

**In the Income-Tax Appellate Tribunal,
Delhi Bench 'I-2', New Delhi**

**Before : Shri Bhavnesh Saini, Judicial Member And
Shri L.P. Sahu, Accountant Member**

**ITA No. 4888/ Del/2011
Assessment Year: 2007-08**

ST Microelectronics Pvt. Ltd., D - 28 , South Extension , Part - I New Delhi , Pin - 110049 PAN- AAACS3406M (Appellant)	vs.	Addl. CIT Range - 9 New Delhi (Respondent)
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Appellant by	Sh. Ajay Vohra, Sr. Advocate Sh. Shahil Sharma, Advocate Sh. Ramit Katiyal, Advocate
Respondent by	Sh. H. K. Choudhary , CIT DR Sh. Rakesh Kumar, Sr. DR

Date of Hearing	17.01.2019
Date of Pronouncement	19.03.2019

ORDER

Per L.P. Sahu, A.M.:

This is an appeal filed by the assessee against the order dated 2.09.2011 passed by the assessing officer U/s 143(3)/144C(13) of the Income Tax Act, 1961 on the following modified grounds of appeal:-

1. *That the impugned order of assessment framed by the assessing officer in pursuance of the directions of the Dispute Resolution Panel (hereinafter referred to as 'DRP') under Section 143(3) read with Section 144C of the Income-tax Act, 1961 ('Act'), is bad in law, violative of principles of natural justice and void ab-initio.*

- 1.1 *That the assessing officer erred on facts and in law in passing order under section 143(3) read with Section 144C of the Act at an income of Rs. 56,87,66,800 as against returned income of Rs. 31,48,35,070.*
2. *That the assessing officer erred on facts and in law in making an adjustment of Rs. 24,40,13,533 to the arm's length price of the 'international transactions' of provision of software development services undertaken with the associated enterprise on the basis of order passed by the Transfer Pricing Officer ('TPO')/ Dispute Resolution Panel ('DRP').*
 - 2.1 *That the assessing officer erred on facts and in law in rejecting the use of multiple year data for the purpose of undertaking benchmarking analysis*
 - 2.2 *That the DRP/ TPO erred on facts and in law in resorting to cherry picking and considering following companies in the final set of comparable companies allegedly holding them to be functionally comparable to the Appellant:*
 - (i) *Tata Elxsi Limited*
 - (ii) *Helios & Matheson Information Technology Ltd*
 - (iii) *Sasken Communications Technologies Ltd.*
 - (iv) *Lanco Global Systems Ltd*
 - 2.3 *That the DRP/ TPO erred on facts and in law in not appreciating that the aforesaid companies do not satisfy the test of comparability as provided in rule 10B(2) of the income tax rules and therefore are liable to be rejected from the set of comparable companies.*
 - 2.4 *That the DRP/TPO erred in rejecting comparable companies as selected by the Appellant in its transfer pricing report*
 - 2.5 *That the DRP/ TPO erred on facts and in law in incorrectly computing the adjustment on account of differences in working capital*
 - 2.6 *That the assessing officer/TPO erred on facts and in law in not allowing appropriate risk adjustment to account for the differences in the risk*

profile of the appellant, a low risk captive service provider and the comparable companies selected by the TPO.

- 2.7 That on the facts and in the circumstances of the case and in law, the TPO erred on facts and in law in incorrectly computing the operating margin of R Systems International Ltd. and Geometric Software Solutions Ltd.*
- 3. That the assessing officer erred on facts and in law in treating expenditure incurred on software licenses amounting to Rs 2,47,95,422 as expenditure of capital nature.*
- 4. That the assessing officer erred on facts and in law in levying interest under section 234A and 234B of the Act.*
- 5. That the facts of the case and in law, the Ld. AO has grossly erred in initiating penalty proceedings under section 271(1)(c) of the Act.*

2. The Ground No. 1 and 1.1 is general in nature hence the same do not require any specific adjudication.

3. The brief facts of the case are that the assessee, ST Microelectronics India Pvt Ltd. is a subsidiary of ST. Microelectronics Pte. Ltd. (ST. Singapore) and filed return of income declaring income of Rs31,48,35,070. The assessee is engaged in the business of Integrated Circuit Design, CAD tools and Software development for its overseas group concerns. In the year under reference, the assessee had undertaken international transactions with its Associate Enterprises, which were in the nature of provision of software development services (SWD), provision of market support services, purchase of capital equipment, provision made in respect of employee stock option plan, payment made for the purchase of shares under the ESOP and buy-back of shares.

4. During the relevant previous year, the appellant earned operating profit margin of 10.69% and applied the Transactional Net Margin Method ('TNMM') for the purpose of undertaking benchmarking analysis of the international transaction of provision of software services. During the impugned year, the assessee calculated mean margin of 13.61% on the basis of three years' data, i.e., F.Y. 2004-05, 2005-06 & 2006-07 (to the extent available) of the following broadly comparable 37 independent companies. The NCP margins earned by the following comparable companies range from 8.85% to 41.29% :

Sl. No.	Name of the Company	NCP 2004-05 %	NCP 2005-06 %	NCP 2006-07 %	Weighted Average (%)
1.	A S M Technologies Ltd.	9.54	7.26	6.48	7.46
2.	Aztecsoft Ltd.	17.72	17.26	18.74	18.13
3.	Blue Star Infotech Ltd.	13.37	6.49	7.7	9.18
4.	BT TechNet Ltd.	-1.55	NA	NA	-1.55
5.	C M C Ltd.	11.22	19.68	19.59	16.99
6.	Computech International Ltd.	8.77	4.59	NA	6.65
7.	Exensys Software Solutions Ltd.	31.55	26.18	19.05	23.10
8.	F C S Software Solutions Ltd.	14.23	14.74	21.92	17.34
9.	Geometric Software Solutions Co. Ltd.	29.9	18.47	13.18	18.01
10.	Goldstone Technologies Ltd.	4.67	3.82	21.90	9.78
11.	Helios & Matheson Information Technology Ltd.	35.42	35.44	21.49	25.63
12.	Hexaware Technologies Ltd.	14.57	16.32	NA	15.53
13.	I C S A (India) Ltd.	28.69	31.87	NA	31.36
14.	Infotech Enterprises Ltd.	21.55	18.76	27.52	23.53
15.	K P I T Cummins Infosystems Ltd.	13.57	13.89	14.48	14.08
16.	Lanco Global Systems Ltd.	10.85	6.00	15.43	10.63
17.	Larsen & Toubro Infotech Ltd.	10.56	11.57	NA	11.15
18.	Maars Software International Ltd.	3.28	12.67	-1.69	5.36
19.	Mascon Global Ltd.	9.69	8.34	11.51	10.08
20.	Melstar Information Technologies Ltd.	-0.50	2.19	-4.99	-1.10
21.	Mphasis Ltd.	18.33	24.50	12.42	16.51

22.	Orient Information Technology Ltd	14.97	-33.93	-24.55	-8.58
23.	P S I data Systems Ltd.	0.05	1.64	5.97	3.01
24.	Patni Computer Systems Ltd.	53.90	32.59	NA	41.29
25.	Prithvi Information Solutions Ltd.	10.49	13.68	14.11	13.24
26.	R S Software (India) Ltd.	7.96	15.44	12.92	12.20
27.	R Systems International Ltd.	5.16	22.35	7.35	11.28
28.	Ramco Systems Ltd.	9.56	-11.48	-19.32	-8.85
29.	Saksoft Ltd.	24.98	26.80	40.54	30.20
30.	Sasken Communication Technologies Ltd	16.03	13.90	24.81	19.06
31.	Shree Tulsi Online.Com Ltd.	1.95	3.32	NA	2.64
32.	Sonata Software Ltd	15.59	5.66	19.99	13.63
33.	Subex Azure Ltd	7.59	2.75	4.35	4.63
34.	Tata Elxsi Ltd	24.34	22.75	26.51	24.77
35.	ViseshInfotecnics Ltd	9.12	21.10	18.86	17.76
36.	Visualsoft Technologies Ltd.	23.52	19.79	NA	21.78
37.	Zensar Technologies Ltd.	38.29	13.26	15.59	17.76
	Arithmetic Mean				13.61

5. The TPO however, selected following 17 comparable companies having mean operating margin of 23.47%. The matter came before the DRP and the ld. DRP after considering the matter, rejected and accepted some of the above companies and directed to add two more new companies in the final set of comparables. Accordingly, based on DRP direction, the mean margin was calculated by AO/TPO at 19.07% as under :

S.No.	Name of the Company	OP/OC (%)
1.	Geometric Software Solutions Co Ltd.	10.71%
2.	LGS Global Ltd.	15.75%
3.	Sasken Communication Technologies Ltd.	22.16%
4.	Tata Elxsi Ltd.	26.51%
5.	Helios & Matheson	36.63%
6.	R S Software India Ltd.	13.47%
7.	R Systems International Ltd.	15.07%
	Less: Working Capital Adjustment	(0.98%)
	Average	19.07%

Accordingly, after selecting aforesaid seven new comparables by the TPO, as above, he calculated the transfer pricing adjustment on account of provision of software services to the tune of Rs.24,40,13,533/- as follows :

Particulars	Amount
Operating Cost	2,867,863,907
Arm's Length margin	19.07%
Arm's Length Price	341,47,65,554
Operating income of the assessee	317,07,52,021
Transfer Pricing Adjustment	24,40,13,533

The AO/TPO also made disallowance of Rs.99,18,169/- on account of license fee paid by the assessee by treating the same to be in the nature of capital expenditure.

6. We have heard the submissions of both the sides on the aforesaid additions and have gone through the entire material available on record.

7. The adjustment made by the Transfer Pricing Officer ('TPO') is challenged vide Ground nos. 2 to 2.7.

7.1 The appellant has challenged the transfer pricing adjustment on the basis that comparables taken by the TPO for benchmarking analysis are inappropriate and do not satisfy the criteria laid down under Rule 10B(2) of the Rules.

7.2 We analyse each of the comparables challenged by the appellant as under:

I. Comparable Companies whose inclusion is challenged by the assessee.

a) Helios and Matheson Information Technology Ltd.

The assessee has challenged the inclusion of this company on the following basis:

i) Functionally different – Low employee cost and High Software Service & development expenses - Outsources services to outside vendors.

8. Referring to the annual report of the company, it was submitted by the assessee that this company has only disclosed a sum of Rs 1.86 crore towards staff welfare which constitutes a mere 1.04% of sales. It was submitted that the DRP has rejected companies with employee cost to sales/total cost of less than 25% and in assessment year 2008-09 the TPO has also applied the same filter for rejection of comparable companies. Accordingly, it was submitted that the company is not a good comparable even applying the benchmarking approach of the TPO/DRP. Reliance was placed by the Ld. Senior Counsel appearing for the assessee on the case of Axsys Healthcare Ltd. (ITA No 2076/Hyd/2011) for assessment year 2007-08 wherein the Tribunal rejected this company on account of low ratio of employee cost to sales. Similarly, the Tribunal in the case of Nebulae technologies Pvt Ltd (ITA No 2114/Hyd/2011) rejected this company as comparable on account of low employee cost. Company is also rejected by the Delhi Bench of the Tribunal for the same assessment year in the following cases:

- Avaya India (P.) Ltd. Vs. ACIT (ITA 5528/Delhi/2011)
- Global Logic India (P.) Ltd. Vs. ACIT (ITA 5809/Delhi/2011)
- AVL India Software (P.) Ltd. Vs. DCIT (ITA 6454/Delhi/2012)
- Element K India Private Ltd. Vs ITO (ITA 431/Del/2012) (Delhi ITAT)

8.1 It was further submitted that the company has disclosed software services and development expenses amounting to Rs 97.67 crores which constitute

more than 54% of the revenue of the company. It was pointed out that while disposing of the objections of the appellant for assessment year 2008-09 with regard to one of the comparable companies, namely Computech International Ltd., the DRP held that software development expenses cannot be regarded as part of employee cost.

8.2. Accordingly, it was the contention of the assessee that the company outsources a significant portion of its business to outside service provider. It would be appreciated that a company which is outsourcing its work to outside vendors cannot be compared to a company which is performing all the function of its business itself. Reliance to support the above contention was placed on the decision of the Hon'ble Delhi High Court in the case of Rampgreen Solutions P. Ltd 377 ITR 533 (Del) wherein the Hon'ble High Court rejected companies engaged in outsourcing of services to outside vendors as comparable to companies performing such services using their own employees and resources. The aforesaid order was followed by the Hon'ble Delhi High Court in the case of Pr. CIT vs New River Software Services Pvt Ltd (ITA No 924/2016).

9. The Ld Departmental Representative relied upon the orders of the lower authorities. He drew our attention to the traveling and conveyance expenditure incurred by the company to the extent of Rs.2,61,38,162/-. The ld. DR doubted the financial statement submitted by the assessee, inasmuch as, the assessee had shown staff welfare expenses at Rs.1,86,43,728/- whereas there is no employee cost mentioned in the financial statement. Therefore, the conveyance expenditure to the extent of Rs.2,61,38,162/- do not invite credence. He, however submitted that the employee cost could have been clubbed by the

company under some other head and accordingly the contention of the assessee that this company outsources majority of its work needs to be examined by the TPO.

ii) Engaged in sale of software products:

10. It was submitted by the Ld Senior Counsel appearing for the assessee that in schedule L to the schedules forming part of the accounts this company has reported that it is earning its entire turnover from 'Software Sales and Services'. Further, in the significant accounting policies and the notes to accounts the company has stated that it recognizes revenue from time and material contract in accordance with terms of the contract. Accordingly, it was submitted that the company is engaged in sale of software products and therefore cannot be regarded as an appropriate comparable for the purpose of benchmarking the international transactions undertaken by the assessee, a captive software service provider. It is respectfully submitted that it is settled position that a company engaged on sale of software cannot be regarded as an appropriate comparable for benchmarking the international transactions undertaken by a software service provider. Reliance to support the aforesaid contention was placed on the decision of the Hon'ble Bombay High Court in the case of CIT vs PTC Software India Pvt Ltd (ITA No 732/2014) wherein the Hon'ble High Court rejected this company on the basis that it is engaged in sale of software products and is therefore not comparable to a software service provider.

10.1 Further, it was pointed out that the Delhi Bench of the Tribunal in the case of Toluna India Pvt. Ltd. vs. ACIT in ITA No. 5645/Del/2011 for the same assessment year i.e. AY 2007-08, directed the company to be excluded from the

final set of comparable companies on account of functionally dissimilarity since the company is engaged in the software sales.

10.2 In view of the aforesaid, it is submitted that Helios and Matheson Ltd. cannot be regarded as an appropriate comparable for the purpose of benchmarking analysis.

(iii) Brand development

10.3 It was submitted that the company is actively pursuing development of its brand and has appointed a renowned brand advisor namely JWT. It was further submitted that the company also organized a global brand launch at the United Nations headquarters during the relevant financial year. Further, the company also incurred a sum of Rs 6.28 crore towards advertisement and marketing which constitutes more than 3% of the sales of this company.

10.4 It was further submitted that the Company is engaged in R&D activities whereas the assessee is a captive service provider and do not undertake any R&D activities. The following extract from the annual report of the company was relied upon by the assessee:

“Research and development of new services, designs, frameworks, and methodologies continue to be important to your company”

10.5 Reliance was placed on the decision of the Hon’ble Delhi High Court in the case of Pr. CIT vs Oracle (OFSS) BPO Services Pvt Ltd (ITA No 124/2018) wherein the Hon’ble Court held that companies having significant brand

presence cannot be regarded as appropriate comparable for the purpose of benchmarking the international transactions undertaken by a captive service provider. The said decision of the Hon'ble High Court has been upheld by the Hon'ble Supreme Court in SLP (CC) No. 32469/2018.

11. We have heard the rival contentions and gone through the annual report of this company. We noted that though the Id. AR did not controvert the contentions raised by Id. DR, but we find ourselves in agreement with the contentions of the assessee that this company is primarily engaged in sale of software products. It is a settled position that a company engaged in development and sale of software products cannot be compared with a software service provider. This company has been excluded on this basis by the Hon'ble Bombay High Court in CIT vs PTC Software India Pvt Ltd (ITA No 732/2014) and the Delhi Bench of the Tribunal in Toluna India Pvt. Ltd. vs. ACIT (ITA No. 5645/Del/2011) (for the same assessment year i.e. AY 2007-08). Accordingly, we direct the exclusion of this company from the final set of comparables.

b) Sasken Communication Technologies Ltd.

12. The primary contention of the assessee is that during the relevant previous year, Sasken Network Systems Limited ("SNS") merged with Sasken Communication Technologies and Balance sheet and Profit and loss account of the company for the relevant previous year includes income and expenses of SNS. Further, the company acquired 100% shares of the Integrated Softech Solutions Private Limited and the said company was thereafter merged with Sasken Communication Technologies during the relevant previous year. The

scheme is effective from April 1, 2006. The Profit and Loss account for the year ended March 31, 2007 includes the income and expenses of iSoft Tech from the appointed date. The relevant pages of the annual report were perused during the course of hearing. In support his contention, the assessee placed reliance on the decision of the Delhi Bench of the Tribunal in the case of Toluna India P Ltd Vs ACIT (ITA 5645/Delhi/2011) wherein for the same assessment year i.e. assessment year 2007-08 while rejecting this company as comparable the Tribunal held as under:

“37. After considering the rival submissions and perusing the relevant material on record, we find that this company acquired Botnia Hitec Oyoy, Finland and its two wholly owned subsidiary companies during the year, which fact is apparent from the Director's report of this company available at page 202 of the paper book. Following the Mumbai Bench decision in Petro Araldite (P.) Ltd. (supra), we order for the exclusion of this company from the list of comparables. The assessee succeeds.”

Similarly, in the case of Global Logic India Pvt Ltd (ITA 5809/Delhi/2011) for AY 2007-08 this company was rejected as comparable by the Delhi Bench of the Tribunal holding as under:

“(x) Sasken Communications Ltd.

27. Here again, we find that in this year, there were acquisitions and mergers. The Tribunal in the case of Toluna India Pvt. Ltd., has also directed the exclusion of this company on the same basis. Following the same, we direct not to treat this company as comparable.”

The company has been likewise rejected in the case of Element K India Private Ltd. V.s ITO (ITA No. 431/Del/2012) for AY 2007-08 and Avaya India (P.) Ltd. Vs. ACIT (ITA 5528/Delhi/2011) for AY 2007-08.

12.1 The assessee further submitted that this company owns IPR in the form of numerous patents and has branded products and accordingly, cannot be compared with the appellant, a captive service provider. Reliance was placed on the decision of Delhi Bench of the Tribunal in the case of Motorola Solutions India Private Limited Vs. ACIT (ITA 5637/Del/2011), wherein, the company was rejected on account of significant intangibles in the form of 'Sasken Branded products' and exceptional year of operation, the relevant extract of which is reproduced as under:

"We have considered the rival submissions and have perused the record of the case.

111. Ld. TPO has completely ignored the extraordinary business circumstances pointed out by assessee for which necessary adjustment was required to be made in accordance with Rule 10B(3) of Income Tax Rules. However, since this adjustment was not possible, therefore, this company should not have been included in the list of comparables. Further, we find that the company owns IPR and has branded products which also distinguishes it from the assessee and, therefore, keeping in view the decision of Hon'ble Delhi High Court in the case of Agnity India Technologies Pvt. Ltd.(supra), we direct the ld. TPO to exclude this comparable from the list of comparables."

The Ld Departmental Representative however contended that firstly, the merger and acquisition cannot be a reason for exclusion of a company and secondly, it is not clear as to whether the aforesaid order of merger was placed by assessee before the ld. DRP or not. He, thus, relied on the orders of the authorities below.

13. We have heard the contentions of the assessee and the Ld. Departmental Representative. We find ourselves in agreement with the contention of the assessee that the profit and loss account of this company is infected by the merger and acquisition activity undertaken during the relevant previous year. The Delhi Bench of the Tribunal in the case of Global Logic India Pvt Ltd (ITA

5809/Delhi/2011) and Toluna India P Ltd Vs ACIT (ITA 5645/Delhi/2011) rejected this company as comparable for the same assessment year i.e. assessment year 2007-08 on the basis that it undertook significant merger and acquisition activity. Accordingly, we direct the exclusion of this company.

c) TATA ELXSI Ltd.

14. The third company selected by the TPO which is being challenged by the assessee is TATA ELXSI Ltd. The contentions of the assessee for exclusion of this company are as follows:

“(i) Functionally different

The company is engaged in provision of industrial design and engineering services, product design services, and visual computing labs. It is submitted that the company is engaged in specialized and niche domain of software products/services and therefore cannot be considered as comparable to the appellant, a contract software development service provider. It is further submitted that that the company has recorded a sum of Rs 33.78 crore as cost of goods sold which indicates that the company is also engaged in sale of hardware products and therefore cannot be regarded as an appropriate comparable for the purpose of benchmarking the international transaction of provision software services.

The Hon’ble Delhi Bench of the Tribunal in the case of appellant’s sister concern ST – Ericsson India Pvt Ltd (ITA No 609/Del/2015) for AY 2010-11 rejected TATA Elxsi as comparable on the basis that it is not functionally comparable to a software service provider.

*The Hon’ble Delhi Bench of the Tribunal in the case of Toluna India Pvt. Ltd. vs. ACIT in ITA No. 5645/Del/2011 for AY 2007-08, too, directed the company to be excluded from the final set of comparable companies on account of functional dissimilarity from the assessee, being a contract software development service provider. Further, the Hon’ble Tribunal following the aforesaid order in the case of Toluna India rejected Tata Elxsi as comparable for AY 08-09 (ITA No.6407/Del/2012) also. **The appeal of the Revenue against the said exclusion was dismissed by the Hon’ble Delhi High Court in ITA No. 393/2016.***

Reliance is also placed on the decision of Hon’ble Delhi Bench of the Tribunal in the case of Steria India Pvt. Ltd. vs DCIT in ITA No. 107/Del/2016 wherein TATA Elxsi was rejected as

comparable on account of functional dissimilarity. **Further the revenue appeal against the said exclusion was dismissed by the High Court in ITA No. 762/2017 (@ Pg 662 of caselaw paper book 1).**

Relying on the decision of Toluna (supra), the Hon'ble Delhi Bench of Tribunal in the following cases held the company to be functionally dissimilar from software development services provider:

- (i) Lear Automotive India P. Ltd. Vs. ACIT (ITA No. 5612/Del/2011)
- (ii) Global Logic India Pvt. Ltd. vs. ACIT (ITA No. 5809/Del/2011) **for AY 2007-08**
- (iii) Element K India Private Ltd., vs. ITO (ITA No.431/Del/2012) **for AY 2007-08**
- (iv) Avaya India (P.) Ltd. Vs. ACIT (ITA 5528/Delhi/2011) **for AY 2007-08**
- (v) AVL India Software (P.) Ltd. Vs. DCIT (ITA 6454/Delhi/2012) **for AY 2007-08**
- (vi) Ness Innovative Business Services Pvt. Ltd., (ITA No. 472/Hyd/2014)
- (vii) Invensys Development Centre (India) Pvt. Ltd., (ITA No. 1256/Hyd/2010)
- (viii) Adaptech India (P) Ltd. vs. ITO (ITA No. 481/Hyd/2011)

Similar view was taken by the Hon'ble Tribunal in the case of Telecordia Technologies India Pvt. Ltd. vs. ACIT (ITA No. 7821/mum/2011), wherein, the Hon'ble Tribunal held as under:

"7.7 Tata Elxsi Limited.:

From the facts and material on record and submissions made by the learned AR, it is seen that the Tata Elxsi is engaged in development of niche product and development services, which is entirely different from the assessee company. We agree with the contention of the learned AR that the nature of product developed and services provided by this company are different from the assessee as have been narrated in para 6.6 above. Even the segmental details for revenue sales have not been provided by the TPO so as to consider it as a comparable party for comparing the profit ratio from product and services. Thus, on these facts, we are unable to treat this company fit for comparability analysis for determining the arms length price for the assessee, hence, should be excluded from the list of comparable parties."

Also, the Hon'ble Benches of various Tribunal, has directed to exclude Tata Elxsi Ltd. from the final set of comparable companies on account of functional dissimilarity in the following cases:

- (i) Cisco Systems (India) Pvt. Ltd. vs. DCIT (ITA No. 130/Bang/2014)
- (ii) Cypress Semiconductor Technology India Pvt. Ltd. vs. DCIT (ITA No. 1167/Bang/2010)
- (iii) Genesis Integrating Systems (India) Pvt. Ltd. vs. DCIT (ITA No. 25/Bang/2014)
- (iv) Yahoo Software Development India P. Ltd. vs. DCIT (ITA No. 1129/Bang/2010)
- (v) Microchip Technology India Pvt. Ltd. vs. DCIT (ITA No. 1429/Bang/2010)

In view of the aforesaid, it is respectfully submitted that Tata Elxsi Limited, a company dealing in specialized and niche domain of software products/services, cannot be considered as comparable for the purpose of benchmarking the international transactions of the assessee.

(ii) Brand

It is submitted that the company being a part of the TATA group enjoys the benefits/returns associated with the TATA brand.

The Hon'ble Delhi High Court in the case of Pr. CIT vs Oracle (OFSS) BPO Services Pvt Ltd (ITA No 124/2018) held that companies having significant brand presence cannot be regarded as appropriate comparable for the purpose of benchmarking the international transactions undertaken by a captive service provider. The said decision of the Hon'ble High Court has been upheld by the Hon'ble Supreme Court in SLP (CC) No. 32469/2018.

Further following the aforementioned ruling, Hon'ble Delhi Bench of Tribunal in the case of Pitney Bowes Software India Pvt. Limited vs. Addl. CIT (7034/Del/2017 in the same AY 14-15 rejected companies on account of ownership of brand"

The assessee accordingly submitted that Tata Elxsi Limited cannot be considered as comparable for the purpose of benchmarking the international transaction of provision of software services.

15. The Ld. Departmental Representative relied upon the orders of the TPO and DRP.

16. We have heard the rival contentions and perused the annual report and decisions relied upon by the assessee. We find that this company is engaged in development and sale of niche software products and also exploits the TATA brand. Therefore, in our considered opinion, this company cannot be regarded as comparable to the assessee, a captive software service provider. Our view is

supported by the decisions of the co-ordinate Benches of the Tribunal including in the case of Toluna India Private Limited and Steria India Pvt Ltd. (supra). We find that the decisions of the Tribunal in the aforesaid cases have been approved by the Hon'ble Delhi High Court. Accordingly, we direct the exclusion of TATA Elxsi Ltd. from the final set of comparable companies.

d) Lanco Global Systems Ltd.

17. With regard to Lanco Global Systems Ltd., it was submitted by the assessee that this company is engaged in development and sale of software products and therefore, cannot be regarded as an appropriate comparable for the purpose of benchmarking analysis. The Ld. Departmental Representative submitted that nowhere in the annual report of this company it is stated that it is engaged in development and sale of software products.

18. We have heard the assessee and the department and perused the annual report of this company. From a perusal of the annual report we find ourselves in agreement with the Revenue Authorities that this company is an appropriate comparable for undertaking benchmarking analysis. Accordingly, we reject the contention of this assessee and uphold the inclusion of this company as comparable.

II. Company whose rejection/exclusion is challenged by the assessee

19. The assessee is disputing the rejection/exclusion of PSI Data Systems Ltd. from the set of comparable companies. The TPO/DRP rejected this company on

the basis that it has entered into significant related party transactions equivalent to 27.66% of sales. It was submitted by the assessee that the aforesaid finding of the DRP is factually incorrect. It was submitted that the RPT entered into by this company constitutes 22.41% of sales computed as under:

Particulars	Amount (Rs)
Transactions relating to income	14,65,21,342
Transactions relating to cost	1,54,32,175
Reimbursements	2,95,69,090
Total (A)	19,15,22,607
Total Income (B)	85,44,33,616
RPT/Sales (A/B)	22.41%

In view of the aforesaid, it was submitted that since the related party transactions entered into by this company constitutes less than 25% of sales, the said company ought to be included in the final set of comparable companies. The LD Departmental Representative submitted that the issue may be restored to the file of TPO for verification of calculation of related party transactions.

20. We have heard the rival contentions. We find that the ends of justice would be met by giving an opportunity to the TPO to verify the aforesaid calculation. Accordingly, we direct the TPO to verify the aforesaid calculation of related party transaction and include the company in the final set of comparable companies if the related party transactions are found to be less than 25% of sales.

III. Incorrect margin computation

21. The assessee submitted that the TPO has incorrectly computed the operating margins of the comparable companies. The submissions of the assessee in this regard are as under:

a) Geometric Software Solutions Ltd.

It is submitted that while computing the segmental operating margin of Geometric Software Solution Ltd. on the basis of information submitted by the company, the DRP/TPO has considered royalty as an extra-ordinary expenditure and accordingly excluded the same from the operating cost. It is submitted that royalty is a routine expenditure inextricably linked to the operations of a company and cannot be regarded as an item of extra-ordinary nature. In view of the aforesaid, it is submitted that expenditure on account of royalty ought to be considered as ordinary operating expenditure and after including the same in the operating cost of this company, the operating margin reduces to 8.38% as against margin of 10.71% considered by the TPO/DRP (pg 60 of appeal folder):

Description	Amount (Rs)
Seg Operating Revenue	1,58,37,97,773
Seg Direct Expenses	95,77,78,134
Common Expenses	557479380
Add: Allocated Common Expenses (in the ratio of turnover)	503613165
Less: Extra-ordinary expenses (proportionate royalty on Rs 3,41,19,125)	30822379
Seg Operating Expenses	1,46,13,91,299
Seg Operating Profit	12,24,06,474
Seg OP/TC	8.38%

Accordingly, it is submitted that segmental operating margin of 8.38% earned by Geometric Software may be considered for the purpose of computing the arm's length price.

b) R Systems International (seg)

It is submitted that while computing the segmental operating margin of R Systems International, the DRP/TPO has considered provision for doubtful debts and provision for doubtful advances as non operating expenses and accordingly excluded the same from the operating cost.

It is submitted that provision for bad debts and advances is a routine expenditure linked to the operations of a company and cannot be regarded as non operating in nature (ref. Sony India Pvt

Ltd 114 ITD 448 (Del) (@ pg 603-604) and Suessen Asia Pvt Ltd (ITA No 1629/PUN/2011) (@pg 545-548). In view of the aforesaid, it is submitted that expenditure on account of provision for bad debts and advances ought to be considered as operating expenditure and after including the same in the operating cost of this company, the operating margin reduces to 7% as against margin of 15.07% considered by the TPO/DRP (pg 61 of appeal folder):

Description	Amount (Rs)
<i>Seg Operating Revenue</i>	<i>1,12,01,72,651</i>
<i>Seg Direct Expenses</i>	<i>1,00,75,62,812</i>
<i>Common Expenses</i>	<i>39334570</i>
<i>Less: proportionate non operating expenses (provision for doubtful debts Rs 5,08,06,788 and provision for doubtful advance Rs 3,39,47,774)</i>	<i>73393613</i>
<i>Seg Operating Expenses</i>	<i>1,04,68,97,382</i>
<i>Seg Operating Profit</i>	<i>7,32,75,269</i>
<i>Seg OP/TC</i>	<i>7.00%</i>

Accordingly, it is submitted that segmental operating margin of 7% earned by Geometric Software may be considered for the purpose of computing the arm's length price.

22. The learned Departmental Representative, on the other hand, relied on the orders of the authorities below.

23. Having considered the rival submissions, we find that this issue needs verification at the stage of AO/TPO on the premise whether the royalty paid by the Geometric Software Solutions Ltd. was the routine expenditure or not. In case, it is found to be the routine expenditure of the company, the same shall be considered as an item of operating expenditure. Regarding the provision for doubtful debts, we find that it is an item of operating expenditure as held in the case of Sony India Pvt. Ltd 114 ITD 448 (Del). Regarding provision for advances, we find that the provision for advances cannot be considered in the instant case

as an item of operating expenditure, as the assessee could not prove that such advances were not made for purchase of capital asset or for any other non-business purpose. The decisions relied by the assessee do not pertain to the provision for advance. We, therefore, direct the TPO/AO to compute the Operating Profit Margin accordingly.

IV. Risk Adjustment

24. The assessee submitted that it is a captive contract service provider, rendering software development services to its overseas affiliates and operates in a risk immune environment. The assessee therefore submitted that an appropriate downward adjustment is required to be made for comparing operating profit margin of the appellant with the operating profit margin earned by the full-fledged entrepreneurial-companies to establish the comparability.

25. We find that this contention of the assessee has been rejected by the Benches of Tribunal in a plethora of judgments due to lack of appropriate data and quantification of risk adjustment. In the following cases the Benches of Tribunal have rejected the risk adjustment claim due to lack of absence of quantification:

- Degania Medical Devices Pvt vs DCIT Ltd [1254/Del/2015]
- Infac India Pvt Limited vs DCIT (3195/Chny/2017)
- ACIT vs Marvell India Pvt Ltd (ITA No 384/Bang/2016)
- Swiss Re Shared Services (India) Pvt Ltd(TS-504-ITAT-2017(Bang)-TP)
- Mercedes-Benz Research and Development India Private Ltd(TS-503-ITAT-2017(Bang)-TP)
- Obopay Mobile Technology India Private Ltd(TS-493-ITAT-2017(Bang)-TP)

Due to the aforesaid reasons and following the judicial precedent, we reject the claim of the assessee towards risk adjustment.

26. Modified ground No. 3 pertains to payment for License of computed software to be allowed as revenue expenditure. The assessee, during the relevant previous year incurred an expenditure of Rs 2,47,95,422/- on account of payment for software licenses. The assessing officer disallowed the claim towards such expenditure on the basis that the expenditure is capital in nature.

27. We have gone through the material placed on record by the assessee. It was submitted that the above expenses are to be regarded as incurred on revenue field as per the test laid down by the Special Bench of Tribunal in the case of Amway India Enterprises, 111 ITD 112 (Del) (SB) in as much as (i) such computer software does not have utility for long duration and hence do not result in enduring benefit and (ii) such software does not constitute a profit earning apparatus and merely enable the appellant to efficiently conduct its business. The aforesaid decision has been affirmed by the Hon'ble Delhi High Court in the case of **CIT vs Asahi India Safety Glass Ltd : 346 ITR 329**.

27.1 It was further submitted that Tribunal while deciding the appeal of the assessee for AY 2006-07 (ITA No 5058/Del/2010) involving identical issue deleted the adjustment made by the assessing officer holding that license fee paid by the appellant is to be treated as revenue in nature.

28. We have duly considered the rival submissions. Since the issue is covered in favour of the assessee by the order of the Tribunal in the assessee's own case for immediately preceding year, we direct the AO to delete the addition.

29. Ground No. 4 pertaining to interest u/s. 234A & 234B of the Act is consequential in nature and the AO is directed to give consequential effect.

30. Ground No. 5 pertaining to initiation of penalty u/s. 271(1)(c), being premature, is dismissed.

31. In the result, the appeal is partly allowed as discussed above.

Order pronounced in the open court on 19.03.2019.

Sd/-

(Bhavnes Saini)
Judicial member

Sd/-

(L.P. Sahu)
Accountant Member

Dated: 19.03.2019

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Copy of order forwarded to:

<i>(1) The appellant</i>	<i>(2) The respondent</i>
<i>(3) Commissioner</i>	<i>(4) CIT(A)</i>
<i>(5) Departmental Representative</i>	<i>(6) Guard File</i>

By order

*Assistant Registrar
Income Tax Appellate Tribunal
Delhi Benches, New Delhi*