

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCHES: Bench 'I-1', NEW DELHI**

**BEFORE SHRI N.K.SAINI, VICE PRESIDENT
AND SMT. BEENA A PILLAI, JUDICIAL MEMBER**

ITA No. 6001/Del/2015
AY: 2011-12

Element K India Pvt. Ltd. C-72, Basement, South Extension, Part-II, New Delhi-110049 PAN: AAACE9836D	vs.	ITO Ward- 8(2) New Delhi
(Appellant)		(Respondent)

Appellant by : Sh. Anubhav Rastogi, Adv.

Respondent by : Sh. Sanjay I Bara, CIT, D.R.

Date of Hearing : 19/12/2018

Date of Pronouncement : 28/01/2019

ORDER

PER BEENA A PILLAI, JUDICIAL MEMBER

Present appeal has been filed by assessee against final assessment order dated 29/09/15 passed by Ld. ITO Ward 8 (2), New Delhi under section 143 (3) read with section 144C of the Act on following grounds of appeal:

“2.3 including certain companies in the final set that are not comparable to the Appellant in terms of functions performed, assets employed and risks assumed, and excluding certain companies on arbitrary/ frivolous/inconsistent grounds even though they are comparable to the Appellant in terms of functions performed, assets

employed and risks assumed;

2.4 including companies having peculiar/ extra-ordinary business situations such as business restructuring, different business strategy etc. in the final comparables set, resulting in selection of comparables having abnormal/ volatile operating margins;

2.5 disregarding the ruling of Hon'ble Income Tax Appellate Tribunal (ITAT) for AY 2007-08 in Appellant's own case, on rejection of certain functionally dissimilar comparables, disregarding relevant judicial pronouncements and relying on the judicial pronouncements that have different facts as compared to the Appellant, while making addition on account of TP adjustment."

2. Brief facts of case are as under:

Assessee filed its return of income declaring 'nil' income on 30/11/11 after claiming unabsorbed depreciation of Rs.2,00,427/-. Case was processed under section 143 (1) of the Act, and was picked up for scrutiny. Accordingly, notice under section 143 (2) along with questionnaire and notice under section 142 (1) was issued to assessee. In response to statutory notices, representative of assessee appeared before Ld.AO and filed requisite details as called for. During assessment proceedings on verification of documents filed, Ld. AO observed that assessee entered into international transaction with its associated enterprises. Report in Form 3 CEB was filed by assessee in regard to transactions entered into between assessee and its AE's.

2.1 Ld.AO observed that assessee has been stated to be engaged in rendering e-learning and courseware content development services, to its holding company, Element K Rochester USA. It was observed that assessee entered into an agreement with its US company to provide variety of services, to be mutually agreed-

upon, and which may include but not to be limited to online course content development, software development and customer and technical call support. Assessee characterised itself to be IT service provider to its AE, which was rendered at an agreed cost plus markup basis. As value of international transaction exceeded Rs. 5 crores, case was referred to Ld.TPO. Upon receipt of reference, Ld.TPO called for various documents.

2.3 Ld.TPO observed that assessee had following international transaction with its AE.

Sl.N	Nature of Transaction	Value Rs.	Method Applied	Result of Assessee
1	Provision of content development service	146,620,521	TNMM	15.00%
2	Purchase of online courseware/e-books for resale	494,589	RPM	43%
3	Commission receivable for marketing of courseware in the Asia Pac region	1,140,708	CUP	N.A.
4	Cost Recharges	11,030	CUP	N.A.

2.4 Assessee used TNMM as most appropriate method for determining value of international transaction, for provision of content development services, and had adopted PLI of OP/OC. Assessee thus computed its margin at 15% for provision of content development services. For purposes of comparability, assessee used following 4 comparables, of which, average margin was computed at 15.79%.

Sl. no.	Comments of this office
1.	Glyph International Ltd.
2.	Shree Tulsi Online Ltd.
3.	Vakarangee Softwares Ltd.
4.	Tata Industries Ltd.

(Assessee thus reported transaction with its AE at arm's length price.)

2.5 Ld.TPO rejected comparables considered by assessee by applying following filters:

- use of current year data
- export sales filters
- different financial year ending filter
- exclusion of very small companies
- persistent loss making companies

2.6 It was observed by Ld.TPO that, assessee used filter of operating income to sales of more than 50%, because of which, Ld.TPO used service income filter.

2.7 Dissatisfied with the compatibility analysis carried out by assessee, Ld.TPO conducted fresh search and arrived at set of following 20 comparables with an average of 23.64%.

Sl. No.	Company Long Name	OP/OC
1	Acropetal Technologies limited (Segment)	36.69%
2	Akshay Software Technologies Ltd.	0.16%
3	Celstream Technologies Pvt. Ltd.	12.26%
4	Evoke Technologies Pvt. Ltd.	8.11%
5	E-infochips Limited	56.44%
6	e-Zest Solutions Limited	34.83%
7	iGate Global Solutions Ltd.	23.71%
8	Infosys Ltd.	43.53%
9	Kireeti Soft Technologies Ltd.	3.63%
10	Larsen & Toubro Infotech Ltd.	18.40%
11	Mindtree Limited (Segment)	10.74%
12	Persistent Systems & Solutions Ltd. (Merged)	22.12%

13	Persistent Systems Ltd.	23.08%
14	R S Software (India) Ltd.	16.20%
15	Sankhya Infotech Limited	26.20%
16	Sasken Communication Technologies Ltd.	24.36%
17	Tata Elxsi Ltd. (Segment)	13.00%
18	Thirdware Solutions	16.19%
19	Wipro Technologies Limited	54.42%
20	Zylog Systems Ltd.	28.74%
Average		23.64%

2.8 Ld.TPO determined prize charged by assessee to its AE falls short of ALP by sum of Rs.1,10,21,853/-. Accordingly, adjustment was proposed in the hands of assessee to that extent. Ld.TPO also recharacterised services rendered by assessee as software development service provider, and determined value of such services at Rs.15,87,94,112/-, instead of Rs.14,77,72,259/- charged by assessee.

2.9 Aggrieved by adjustment proposed by Ld.TPO, assessee raised objections before DRP. While deciding objections raised by assessee, DRP upheld the approach of Ld.TPO for benchmarking international transaction of provision as ITeS services. They also rejected Zylog systems as comparable. Thus after DRP directions final set of comparables are as under:

Sl. No.	Company Long Name	OP/OC
1	Acropetal Technologies limited (Segment)	36.69%
2	Akshay Software Technologies Ltd.	0.16%
3	Celstream Technologies Pvt. Ltd.	12.26%
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17	Thirdware Solutions	16.19%
18	Wipro Technologies Limited	54.42%
19	Igate Global Solutions Ltd.	23.71%
Average		23.37%

2.10 Based upon directions of DRP, Ld. AO passed the impugned final assessment order and made addition in the hands of assessee at Rs.1,10,21,853/-.

2.11 Aggrieved by addition so made by Ld. AO, assessee is in appeal before us now.

2.12 At the outset, assessee only objects comparables, finally selected by Ld.TPO for purposes of determining ALP of international transaction. Ld.Counsel submitted that, assessee do not object re-characterisation of services as 'software development service provider' by Ld.TPO. Ld.Counsel submitted that **Ground No. 1-2, 2.1-2.6 & 3 - 4** are therefore not pressed.

2.13 Accordingly, Ground No. 1-2, 2.1-2.6 & 3 - 4 stands dismissed as not pressed.

3. Only issues raised by assessee in **Ground No. 2.3-2.5**, pertains to comparables wrongly included/excluded by Ld.TPO.

3.1 Ld. Counsel submitted that assessee objects inclusion of following comparables:

- Acropatel Technologies Ltd., (Information Technology service segment);
- E-Infochips Ltd;
- Wipro Technology Solutions Ltd;

- Infosys Technologies Ltd;
- Sasken Communication Technologies

3.2. Before we deal with the comparability analysis, it is *sine qua non* to understand functions performed, assets owned and risks assumed by assessee before us.

Functions:

3.3 In transfer pricing study placed at page 1-64 of paper book, it is observed that assessee undertakes sales and marketing activities in India in order to promote market and solicit customers for printed courseware in India under overall global policy of Element K group in this regard. It is observed that assessee is primarily engaged in distribution of printed courseware developed and owned by EK USA and other 3rd parties.

3.4 Sales and marketing: assessee is responsible for marketing of courseware in Indian market. The activities of Indian entity included development and maintaining a distribution network in India for sale of courseware/books. It has been submitted by assessee in the TP study that it carries out extensive market research in order to hope information on local market trends, other players, competition, needs and feedback of customers etc., Based upon which, assessee projects estimates the courseware demand in India, determined acceptable prizes, price band etc. It is also involved in identifying potential customers, make presentation etc in order to solicit customers/contracts.

“Pricing and contractual negotiations: *EK India was responsible for undertaking the pricing/ contractual negotiations/ discussions with the customers. Such pricing etc. decisions are taken by the Indian entity in accordance with the group standards/ policies,*

standard price lists, etc. developed by Element K at the group level, which are required to be followed by all Element K group companies and/ or by third party distributors (if any) involved in sale/ resale of printed courseware.

Printing and delivery of the courseware: EK India is responsible for arranging a printing of such e-books in India and thereafter arrange to deliver the printed courseware to the end customers in India. To this end, during FY 2010-11, EK India appointed a third party printer. Further, the Indian entity also ensures that the printer adheres to the quality standards etc. provided by EK USA to the printer in this regard.

However, in case of sale of courseware of courseware in the AsiaPac region (outside India), printing is the responsibility of the US entity.

Invoicing/ Billing: EK India is responsible for billing and collecting the sales proceeds from its customers after sale of such courses in India. The Indian entity undertakes the necessary credit evaluations, reference checks, etc. before entering into customer contracts.

However, in case of sale in AsiaPac region (other than India), invoicing, billing and collection etc. related activities are the responsibility of the US entity.

Inventory Management: EK India is responsible for the inventory management function. The group follows the 'Print on demand' model and thus does not maintain inventory/ stock of courseware. Further, EK India is responsible for ensuring print fulfillment and delivery of the books to the customers.

Accordingly, in this category, for sale of courseware in India, EK India is responsible for undertaking all functions related to the marketing and distribution of the printed courseware of Element K in India, including activities like sales and marketing, client interface, identification and development of business partner network, invoicing, collection and post sales support etc.

Further, with respect to sale of courseware in AsiaPac region (outside India), the Indian entity acts as a marketer/ commission agent wherein the printing and sale of courseware is undertaken by the US entity.

General Management Functions

The functions addressed below are common functions that are carried out by any business irrespective of their size and type. These functions are drivers of every business and are indispensable in the economic environment.

- **Corporate Strategy Determination:** Generally, all policies within EK India are determined by its own management who continuously monitor the economic environment surrounding the

Indian entity, assess their strategic position within the industry' and target to achieve its corporate objective with guidance from EK USA.

• **Finance, Accounting, Treasury and Legal Function:** The management of EK India is responsible for managing the finance, treasury, legal and accounting functions. EK India is also responsible for all local statutory compliance. In this respect, where appropriate, it is guided by EK USA policies.

III. Assets employed

• **Human Resource Management Function:** The HR function at EK India is coordinated by its management, which is responsible for recruitment, development and training of the personnel including the emolument structure. In this respect, where appropriate, it is guided by EK USA policies.

Any business requires assets (tangible or intangible) without which it cannot carry out its activities. Intangibles play a significant role in the functioning of a business and are accordingly more important. An understanding of the assets employed and owned by EK India provides an insight into the resources deployed by EK India and their contribution to the business processes/economic activities of EK India.

IV. Tangibles owned by EK India

EK India utilises routine tangible assets like computers and peripherals, office premises, communication facilities, furniture and fixtures etc. for the purpose of its business.

V. Intangibles

EK India does not own any significant intangibles and does not undertake any Research and Development on its account that leads to the development of non-routine intangibles. EK USA, on the other hand, develops/ owns significant intangibles like corporate logo/ trademarks, customer relationships and networks, library of products, copyrights, processes, platform, know-how, technical data, software, operating/ quality standards, etc. Moreover, the US entity has a rich experience of over 30 years.

VI. Risks assumed

The risk profile of EK India vis-a-vis its AEs is provided in Table below.”

3.5 Based upon the above, assessee has been characterised as a value added distributor of printed courseware/e-books in India which assumes normal/significant risks associated with carrying out such marketing/distribution activities in India.

3.6 At the outset, Ld. Counsel submitted that Zylog systems Ltd., has been excluded by DRP and Infosys Technologies Ltd., has been excluded by coordinate bench of this Tribunal in assessee's own case for assessment year 2007-08 in ITA No. 431/del/2012 vide order dated 14/11/14 as well as for assessment year 2008-09 in ITA No. 6 to 77/del/2012 vide order dated 22/11/2017.

3.7 It has been submitted that this Tribunal while excluding Infosys Technologies Ltd., followed decision of *Hon'ble Delhi High Court* in the case of *CIT vs Agnity India Technologies Pvt. Ltd.*, reported in (2013) 219 Taxmann 26.

3.8 Ld. CIT(DR) though objected to exclusion of Zylog Systems Ltd., and Infosys Technologies Ltd., could not controvert their exclusion in assessee's own case. Further, he has not been able to bring out any distinguishing factor factually, for us to take a contrary view.

3.9 Therefore, respectfully following the same, we also direct Ld.TPO to exclude Infosys Technologies Ltd., from the list of comparables.

4. We shall now deal with remaining comparables independently as under:

1. Acropatel Technologies Ltd., (Information Technology service segment):

Ld.TPO included this company in the list of comparables. Ld.Counsel contended that this company is functional dissimilar, as it is engaged in diversified activities and has three segments namely; engineering design services, information technology services and healthcare segment. It has been submitted that this

company is engaged in provision of high end healthcare services and develops & owns related intellectual property providing substantial competitive advantage to this company, leading to higher profitability. Relying on annual report, placed at page 1-80 of paper book Ld.Counsel submitted that it is engaged in sale of software products. The Ld. AR submitted that from page 8-11 of annual report, it is evident that, within each vertical, this company is operating as a KPO service provider. The Ld.Counsel further submitted that from profit and loss account, it is evident that it earns revenue from sale of products, namely, product hardware and product software.

On the contrary, Ld.DR submitted that there is no related party transaction during year under consideration.

We have heard rival submissions of both sides in light of records placed before us.

This company is engaged in provision of high end healthcare services and develops & owns related intellectual property providing substantial competitive advantage to this company, leading to higher profitability. As per annual report, this company is engaged in sale of software products. It is observed that assessee is undertaking software development relating to presentation of course material by way of including animation, graphics and audio training aids etc. Therefore, Acropetal Technologies Limited is functionally different from that of assessee and should have been excluded by Ld.TPO. The company is also engaged in two business segments, i.e., sale of products and sale of services but segmental profitability is not available in audited financial statements.

Therefore, we direct Ld.TPO to exclude this company from comparables.

2. E-Infochips Ltd:

Ld.TPO included this company in the list of comparables. Ld.Counsel contended that this company is functional dissimilar, in as much as it is engaged in software development and IT enabled services and also Products. Ld.TPO included this company into final list as it has 2 heads of income being income from software development and income from IT services which together amounts to 86% of total income of the company. Ld. TPO opined that segmental data, the other activities are of very small volume and integrally connected with functions of providing software services

On the contrary, Ld.DR submitted that there is no related party transaction during the year under consideration.

We have heard the rival submissions of both sides in the light of records placed before us.

We find from Annual report of this company placed in paper book at page 81-149, that schedule of Income indicates its operating revenue from software development, hardware maintenance, information technology, consultancy etc. There is no segmental information available as regards revenue from sale of products and revenue from software development segment. As assessee is simply engaged in rendering software development services and there is no sale of any software products, this company, in our considered opinion, ceases to be comparable. It is obvious that from common pool of income from both streams of software products and software services, one cannot deduce revenue from

software services and no one knows impact of revenue from Products on overall kitty of profit, which may be significant.

Since no segmental data of this company is available indicating operating profit from software development services, we order to exclude this company from the list of comparables.

3. Wipro Technology Solutions Ltd:

This Comparable has been included by Ld.TPO. Ld.Counsel objected for inclusion of this company in the list of comparables by arguing that apart from this company being functionally different and availability of insufficient segmental information, there were also significant related party transactions. Ld.TPO did not accept assessee's contention of related party transactions and proceeded to include it in the final set of comparables.

On the contrary, Ld.DR submitted that there is no related party transaction during the year under consideration.

We have heard the rival submissions of both sides in the light of records placed before us.

Ld.Counsel submitted that Wipro Technology Services Limited (formerly Citi Technology Services Limited) ('the Company') was incorporated on 15 September, 2004. The entire share capital of the Company was held by Citicorp Banking Corporation, a company incorporated under laws of Delaware, USA, upto 20 January, 2009.

It was submitted that Wipro Limited (Wipro) executed agreement with Citigroup Inc. for acquiring all of Citigroup interest in the

Company w.e.f. 21 January 2009. On 21 January 2009, Wipro signed master service agreement (MSA) with Citigroup Inc. for delivery of technology infrastructure services, application development and maintenance services After acquisition by Wipro, name of Company was changed to Wipro Technology Services Limited ('WTS' or 'the Company') on 16 March 2009.”

It is observed from the above that, Wipro Technology Services Ltd., which was earlier Citi Technology Services Ltd., was held by Citi Corp. Banking Corporation, USA upto 20th January, 2009. Wipro Ltd., parent company of which executed agreement with Citi Group Inc., for acquiring Citi Technology Services Ltd., now called Wipro Technology Services Ltd. On 21.1.2009, Wipro Ltd. signed master agreement with Citi Group Inc., for the delivery of technology Infrastructure Services and application development and maintenance services for the period of six years, which also includes the year under consideration. This shows that income from software development support and maintenance services was earned by Wipro Technology Services Ltd., from Citi Group Inc., by means of master service agreement entered into between Wipro Ltd., its parent company and Citi Group Inc., a third person.

It is observed that the issues raised by Ld. CIT DR in respect of comparability of this comparable has been dealt with by coordinate bench of Delhi tribunal in *Saxo India Pvt.Ltd vs. ACIT (supra) as under:*

“We have noticed above from the language of Rule 10B(1)(e)(ii) that it is the net profit margin realized from a comparable uncontrolled transaction, which is considered for the purposes of benchmarking. The

epitome of 'comparable uncontrolled transaction' is that the companies or transactions in order to fall within the ambit of sub-clause (ii) of rule 10B(1)(e), should be both comparable as well as uncontrolled. 'Uncontrolled transaction' has been defined in Rule 10A(a) to mean: 'a transaction between enterprises other than associated enterprises, whether resident or non-resident.' This shows that in order to be called as an uncontrolled transaction, it is necessary that the same should be between enterprises, other than associated enterprises.

Section 92B(2) provides that:

"A transaction entered into by an enterprise with a person other than an associated enterprise shall, for the purposes of sub-section (1), be deemed to be a transaction entered into between two associated enterprises, if there exists a prior agreement in relation to the relevant transaction between such other person and the associated enterprise, or the terms of the relevant transaction are determined in substance between such other person and the associated enterprise'.

On going through sub-section (2) of section 92B, it is clearly borne out that a transaction with non-AE shall be deemed to be a transaction entered into between two AEs, if there exists a prior agreement in relation to the relevant transaction between third person and the AE, or the terms of relevant transaction are determined in substance between the third person and AE. When we consider section 92B(2) in combination with Rule 10A(a), it follows that transaction between non-AEs shall be construed as a transaction between two AEs, if there exists a prior agreement in relation to relevant transaction between third person and AE. If such an agreement exists, third person is also considered as an AE, and transaction with such third person becomes international transaction within the meaning of section 92B. Once there is a transaction between two associated enterprises, it ceases to be an 'uncontrolled transaction' and, thereby, goes out of reckoning under Rule 10B(1)(e)(ii).

Adverting to the facts of the instant case, we find that Wipro Technology Services Ltd. earned revenue from Master services agreement with Citigroup Inc. for the delivery of technology infrastructure services. This agreement was, in fact, executed between the assessee's AE, Wipro Ltd., and Citigroup Inc., a third person. This unfolds that the transaction of earning revenue from software development support and maintenance services by Wipro Technology Services Ltd., is an international transaction because of the application of section 92B(2) i.e., there exists a prior agreement in relation to such transaction between Citigroup Inc. (third person) and Wipro Ltd. (associated enterprise). In the light of this structure of transaction, it ceases to be uncontrolled transaction and, hence, Wipro Technology Services Ltd.,

disqualifies to become a comparable uncontrolled transaction for the purposes of inclusion in the final list of comparables under Rule 10B(1)(e)(ii). We, therefore, direct removal of this company from the list of comparables.”

Respectfully following the same we also direct removal of this company from the list of comparables.

4. Sasken Communication Technologies

Ld.TPO included this company in final set of comparables. Ld.Counsel submitted that this company is engaged in sale of software products and offers IP led products in multimedia, and android software platform. He submitted that, it owns branded products and has its own IPR. He thus submitted that this company deals in is products as well as services. Thus Ld.Counsel submitted that it cannot be compared with captive service provider like that of assessee.

Ld.Counsel submitted that this comparable has been excluded by *Hon'ble Delhi High Court, in Agilis Information Technologies International Pvt.Ltd.*, reported in *88 Taxmann.com 6*, decision of coordinate benches of this Tribunal in case of *Conexant Systems Pvt.Ltd vs. DCIT* reported and *91 taxman.com 308*, *Clear2pay India Pvt.Ltd vs ITO* reported and *95 Taxmann.com 284*, on similar ground Ld.DR submitted that segmental information is available and services rendered by this company is similar to assessee and therefore must be considered as a comparable. He submitted that the branded products amounts to only 10% of total revenue and therefore will not have much impact.

We have considered rival submissions on basis of records placed before us. From TP study placed at page 378-501, it is observed

that revenue generated from sale of software services/ products and other services are to the tune of Rs.39,419.62 crores. Further it is observed from order of Ld.TPO that this company has been selected as a comparable only because it satisfies filter of applicability of 75% of its income from services. However on perusal of accounts, no segmental financials are available. Moreover in our considered opinion functionally itself this company is not comparable with that of assessee.

Accordingly we direct this comparable to be excluded from the final list.

5. Accordingly we dispose of these grounds raised by assessee as discussed herein above.

6. In the result appeal filed by assessee stands partly allowed. Order pronounced in the open court on 28/01/2019.

Sd/-
(N.K.SAINI)
VICE PRESIDENT

Sd/-
(BEENA A PILLAI)
JUDICIAL MEMBER

Dt. 28/01/2019
Bidhan

Copy forwarded to: -

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT

- TRUE COPY -

By Order,

ASSISTANT REGISTRAR
ITAT Delhi Benches

S.No.	Details	Date
1	Draft dictated on Dragon	
2	Draft placed before author	
3	Draft proposed & placed before the Second Member	
4	Draft discussed/approved by Second Member	
5	Approved Draft comes to the Sr. PS/PS	
6	Kept for pronouncement	28.01.2019
7.	Order uploaded on	
8	File sent to Bench Clerk	
9	Date on which the file goes to Head Clerk	
10	Date on which file goes to A.R.	
11	Date of Dispatch of order	