. DRP had given the direction to the Assessing Officer to examine whether the assessee has included the unbilled revenue as per accrual basis of accounting in his books of accounts or not. Accrual basis of accounting says that when right to receive payment has established, the Revenue should be recognised. The Id. Counsel submitted before us that neither Id AO nor Id DRP understood the facts in right perspective. In fact, as per audited books of accounts, the assessee has included unbilled revenue to the tune of Rs.17,44,27,000/- and offered for taxation, therefore, there is no any ground for making disallowance.

On the other hand, the Id. DR of the Revenue has primarily reiterated the stand taken by the Assessing Officer which we have discussed in our earlier para and is not being repeated for the sake of brevity.

We note that the Id. DRP had already given instruction to the Assessing Officer to examine whether the assessee had included unbilled revenue in his turnover and offered for tax or not. We note that the Assessing Officer had not followed the direction of the Id DRP in right perspective and he did not examine accounts of the assessee to find out whether the assessee had offered the same for taxation or not.

Therefore, now we direct the Assessing Officer/TPO to examine the books of accounts of the assessee and if the assessee has included the turnover on accrual basis of accounting and offered for taxation then the addition should not be made or if this unbilled revenue has not been included in the Assessment Year under consideration and has been included in the subsequent Assessment Year, the same fact should also be examined that the assessee has offered for taxation the said unbilled revenue in subsequent year. Therefore, we direct the Assessing Officer to examine this fact with respect to the books of accounts, we also direct the assessee to submit relevant documents and books of accounts to substantiate his claim before the Assessing Officer, therefore, we allow this ground for statistical purposes.

21. In the result, the appeal filed by the assessee is partly allowed.

Order is pronounced in the open court on 25.10.2018.

**Sd/-**  
**(A. T. VARKEY)**  
**JUDICIAL MEMBER**

**Sd/-**  
**(A. L. SAINI)**  
**ACCOUNTANT MEMBER**

Place: Kolkata;  
Date: 25/10/2018  
(RS, Sr.PS)

**Copy of the Order forwarded to :**

1. The Appellant- M/s. R.S. Software (India) Ltd.
2. The Respondent- ACIT/Cir-2(2), Kolkata
3. The CIT(A) , Kolkata
4. CIT
5. DR, ITAT, Kolkata
6. Guard file.

//True Copy//

By Order

Assistant Registrar,  
I.T.A.T, Kolkata Benches,  
Kolkata.