

**IN THE INCOME TAX APPELLATE TRIBUNAL
Hyderabad ' B ' Bench, Hyderabad**

**Before Smt. P. Madhavi Devi, Judicial Member
AND
Shri S.Rifaur Rahman, Accountant Member**

ITA No.2039/Hyd/2017
(Assessment Year: 2013-14)

M/s. Hackett Group (India) Vs Dy. Commissioner of Income
Ltd, Hyderabad Tax, Circle 2(2)
PAN:AAACE9813C Hyderabad
(Appellant) (Respondent)

For Assessee : Shri Rishi Harlalka
For Revenue : Shri Y.V.S.T. Sai, DR

Date of Hearing: 08.01.2019
Date of Pronouncement: 15.03.2019

ORDER

Per Smt. P. Madhavi Devi, J.M.

This is assessee's appeal against the assessment order passed u/s 143(3) r.w.s. 144C(5) r.w.s. 144C(13) of the Income Tax Act, 1961 for the A.Y 2013-14 dated 28.09.2017.

2. Brief facts of the case are that the assessee company furnished its return of income for the A.Y 2013-14 on 29.11.2013 electronically declaring a total income of Rs.1,31,69,290/-. The return was selected for scrutiny under CASS to examine (i) international transaction in respect of lending/borrowing of money; and (ii) depreciation claimed at higher rates/higher additional depreciation claimed. Accordingly, notices were issued to the assessee. Since the assessee had entered into international

transactions, the determination of the Arms' Length Price (ALP) of the said transaction was referred to the TPO u/s 92CA of the Act.

3. The TPO considered that the assessee is providing software development and other related support services to its parent company from its software company in Hyderabad. He observed that the assessee has entered into two international transactions, (i) provision of SDS to the tune of Rs.17,40,35,664/- and (ii) recovery of expenses of Rs.1,29,07,441/-. Further, the TPO also noticed that the assessee has not reported the transaction of receivables of Rs.6,04,89,522/- either in the form 3CEB or T.P. document.

4. During the T.P. proceedings, the TPO observed that the assessee, after applying certain filters, has short-listed around 10 comparables to benchmark the software development services (SDS) transaction at 8.49% as against the margin of the assessee at 8.32% and therefore, treated the transaction to be at ALP. The TPO, however, was of the view that the search process conducted by the assessee is not in conformity with the TP regulations and therefore, has resulted in selection of inappropriate comparables. He, therefore, rejected the TP documentation of the assessee and conducted an independent analysis by aggregating all the transactions under the TNMM. The TPO rejected all the comparable companies taken by the assessee, except for CG Vak Software & Exports Ltd. Thereafter, he proceeded to conduct an independent search and adopted nine companies as comparables and arrived at the average margin of the said companies at 19.76% and after allowing working capital adjustment of 2.8%, he

arrived at the ALP of 17.15% and proposed the adjustment u/s 92CA of Rs.1,41,89,289.

5. Accordingly, the draft assessment order was passed, against which, the assessee preferred its objections before the DRP. The DRP, however, confirmed the order of the TPO and in accordance with the same, final assessment order was passed and the assessee is in appeal before us against the final assessment order by raising the following grounds of appeal:

“On the facts and in the circumstances of the case and in law, the Id. Assessing Officer ("AO"), the Id. Transfer Pricing Officer ("TPO") and Hon'ble Dispute Resolution Panel ("DRP") have erred in:

- 1. Passing the order, which is bad on facts and in law.*
- 2. Not allowing the use of multiple year data as prescribed under Rule 10B of the Income-tax Rules, 1962 (the Rules).*
- 3. Incorrectly rejecting the appellant's Transfer Pricing study.*
- 4. Making factually incorrect statements in TP order regarding Functions performed, Assets employed and Risks assumed by the Appellant.*
- 5. Incorrectly rejecting the Internal Transactional Net Margin Method as submitted by the Appellant.*
- 6. Erred in applying the following filters*
 - a. 75% export revenues as filter criteria*
 - b. Filter to eliminate companies having different financial year ending*
- 7. Incorrectly accepting companies namely R S Software (India) Limited, Mindtree Limited (Segment), Larsen & Toubro Infotech Limited (Segment), Persistent Systems Limited, and Infobeans Technologies Limited which are not comparable to the Appellant.*
- 8. Incorrectly rejecting Acropetal Technologies Limited, Akshay Software Technologies Limited, Cigniti Technologies Limited, Cat Technologies Limited, Prism*

Informatics Limited, R Systems International Limited, Thinksoft Global Services Limited, Sankhya Infotech Limited and Spry resources India Limited, being comparables selected by the Appellant in its Transfer Pricing study.

9 Not accepting E-Zest Solutions Limited as additional company proposed by the Appellant from the TPO's search process

10. Incorrectly computing the operating profit margins of the comparable companies.

11. Not granting comparability adjustment on account of differences in risk profile of the Appellant vis-a-vis that of independent entrepreneurial companies.

12. Not granting the benefit of proviso to section 92C(2) of the Act.

13. Considering outstanding receivables from Associated Entity as a separate international transaction for arm's length bench marking analysis.

14. Not considering the fact that working capital adjustment takes into account the differences between credit period of the Appellant and comparable independent companies and hence no separate adjustment is required for outstanding receivables

15. Not considering the jurisdictional tribunal rulings which have held that a separate adjustment for outstanding receivables is not warranted

16. Not considering the fact that the average receivables collection period of the Appellant is within the range of average receivables collection period of comparable uncontrolled companies and industry average.

17. Not considering the fact that in the case of software services provided by the Appellant to third parties, the invoices have been realised over a period as long as six months and hence the credit period allowed to Associated Entity is not excessive.

18. Not considering LIBOR based rates for charging notional interest on outstanding receivables.

The Appellant submits that the above grounds are independent and without prejudice to one another. The appellant craves leave to add to or alter, by deletion,

substitution or otherwise, the above grounds of appeal at any time before or during the hearing of the appeal”.

6. At the time of hearing, the learned Counsel for the assessee submitted that the assessee does not wish to press grounds 1, 2, 3, 4, 6, 11 and 12. They are accordingly rejected as not pressed.

7. As regards Ground No.5, the learned Counsel for the assessee submitted that the assessee's gross turnover was Rs.19.00 crores out of which, the turnover of the international transaction itself was Rs.17,40,35,667/- and the balance of the turnover i.e. Rs.1.83 crores was from non-AE transactions. He submitted that the non-AE Companies were also into similar line of business and the services rendered by the assessee to such parties are also similar. Therefore, he pleaded before the AO to consider the internal TNMM as the most appropriate method, but the AO has rejected the said contention of the assessee on the ground that only 10% of the turnover was with non-AE and therefore, it cannot be considered as the most appropriate method and also on the ground that the segmental results of the Non-AE companies are not audited and therefore, they cannot be relied upon. For the proposition that the size of the comparable or quantum of sales with non-AEs are not the criteria and that it does not render the transaction incomparable, the ld Counsel placed reliance upon the decision of the Hon'ble Delhi Bench of the Tribunal in the case of Lummus Technology Heat Transfer BV v. Deputy Commissioner of Income-tax, Circle -3(2), New Delhi reported in (2014) 42 Taxmann.com 342 (Delhi) Trib. As regards the contention that the AE and third parties profitability working do not require audited financial

statements, he placed reliance upon the decision of the Tribunal at Delhi in the case of Lummus Technilogy Heat Transfer BV (Supra) and also in the case of NTT Data Global Delivery Services Ltd.v. Deputy Commissioner of Income-tax, Circle-16 (1), Hyderabad reported in (2015) 63 Taxmann.com 92 Hyderabad ITAT.

8. The Id DR, on the other hand, submitted that the assessee itself in its TP study had not taken the internal TNMM as the most appropriate method and further that the non-AE transactions of the assessee are with domestic companies, whereas AE transactions are international transactions and therefore, the market conditions of domestic as well as international are not the same and therefore, the AE and non-AE transactions cannot be treated on par with each other. Therefore, he submitted that the internal TNMM cannot be accepted.

9. Having regard to the rival contentions and the material on record, we find that the Coordinate Bench of the Tribunal at Delhi in the case of Lummus Technology Heat Transfer BV (Supra) was considering the case of an assessee which had both AE and non-AE transactions. It is not clear from the said case, whether the non-AE transactions were also international transactions. As rightly pointed out by the Id DR, the market conditions would not be the same for domestic and international transactions and therefore, they cannot be considered on par with each other and particularly, in the case before us, as the assessee itself has not adopted the internal TNMM as the most appropriate method. Therefore, we do not see any reason to direct the

TPO to adopt the same and therefore, confirm the order of the TPO on this issue. Thus, ground of appeal No.5 is rejected.

10. As regards Ground No.10, it is the case of the assessee that there are errors in computation of operating profit margins of companies selected by the TPO as comparables. He submitted that in the case of CG-VAK Software Exports Ltd, L&T Infotech and Persistent Systems Ltd, the TPO has not considered the provision for doubtful debts as operating expense and in the case of Mindtree Ltd, the unallocated expenses have been erroneously considered as Rs.62,41,60,300/- instead of Rs.96.40 crores. He submitted that in the case of Mindtree Ltd, the Id DRP had directed the AO to examine the issue, by the AO has not done so while passing the final assessment order.

11. On the issue of Mindtree Ltd, the Id DR did not object to the remand of the issue to the AO. We therefore, direct the AO to follow the directions of the DRP on this issue and recompute the margin of the said company.

12. As regards the provision for bad and doubtful debts, the Id Counsel for the assessee submitted that as per the generally accepted accounting provisions, the management is required to make estimates that affect the reported balances of assets and liabilities as on the date of financial statements and reported amounts of incomes and expenses during the period. He submitted that a provision is recognised if, as a

result of a past event, the company has a present legal obligation that can be estimated reasonably. He submitted that this is mandatory for all the companies to whom GAAP is applicable and hence provision for doubtful debts cannot be considered as non-operating expense. He submitted that all the three companies have consistently created provision for doubtful debts over the past years following the GAAP. In favour of this contention, he placed reliance upon the following decisions:

- i) *Alliance Global Services IT India Pvt. Ltd (ITA Nos.58/Hyd/2014)*
- ii) *TNS India Pvt. Ltd vs DCIT (ITA No.604/Hyd/2014)*
- iii) *DCIT vs. M/s. Palred Technologies Ltd (formerly Four Soft Ltd) (ITA No.186/Hyd/2014, 207/Hyd/2014 & 268/Hyd/2015).*
- iv) *M/s Sum Total Systems vs. DCIT (ITA No.255/Hyd/2015)*

13. The Id DR, on the other hand, submitted that the provision for bad and doubtful debts cannot be considered as operating expense as it is not uniform in the case of the assessee as well as the comparable companies. He submitted that the FAR analysis requires that all the factors of the comparability should be uniform and consistent and provision of bad and doubtful is not a consistently uniform factor which could bring the companies on par. He therefore, relied upon the order of the TPO.

14. Having regard to the rival contention and the material on record, we find that in the case of Alliance Global Services IT India Pvt. Ltd (Supra), the Coordinate Bench of this Tribunal by following the decision of the Coordinate Bench in the case of M.s Kenexa Technologies (P) Ltd has held that the provision for bad and doubtful

debts is part of operating expenses. The Tribunal has directed the TPO to allow the same. Similarly, in the case of TNS India Pvt. Ltd, the Tribunal has directed the TPO therein, to treat the provision for bad and doubtful debts as operating expenses. Respectfully following the same, we direct the TPO to treat the provisions of bad and doubtful debts in the case of the assessee as well as comparables as part of the operating expenses. Ground of appeal No.10 is accordingly treated as partly allowed.

15. As regards Grounds of appeal Nos. 13 to 18, i.e. treating the outstanding receivables from Associated Entity as a separate international transaction and bringing the interest thereon to tax, the ld Counsel for the assessee submitted that the average period of credit given by the assessee is 79 days as against the companies selected by the assessee wherein the credit period is 156 days and in the case of companies selected by the TPO, it was 81 days. He submitted that the average period of credit in the I.T. Industry is 114 days. He also submitted that the assessee is a debt free company and the credit terms in both the AE and non-AE transactions are similar. Therefore, he submitted that the outstanding receivables ought not to have been treated as international transaction. Further, he also submitted that the AO, while computing the working capital adjustment, has also taken note of the average of the payments of payables and receivables and therefore, the same cannot again be taken as a separate international transaction. He placed reliance upon various caselaw in support of his contentions which are as follows;

- i) *Hon'ble Bombay High Court in the case of Vodafone India Services Pvt. Ltd (W.P. No.871 of 2014)*

- ii) *Bharati Airtel Ltd vs. ACIT (ITA No.816/Del/2012)*
- iii) *ITAT Hyderabad in the case of Open Text Corporation India Pvt. Ltd vs. DCIT (ITA No.232/Hyd/2016)*
- iv) *Pr.CIT vs. Kusum Healthcare Pvt. Ltd vs. ACIT (ITA No.765/2016)*
- v) *Bangalore Bench of the ITAT in the case of Tally Solutions vs. ACIT (ITA No.1364/Bang/2011)*

16. The Id DR, however, submitted that as recorded by the TPO as per the assessee's own agreement, the credit period was only 30 days and therefore, the TPO was right in treating the outstanding receivables as an independent international transaction.

17. Having regard to the rival contentions and the material on record, we find that this Bench, in a number of cases, has held that when the outstanding receivables have factored in computation of working capital adjustment, no separate adjustment is required. Further, we also find that the average credit period of the comparables is 81 days, whereas in the case of the assessee, it is 79 days and therefore, there is no need for any adjustment towards outstanding receivables. Further, we also agree with the contention of the assessee that when the assessee is not paying interest on its payables, assessee is also not justified in charging interest on outstanding receivables. Therefore, on all these counts, the grounds of appeal Nos. 13 to 18 are allowed.

18. As regards Ground No.7 is concerned, the assessee is seeking exclusion of RS Software (India) Ltd, Mindtree Ltd, Persistent Systems Ltd, L&T Infotech Ltd and Infobeans Technolotgies Ltd, since

according to the assessee, they are not comparable to the assessee. Let's therefore, consider the assessee's objections, company-wise:

i) **RS Software India Ltd**

18.1 The Id Counsel for the assessee submitted that the said company has a turnover of Rs.293.02 crores as against the assessee's turnover of Rs.17.04 crores revenue from the international transaction. Therefore, according to the assessee, it is incomparable in terms of the scale of operations and that the competitors to the said company are huge IT Companies like Infosys, Wipro, TCS, HCL whose brand and market reach are their major strengths. He referred to the non-routine intangibles possessed by the company such as patents for mobile solutions in USA. He submitted that the DRP has rejected the objections of the assessee holding that the companies cannot be rejected only because they have high turnover and that the assessee failed to establish the material differences on margin due to presence of IPRs and Brand Value. In support of his contention that this company is not comparable, the Id Counsel for the assessee placed reliance upon the following decisions:

- A) *M/s. G.T. Nexus Software Pvt Ltd vs. DCIT IT(TP)A No.409/Bang/2016 for the ay 2011-12*
- B) *CIT vs. Agnity India Technologies Pvt. Ltd (TS 189 HC 2013 (DEL) TP (AY 2006-07*
- C) *Adaptec (India) Pvt. Ltd (ITA No.1758/Hyd/2012 (AY 2008-09)*
- D) *Nebulae Technologies Pvt Ltd vs. DCIT (ITA No.2144/Hyd/2011 (AY.2007-08)*
- E) *GS Research Center P Ltd vs. ACIT (ITA No.411/Hyd/2015)(AY 2010-11)*
- F) *Invensys Development Centre India P Ltd vs. DCIT (ITA No.383/Hyd/2014 (AY 2009-10).*

18.2 The Id DR, on the other hand, supported the orders of the authorities below and placed reliance upon the decision of the Hon'ble

Delhi HC in the case of Chryscapital Investment Advisors (India) (P.)Ltd. v. Deputy Commissioner of Income-tax reported in (2015) 56 Taxmann.com 417 (Del.). A copy of the said order is also filed before us.

18.3 Having regard to the rival contentions, we find that the assessee does not own any intangibles and also its turnover is only 17.04 crores as against the huge turnover of more than 10 times i.e. 292.02 crores of R.S. Software. The Hon'ble Delhi High Court in the case of CIV vs. Agnity India Technologies (P) Ltd (Supra) has held that the scale of operations is an important factor for T.P. analysis. In the case of Chryscapital Investment Advisors (India) (P.)Ltd. v. Deputy Commissioner of Income-tax relied upon by the ld DR, the Hon'ble High Court has held that the mere fact that an entity make extremely high margin does not ipso facto lead to the exclusion from the list of comparables for the purpose of determination of ALP as in such circumstances, an inquiry under Rule 10B(3) ought to be carried to determine as to whether material differences between the assessee and the comparables can be eliminated and unless such differences cannot be excluded, it has to be included as a comparable. In the case before us, the assessee has brought out that the comparable companies have huge turnover and also has brought out the ownership of non-routine intangibles of RS Software India Ltd which could be a factor for its high turnover. We find that in the case of M/s. GT Nexus Software (P) Ltd in IT(TP)A No.409/Bang/2016, the Coordinate Bench of the Tribunal has considered the turnover filter of 10 times tolerance range of assessee's turnover to direct exclusion of RS Software India Ltd, Mindtree Ltd, Persistent Systems Ltd, Infosys Technologies Ltd, L&T Infotech Ltd and TATA Elxsi Ltd and Sasken Communications Ltd. Further, in the case

of M/s Nebulae Technologies Pvt Ltd in ITA No.2144/Hyd/2011, the Coordinate Bench of this Tribunal has considered the turnover, brand value, scale of operations, diversified activities and owning of intangible assets as relevant factors to exclude the companies. Therefore, respectfully following the said decision and the rationale given therein, we direct the TPO to exclude this company from the list of comparables.

ii) **Minidtree Ltd**

18.4 The assessee's objections to this company are almost similar to the objections in the case of RS Software India Ltd, such as diversified activities; incomparable scale of operations, the Revenue being Rs.1608 crores and ownership of non-routine intangibles, branding and payments etc., As held in the case of RS Software India Ltd, this company has to be excluded from the final list of comparables due to its high turnover and also owning of non-routine intangibles.

iii) **Persistent Systems Ltd**

18.5 As regards Persistent Systems Ltd, the objection of the assessee that it is not only functionally dissimilar as it develops software products and is involved in diversified operations, but it also owns intangibles worth INR 24.00 crores and has incomparable scale of operations with the Revenue being Rs.990/- crores. The 1d DR's objections are almost similar as in the case of RS Software India Ltd and according to the DR, the said companies are also functionally similar.

18.6 We find that we have considered the high turnover filter as a relevant factor and if the turnover of the company in comparison to that of the rate of assessee, is more than 10 times tolerance range, then it

has to be excluded. Therefore, the AO/TPO are directed to exclude this company also from the list of comparables.

iii) **Infobeans Technologies Ltd**

18.7 According to the assessee company, it has an extraordinary event of demerger of the software business of Infobeans Systems and transfer of the same to Infobeans Technologies. The TPO & DRP rejected the said contention holding that the assessee has failed to prove with any evidence that such an event had any impact of the company during the relevant financial year on the margin and according to the DR, the company is functionally comparable.

18.8 The learned Counsel for the assessee submitted that wherever there is an extra-ordinary event, such as a merger/demerger/acquisition, there is bound to be an impact on the margins of the said company and therefore, this company it ought to have been excluded. In support of this contention, he placed reliance upon the decision of the Tribunal at Pune in the case of PubMatic India (P) Ltd vs. ACIT reported in (2018) 91 Taxmann.com 356 (Pune-Trib.).

18.9 Having regard to the rival contentions, we agree with the contention of the learned DR that the assessee has to prove the impact of the merger/demerger of the said company on its margin for the relevant financial year. Since the assessee has failed to prove the same even before us, we reject the assessee's

contention on the comparability of this company with the assessee.

(iv) **Larsen & Toubro Infotech Ltd**

18.10 The objections of the assessee are that the company is functionally dissimilar and that it develops in-house intangibles, has strong brand value, is involved in diversified operations which includes products and also performs R&D Activities. He submitted that the Revenue of the L&T ranges to Rs.3,613/- crores and therefore, the scale operation is incomparable. As we have already held that the turnover filter of 10 times of the tolerance range is a relevant filter. Respectfully following the same, we direct the AO/TPO to exclude this company also from the final list of comparables. Ground of appeal No.7 is accordingly partly allowed.

19. As regards Grounds of appeal No.8 & 9, we find that the assessee is seeking inclusion of these companies in the final list of comparables. The assessee has relied upon the arguments culled out in the chart and also in the caselaw which are mentioned in the chart. When a query was raised by us as to whether exclusion of the above 4 companies from the final list of comparables would result in assessee's margin falling within $\pm 3\%$ of the assessee's margins and therefore, it would be necessary even to adjudicate the grounds of appeal, the learned Counsel for the assessee submitted that if the above companies are excluded, then it would not require these companies to be included in the final list of comparables. Since we have already excluded the four companies, we direct the TPO to recompute the ALP of the comparables and if the average margin falls within

+_3%, then no further companies are to be taken. However, if it does not fall within the said range, the TPO shall reconsider the assessee's contentions on comparability of the companies in Ground Nos. 8 & 9 and pass a reasoned order on their comparability after giving the assessee a fair opportunity of hearing.

20. In the result, Grounds of appeal No.8 & 9 are treated as allowed for statistical purposes.

21. In the result, assessee's appeal is partly allowed.

Order pronounced in the Open Court on 15th March, 2019.

Sd/-
(S.Rifaur Rahman)
Accountant Member

Sd/-
(P. Madhavi Devi)
Judicial Member

Hyderabad, dated 15th March, 2019.

Vinodan/sps

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- 6 The DR, ITAT Hyderabad
- 7 Guard File

By Order