

**IN THE INCOME TAX APPELLATE TRIBUNAL**  
**“A” BENCH : BANGALORE**  
**BEFORE SHRI J. SUDHAKAR REDDY, ACCOUNTANT**  
**MEMBER AND MS. BEENA PILLAI, JUDICIAL MEMBER**

**IT(TP)A No. 589/Bang/2016**

**Assessment Year : 2011-12**

M/s. SanDisk India Device Design Centre Private Limited, Survey No. 143/1, Amani Bellandur Khane Village, Prestige Excelsior, Prestige Tech Park, Marathalli, Kadubeesanahalli, Varthur Hobli, Bengaluru, Karnataka – 560 103. <b>PAN: AAICS9204M</b>	Vs.	The Assistant Commissioner of Income Tax, Circle – 6 (1) (1), Bangalore.
APPELLANT		RESPONDENT

<b>Assessee by</b>	:	Shri T. Suryanarayana, Advocate
<b>Revenue by</b>	:	Shri C.H. Sundar Rao, CIT (DR)

<b>Date of hearing</b>	:	03.06.2019
<b>Date of Pronouncement</b>	:	07.06.2019

**O R D E R**

**PER MS. BEENA PILLAI, JUDICIAL MEMBER**

Present appeal has been filed by assessee against final assessment order dated 29/01/16 passed by Ld. ACIT, Circle 6 (1) (1)

Bangalore, for assessment year 2011-12 on following grounds of appeal:

*“The Appellant submits as under:*

**1. Order/ Directions bad in law and on facts**

1.1 *The order passed by the Assistant Commissioner of Income-tax, Circle 6(1)(1) [‘the AO’], under section 143(3) read with section 144C(13) of the Income-tax Act, 1961 (‘the Act’) pursuant to the directions issued by the Hon’ble Dispute Resolution Panel [‘DRP / Ld. Panel’], is bad in law and on facts and is in violation of the principles of natural justice. The order passed by the AO, under section 154 of the Act, dated 9 February 2016, is bad in law and on facts.*

1.2 *Without prejudice to the generality of the above, the order issued by the AO is bad in law in so far as the fact that the AO did not issue to SanDisk India Device Design Centre Private Limited (‘the Appellant or ‘the Company’), a show cause notice as per proviso to section 92C(3) of the Act.*

1.3 *The Ld. Panel erred in law and on facts in not taking cognizance of the objections raised by the Appellant in relation to the transfer pricing matters, while issuing the directions under Section 144C(5).*

1.4 *On the facts and in the circumstances of the case and in law, the Ld. Panel and AO/ TPO erred in not demonstrating that the motive of the Appellant was to shift profits outside India by manipulating the prices charged in the international transaction, which is a pre-requisite condition to make any adjustment under the provision of Chapter X of the Act.*

**2. Comparability Analysis adopted by the TPO for determination of arm's length price —  
Software Development Services**

2.1 *The Ld. Panel and AO/ TPO erred in rejecting the value of international transactions as recorded in the books of account, as the arm's length price.*

2.2 *The Ld. Panel and AO/ TPO erred in determining a new arm's length price in substitution of the arm's length price as determined by the Appellant.*

2.3 *The Ld. Panel and the AO / TPO erred on facts in rejecting the comparable companies arrived at in the Transfer Pricing Study without considering the functional and risk analysis of the Appellant.*

2.4 *The Ld. Panel and the AO / TPO erred in law in holding the fresh comparability analysis using non contemporaneous data conducted by the TPO and further substituting the Appellant's analysis with fresh benchmarking analysis on his own conjectures and surmises. Thus, the Appellant prays that the fresh benchmarking analysis conducted by the TPO is liable to be quashed.*

2.5 *The Ld. Panel and the AO / TPO grossly erred on facts in confirming the benchmarking of transactions of software development services of the Appellant with companies operating as full-fledged entrepreneurs without considering the differences in the functions performed, assets employed and risk undertaken by the Appellant vis-a-vis comparable companies.*

2.6 *The Ld. Panel and the AO/ TPO erred on facts in law by including the foreign exchange loss while calculating the net margins of the Appellant and excluded the same while calculating the margins of the comparable companies.*

2.7 *The Ld. Panel and the AO / TPO erred in law and on facts in applying arbitrary filters as criterion for rejection of companies identified by the Appellant in the Transfer Pricing Study, such as (i) companies whose data for financial year ('FY') 2010-11 was not available, (ii) companies with software development service revenue less than 75% of total operating revenue, (iii) companies with related party transactions greater than 25% of sales (iv) companies with export sales less than 75% of total sales, (v) companies with employee cost less than 25% of total revenues, (vi) companies with different financial year ending (i.e. other than 31 March 2011) and (vii) companies having persistent losses up to and including financial year 2010-11.*

2.8 *The AO/ TPO also erred on facts in wrongly computing the margins of certain companies identified as comparable by the TPO.*

2.9 *The Ld. Panel and the AO/ TPO erred on facts and in law in considering Acropetal Technologies Ltd, e-Zest Solutions Ltd, E-Infochips Ltd, ICRA Techno Analytics Ltd, R S Software (India) Ltd. and Persistent Systems & Solutions Ltd. despite these companies being functionally*

*dissimilar to the Appellant. The Ld. Panel also erred in confirming the same.*

**3. Comparability Analysis adopted by the TPO for determination of arm's length price - Marketing Support Services**

3.1 *The Ld. Panel and the AO/ TPO grossly erred on facts in confirming the benchmarking of transactions of marketing support services of the Appellant with companies operating as full- fledged entrepreneurs without considering the differences in the functions performed, assets employed and risk undertaken by the Appellant vis-a-vis comparable companies.*

3.2 *The TPO erred in law by not providing the search strategy on the basis of which the fresh benchmarking analysis has been undertaken. The Ld. Panel and AO erred in confirming the same.*

3.3 *The AO/ TPO erred in facts in arbitrarily rejecting companies based on their financial results without considering the functional comparability.*

3.4 *The AO/ TPO also erred on facts in erroneously computing the mark-up of the assessee and companies identified as comparable by the TPO.*

**4. Erroneous data used by the TPO**

4.1 *The Ld. Panel and the AO / TPO erred in law in using data. which was not contemporaneous and which was not available in the public domain at the time of conducting the transfer pricing study by the Appellant.*

4.2 *The Ld. Panel and the AO / TPO erred in law and on facts in disregarding the application of multiple-year data while computing the margins of comparable companies.*

**5. Non-allowance of appropriate adjustment to the comparable companies by the Ld. Panel and AO/ TPO**

5.1 *AO/ TPO erred in law and on facts in not allowing appropriate adjustments under Rule 10B to account for, inter alia, differences in (i) accounting practices, (ii) marketing expenditure adjustment, (iii) research and development expenditure adjustment, (iv) working capital. and (iv) risk adjustment to account for the difference in profile between the Appellant and the comparable companies.*

5.2 *The TPO erred in incorrectly computing the working capital adjustment and restricting the working capital adjustment to 1.63% in respect of software development services*

5.3 *The TPO erred in not providing working capital adjustment in respect of the marketing support services.*

#### **6. Variation of 5% from the arithmetic mean**

6.1 *The AO/ TPO erred in law in not granting the variation as per the proviso to section 92C(2) of the Act*

#### **7. Setting-off of appropriate credit under section 115JAA of the Act**

*The AO, having determined the tax liability of the Appellant at Rs. 14,453,147 (excluding credit of taxes deducted at source, advance tax payments. interest under section 234B, 234C and 234D of the Act) under the normal provisions of the Act, has erred in not setting-off appropriate brought forward MAT credit entitlement under section 115JAA of the Act.*

#### **8. Non-grant of refund and levy of interest under section 234D of the Act**

*The AO has erred in considering that a refund of Rs. 25,375 pertaining to AY 2011-12 has been granted to the Appellant under section 143(1) of the Act. Accordingly, the AO has also erred in levying interest under section 234D of the Act of Rs. 6,344.*

#### **9. Initiation of penalty proceedings**

*The Appellant submits that based on the facts and circumstances of the case, there was no basis for the AO to initiate proceedings under section 274 read with section 271 of the Act.*

#### **10. Relief**

10.1 *The Appellant prays that directions be given to grant all such relief arising from the above grounds and also all relief consequential thereto.*

10.2 *The Appellant desires leave to add to or alter, by deletion, substitution or otherwise, any or all of the above grounds of objections, at any time before or during the hearing of the Appeal.*

10.3 *Further, the Appellant prays that the adjustment in relation to transfer pricing matters made by the learned AO/*

*TPO and upheld by the Ld. Panel is bad in law and liable to be deleted.*

*The Appellant submits that the above grounds are independent of and without prejudice to one another."*

2. Additional ground raised by assessee vide application dated 27/03/18 are as under:

*"2.10. That, the TPO/AO erred in not giving effect to the DRP's directions.*

*2.11 That, in any event, in the facts and circumstances of the case, Infosys Ltd., L & T Infotech Ltd., Persistent Systems Ltd., Sasken Communication Technologies Ltd. and Tata Elxsi Ltd, which were directed to be excluded by the DRP on account of their turnovers being in excess of Rs. 200 crores, ought to stand rejected as comparables as they are functionally dissimilar to the Appellant."*

3. Brief facts of the case are as under:

Assessee filed its return of income on 30/11/11 declaring total income of Rs. 41, 92, 042/-for year under consideration. Ld.AO issued notice under section 143 (2) of the Act, in response to which, representative of assessee appeared before Ld.AO and filed requisite details as called for. During the year under consideration, Ld.AO observed that, assessee had international transaction with its associated enterprises's SanDisk Corporation in USA and SanDisk Manufacturing, Ireland to carry out its business. Ld. AO accordingly referred the issue to Ld. TPO for determination of arm's length price of transaction. On receipt of reference under 92CA of the Act, Ld. TPO issued notice to assessee calling upon to furnish economic analysis of

international transaction, in accordance with section 92CE of the Act, read with Rule 10 B of Income tax Rules.

As per TP documentation filed by assessee, Ld. TPO observed that assessee was incorporated in Bangalore in software technology Park as a 100% export oriented unit. It has been submitted in TP study that assessee is a captive service provided to SanDisk group entity's, and provides software development and related services as well as marketing support and related services to SanDisk U.S. and SanDisk Ireland respectively.

Ld.TPO observed that, assessee entered into following international transactions:

<b>SI. No.</b>	<b>Type of transaction</b>	<b>Amount (Rs)</b>
1	<i>Provision of software development services</i>	382976214
2	<i>Marketing services</i>	39031321
3	<i>Recovery of expenses</i>	1304314
4	<i>Total</i>	423311849

4. It has been submitted by both sides that there is no dispute insofar as the most appropriate method adopted by assessee under both these segments and the PLI for determining the average margin. Assessee has used TNMM as the most appropriate method and OP/TC as the PLI under both these segments.

**Software development services**

Functions performed by assessee under this segment are as under:

As per TP study assessee under this segment is engaged in provision of software development and related services in relation to chip design services. Assessee computed its margin at 12.5% by using OP/TC as PLI and TNMM as most appropriate method. Ld.TPO observed that assessee carried out following functions under this segment:

*“SanDisk India is engaged in provision of software development and related services to SanDisk US. The Company provides these services in accordance with the specifications provided by its associated enterprises. The nature of software development services provided is in relation to chip designed and developed by the SanDisk Group.*

*Following functions are performed by SanDisk India in relation to provision of software development and related services:*

*Support and development services*

*SanDisk India assists SanDisk US in designing and developing ASIC controllers specifically in the controller development activity including designing the high level and low level controllers and verification of controller design and IP development activity.*

*Design services*

*NAND flash memory chips are key components of SanDisk products like memory cards used in digital cameras and mobiles. MP3 players etc. The NAND project team of SanDisk India operates as an extension to the parent team of SanDisk US in the areas of analogue design, custom design, timing and logic verification and physical design. SanDisk India gets specifications as inputs and designs various models of NAND flash memories as per specifications and verifies the design of robustness using CAD tools. It also contributes in the area of logic design and verification for full chip*

*functionality and interface timing verification that confirm the chip for NAND interface.*

*Product testing services*

*SanDisk India provides compatibility testing services for SanDisk products like readers, flash drives, USB drives etc. It also provides application engineering support for product and design teams in consumer business unit.*

*Software testing services*

*SanDisk India also assists in developing Flash Test Automation Software Tool and other similar tools to help automating the test processes. SanDisk India also assists in the development of backed firmware verification suite.”*

5. Assets utilised:

It has been submitted that assessee owns routine intangible assets like furniture fixtures, computer, computer software is etc.

6. Risks assumed

According to TP study assessee does not have to undertake service delivery risk, credit risk. However Ltd risks are assumed in respect of market, quality and compliance risk and technology risk. It has been submitted that it is the AE, that undertakes risks substantially due to rapid advancement in software development sector.

The only risk that this assumed by assessee is in terms of foreign exchange risk as assessee earns its revenue in foreign currency and the foreign exchange difference impact cash flow of assessee.

7. Assessee thus categorised itself as backend captive service provider bearing less than normal risk in relation to software

development and related services. Ld.TPO observed that assessee had selected 9 comparables, with an average margin of 10.62% for computing the arms length price of the international transaction under this segment. It was thus submitted by assessee that the transaction was at arms length price with its AE.

<b>Sl. No.</b>	<b>Name of the company</b>	<b>Average Margins</b>
1	<i>Bells Softech Ltd.</i>	5.4%
2	<i>LGS Global Ltd.</i>	14.15%
3	<i>Mindtree Ltd.</i>	13.28%
4	<i>CG - VAK software and export Ltd.</i>	1.92%
5	<i>Infinite Computer Solutions India Pvt. Ltd.</i>	17.08%
6	<i>Melstar information Technologies Limited</i>	-5.65%
7	<i>R Systems International Ltd.</i>	12.43%
8	<i>Sasken Communications Technologies Ltd.</i>	21.83%
9	<i>Tata Elxsi Ltd.</i>	15.11%
<b>Arithmetical Mean</b>		<b>10.62%</b>

8. Ld.TPO by applying following filters eliminated most of comparables selected by assessee and selected 10 new comparables by accepting 3 comparables as under:

<b>Step</b>	<b>Description</b>
1	<i>Companies whose data for FY 2010-11 is not available - excluded</i>
2	<i>Companies whose software development service income &lt; Rs. 1 Cr-excluded</i>
3	<i>Companies whose software development service revenue is &lt; 75% of the total operating revenue - excluded</i>
4	<i>Companies which have related party transactions &gt; 25% of sales -excluded</i>
5	<i>Companies which have export sales &lt; 75% of sales - excluded</i>
6	<i>Companies whose employee cost is &lt; 25% of their turnovers - excluded</i>

7	<i>Companies having different financial year ending - excluded</i>
8	<i>Companies that are having persistent losses for the last three years up to and including the previous year - excluded</i>
9	<i>Companies having peculiar economic circumstances - excluded</i>
10	<i>Companies that are functionally different - excluded</i>

<b>Sl. No.</b>	<b>Name of the Company</b>	<b>Mark-up on Total Costs (WC— unadj) (in %)</b>	<b>Mark-up on Total Costs (WC — adj) (in %)</b>
1	<i>Acropetal Technologies Ltd. (seg.)</i>	31.98	24.35
2	<i>e-Zest Solutions</i>	21.03	14.78
3	<i>E-Infochips Ltd.</i>	56.44	51.34
4	<i>Evoke</i>	8.11	3.95
5	<i>ICRA Techno Analytics Ltd.</i>	24.83	18.54
6	<i>Infosys Ltd.</i>	43.39	38.87
7	<i>Larsen &amp; Toubro Infotech Ltd.</i>	19.83	15.58
8	<i>Mindtree Ltd. (seg.)</i>	10.66	5.20
9	<i>Persistent Systems &amp; Solutions Ltd.</i>	22.12	16.92
10	<i>Persistent Systems Ltd.</i>	22.84	17.37
11	<i>R S Software (India) Ltd.</i>	16.37	12.05
12	<i>Sasken Communication Technologies</i>	24.13	20.17
13	<i>Tata Elxsi Ltd. (seg.)</i>	20.91	14.71
<b>AVERAGE MARGIN</b>		<b>24.82</b>	<b>19.12</b>

9. The margin of 13 comparables so selected by Ld.TPO was at 24.82%. It has been submitted that, although working capital adjustment was 5.10%, the same was restricted to 1.63% by Ld.TPO, thereby computing proposed adjustment of Rs.3,63,91,252/-.

## 10. Marketing support services

In the TP study, Ld.TPO observed that, assessee entered into a Service Agreement with SanDisk Ireland for provision of marketing and related support services, and that, the Service Agreement was in force during the year under consideration. It is also been submitted that against the provision of such services, assessee was remitted at cost +10%. In TP study, as per Service Agreement, assessee was to render following services to SanDisk Ireland:

- *Coordination of promotion and advertising of SanDisk products and related supplies and components;*
- *Conduct market research and keep SanDisk Ireland and its manufacturers representatives, distributors and retailers advised and informed regarding all matters concerning the products;*
- *Provision of technical information, education and service programs for customers and potential customers of products,*
- *Provision of assistance in gathering research and development information for the products;*
- *Coordinate local purchase of supplies as necessary;*
- *Provide SanDisk Ireland with such reports concerning the above matters as may from time to time be reasonably required by SanDisk Ireland; and*
- *Other related activities.*

*Summarized below are the functions performed by SanDisk India in relation to provision of marketing support and related services*

### *Provision of services*

*SanDisk India renders marketing and related support services based on instructions and directions received from SanDisk Ireland.*

### *Other support functions*

*SanDisk India with the assistance of SanDisk Ireland performs all corporate functions such as administration, finance, accounting, legal and regulatory affairs.*

*Ownership of Intellectual Property*

*SanDisk Ireland owns all transferable intellectual property rights in respect of any incidental intellectual property product developed or created by SanDisk India in the course of provision of marketing and related support services.*

*Based on the discussion presented above, the aforesaid activities as rendered by SanDisk India have been categorized as low end marketing support and related services. These services essentially comprise of provision of back-end support to other group enterprises and are ancillary in nature. Given that the primary objective of rendering these services is to facilitate the business of other group enterprises, they have been characterized as business support services.*

11. Risks assumed:

Assessee under this segment assumed no credit risk and to limited extent service delivery risk. Assessee was only undertaking foreign exchange risk, as revenue is received by assessee in foreign currency.

Ld.TPO observed that assessee computed its margin by using OP/TC as PLI and TNMM as most appropriate method at 10% as compared to following 7 comparables selected by assessee whose margin was computed at 5.01%. It was observed that assessee thus held its transaction under this segment to be at arms length price.

**C.4. Comparables selected by Assessee and their arithmetic mean:**

<b>Sl.</b>	<b>Name of the company</b>	<b>Average</b>
1.	Acme Advertisements Pvt. Ltd.	1.49%
2.	Educational Consultants (India) Ltd.	10.27%

3.	<i>Export Promotion Council for</i>	6.52%
4.	<i>IDC (India) Ltd.</i>	11.55%
5.	<i>Kestone Integrated Mktg Services Pvt.</i>	0.94%
6.	<i>Ma Foi Management Consultants Ltd.</i>	-0.4%
7.	<i>Office Care Services</i>	4.72%
<b>Arithmetical Mean</b>		<b>5.01%</b>

Ld.TPO analysed functions performed by assessee as a captive service provider to SanDisk group entities in respect of software development and related services as well as marketing support and related services.

12. It has been submitted by Ld.AR that Ld.TPO for exclusion/inclusion of comparables applied certain filters which were not made available to assessee under Marketing Service segment. Ld.TPO thus selected following comparables with an average margin of 18.25% and proposed an adjustment of Rs.29,27,349/- under this segment.

<b>Sl. No.</b>	<b>Name of the Company</b>	<b>Mark-up on Total Costs (in %)</b>
1.	<i>Asian Business Exhibition &amp;</i>	19.51
2.	<i>Cyber Media Research Ltd.</i>	10.59
3.	<i>ICC International Agencies Ltd.</i>	24.66
<b>AVERAGE MARGIN</b>		<b>18.25</b>

13. Aggrieved by proposed adjustment, assessee preferred objections before DRP. DRP while passing its order directed Ld. TPO to apply turnover filter of 1 to 200 crores to select comparables under Software Development Service segment.

Insofar as market support service segment was concerned Ld.TPOs method was upheld by DRP. Subsequently, Ld. AO on receipt of DRP directions passed final assessment order.

14. Ld.AR submitted that Ld.AO while passing final assessment order did not comply with directions of DRP in respect of applying the Turnover range for selecting comparables under Software Development Service segment, and made addition in the hands of assessee as under:

<b>Segment</b>	<b>Adjustment</b>
<i>SWD</i>	<i>Rs. 3,63,91,252/-</i>
<i>Marketing Support Services</i>	<i>Rs. 29,27,349/-</i>
<i>Total adjustment u/s 92CA</i>	<i>Rs. 3,93,18,601/-</i>

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

16. Ld.AR as well as Ld. CIT DR submitted that Ld. AO failed to follow directions regarding application of turnover range filter directed by DRP, for selecting comparables under software development service segment. At the outset admittedly it has also been submitted that various filters applied by Ld.TPO which was objected before DRP has not been dealt with by DRP and therefore needs consideration. It has been submitted by Ld.AR that, additional ground raised is in respect of comparables which has been upheld without considering

functional dissimilarity and filters arbitrarily applied by Ld.TPO.

17. We have perused the submissions advanced by both sides in the light of the records placed before us.
18. It has been observed that Ld.TPO on one hand applied filters like service revenue filter, employee cost filter etc., for exclusion of certain comparables however it has been submitted that some of the comparables selected by Ld.TPO itself does not pass through his own filters. It is also observed that admittedly objections raised in regards to the same before DRP by assessee has not been dealt with. Further it is observed that in Market Support service segment Ld.TPO has not provided with filters applied while finalizing the final comparables.
19. We are therefore inclined to set aside this issue back to DRP for analysing both the segments afresh and to deal with the objections raised by assessee in detail independently. Needless to say that assessee shall be granted proper opportunity as per law to represent its case.
20. **Accordingly ground No. 1-6 raised by assessee stands allowed for statistical purposes.**
21. In regards to **Ground No. 7-8**, Ld.AR submitted that Ld.AO failed to grant appropriate MAT credit and compute interest

under section 234D. We therefore direct Ld.AO to verify the same, and grant appropriate credit under MAT. In respect of interest under section 234D of the act, Ld.AO is directed to verify the refund and to levy interest accordingly as per law.

22. In the result these grounds raised by assessee stands allowed for statistical purposes.

23. In the result appeal filed by assessee stands allowed for statistical purposes.

**Order pronounced in the open court on 07<sup>th</sup> day of June, 2019.**

Sd/-  
**(J. SUDHAKAR REDDY)**  
**Accountant Member**

Sd/-  
**(BEENA PILLAI)**  
**Judicial Member**

Bangalore,  
Dated, the 07<sup>th</sup> June, 2019.  
/MS/

Copy to:

- |               |                        |
|---------------|------------------------|
| 1. Appellant  | 4. CIT(A)              |
| 2. Respondent | 5. DR, ITAT, Bangalore |
| 3. CIT        | 6. Guard file          |

By order

Assistant Registrar,  
Income Tax Appellate Tribunal,  
Bangalore.