

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. 1415/Bang/2010

Assessment Year : 2006-07

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| M/s. Schneider Electric IT Business India Private Limited, (Formerly known as American Power Conversion (India) Private Limited), No. 187/3 & 188/3, Jigani, Bangalore, Karnataka State – 562 106. PAN: AACCA6398Q | Vs. | The Deputy Commissioner of Income Tax, LTU, Bangalore. |
| APPELLANT | | RESPONDENT |

| | | |
|--------------------|---|--------------------------------|
| Assessee by | : | Shri Sharath Rao, CA |
| Revenue by | : | Shri C.H. Sundar Rao, CIT (DR) |

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| Date of hearing | : | 04.06.2019 |
| Date of Pronouncement | : | 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 05/10/10 passed by Ld.DCIT, LTU, Bangalore on following grounds of appeal:

“The grounds mentioned herein are without prejudice to one another.

Transfer Pricing

1. That the order of the Learned Deputy Commissioner of Income-tax, LTU, Bangalore (Assessing Officer' or 'Learned AO') which is in conformity with the directions of the Dispute Resolution Panel. Bangalore (learned Panel'), to the extent prejudicial to the Appellant, is bad in law and liable to be quashed.

2. That the Assessment Order passed in pursuance the directions issued by the Learned Panel is a vitiated order as the Learned Panel erred both on facts and in law in confirming the addition made by the Learned AO to the Appellant's income by issuing a non-speaking order without appropriate application of mind.

A) Payment of License Fee (Royalty):

3. That on the facts and in the circumstances of the case the Learned AO/ the Learned Joint Director of Income Tax (Transfer Pricing) - I, Bangalore (Transfer Pricing Officer' or Learned TPO') and the Learned Panel erred in making adjustment in arm's length price of the Appellant's international transactions with related parties of Rs. 69,264,977 /- (pertaining to payment of license fee).

4. That the Learned AO and the Learned Panel erred in not appreciating the fact that the Appellant had prepared the TP documentation bona fide and in good faith in compliance with the Act and Income tax Rules, 1962 (the Rules).

5. The Learned AO and the Learned Panel erred in disregarding the determination of the arm's length pricing for the international transactions relating to the payment of license fee (royalty) as per the Transfer Pricing Documentation, maintained by the Appellant.

6. In connection with the payment of license fee, the Learned AO and the Learned Panel erred in facts and in law in confirming the action of the Learned TPO in determining the arm's length price of payment of license fee to be NIL, and in doing so grossly erred in;

6.1. concluding that the Appellant has not received any tangible economic benefit.

6.2. did not appreciate the fact that the Appellant is a licensed manufacturer in India and is entirely dependent on the associated enterprise for the related technical know-how, expertise, etc.

6.3 concluding that no supporting evidence were furnished to justify the payment of license fee;

6.4 erred in ignoring the fact that the Appellant had used Comparable Uncontrollable Price (CUP) Method to benchmark the transaction.

7. Learned AO and the Learned Panel erred in ignoring the fact that the Learned TPO has transgressed the powers provided u/s 92CA of the Act.

B) Provision of Technical Support Services (Software Development):

8. That on the facts and in the circumstances of the case the Learned AO/ the Learned TPO and the Learned Panel erred in making adjustment in arm's length price of the Appellant's international transactions with related parties by Rs. 7,078.623/- (pertaining to software development services).

9. That on the facts and circumstances of the case. the Learned AO and the Learned Panel erred in upholding the rejection of Transfer Pricing (TP) documentation by the Learned. TPO

10. That the Learned AO/TPO and the Learned. Panel erred in ignoring the limited risk nature of the software development services provided by the Appellant and not providing adjustment on account of risk differential with entrepreneurial comparables, as required. while determining the Arm's Length Price of the international transactions of the Appellant.

10.1 That the Learned TPO and the Learned Panel erred in collecting selective information of the companies by exercising power granted to him under section 133(6) of the Act that was not available to the Appellant in the public domain and relying on the same for comparability purposes

10.2. That the Learned TPO erred in not applying multiple year/prior year data for comparable companies while determining arm's length price.

10.3. That the Learned TPO erred in using data as at the time of assessment proceedings. instead of that available during financial year 2005-06 wherein the Appellant was required to prepare and maintain the TP documentation.

10.4. That the Learned TPO erred in including companies in the comparability analysis, which are different from the Appellant in functions, assets and risk profile.

10.5. That the Learned TPO erred in rejecting companies that are similar to the Appellant, while performing the comparability analysis.

10.6. That the Learned TPO erred in not allowing the benefit of range of +/- 5% as provided in proviso to Section 92C(2) of the Act, while determining the arm's length price.

10.7. The Learned TPO erred in not providing appropriate adjustment towards the working capital difference.

10.8. That the Learned Panel erred in upholding the erroneous actions of the Learned TPO as stated in Grounds 10.1 to 10.7 above.

C) Others:

11. That the Learned AO has erred in not allowing the reduction of telecommunication expenses of Rs 4,431.074 from the total turnover of the Appellant in computing the deduction under section 10A of the Act.

12. The Learned AO has erred in not following the decisions of the jurisdictional Income Tax Appellate Tribunal in respect of the application of the formula as prescribed under sub-section (4) of Section 10A in terms of which the total turnover needs to be adjusted corresponding to any adjustment in export turnover.

13. The Learned AO failed to appreciate and ought to have held that the deduction under section 10A of the Act is granted on the proportion which export turnover bears to total turnover of the undertaking. corresponding effect of reduction of various expenses from export turnover would have to be given to total turnover to achieve uniformity between the export turnover and total turnover.

14. Consequently, the Learned AO erred in charging interest under section 234B of the Act.

15. Consequently, the Learned AO erred in charging interest under section 234D of the Act.

16. That the Appellant craves leave to add to and / or to alter, amend, rescind, modify, the grounds herein above or produce further documents before or at the time of hearing of this Appeal.”

Additional Grounds of appeal:

“Transfer Pricing-Additional Ground of Appeal

It is most humbly prayed to the Hon'ble Tribunal to permit the Appellant to raise the following additional grounds of appeal in continuation to the existing revised grounds of appeal and this additional ground be read as Ground No. 10.4.1 to 10.4.11

Ground No. 10.4.1: Aztec Software Ltd (‘Aztec Software’) should be rejected as a comparable

The Appellant submits that the Ld. Transfer Pricing Officer (TPO) has erred in including ‘Aztec Software’ as functionally comparable company to the Appellant, while doing the comparability analysis. The Appellant submits that Aztec Software is not comparable to the Appellant for the following reasons:

- It fails the related party transaction filter of 15%
- It is primarily engaged in Outsourced Product Engineering
- It is engaged in research and development activities and own Intellectual Property Rights

- It is engaged in brand building activities

Ground No. 10.4.2: Infosys Limited ('Infosys') should be rejected as a comparable

The Appellant submits that the Ld. TPO has erred in including, 'Infosys' as functionally comparable company to the Appellant, while doing the comparability analysis. The Appellant submits that Infosys is not comparable to the Appellant for the following reasons:

- It owns substantial brand value and sales is brand driven
- It is not comparable on the basis of its size, scale of operations,
- It is engaged in product development and diversified services;
- It has its own technology research center for software engineering and enterprise technology.

Ground No. 10.4.3 : Kals Information Systems Ltd. (seg) ('Kals') should be rejected as a comparable

The Appellant submits that the Ld. TPO has erred in including 'Kals' as functionally comparable company to the Appellant, while doing the comparability analysis. The Appellant submits that Kals is not comparable to the Appellant for the following reasons:

- It is predominantly a product company
- It has been specifically held as not comparable to a software development service company by various judicial forums including jurisdictional ITAT

Ground No. 10.4.4: Persistent Systems Limited. (seg) ('Persistent') should be rejected as a comparable

The Appellant submits that the Ld. TPO has erred in including 'Persistent' as functionally comparable company to the Appellant, while doing the comparability analysis. The Appellant submits that Persistent is not comparable to the Appellant for the following reasons:

- It is engaged in diversified activities of products development and services and owns Intellectual property Rights ;
- It has made strategic acquisitions during the AY 2006-07

Ground No. 10.4.5: R Systems International Limited ("R Systems") should be rejected as a comparable

The Appellant submits that the Ld. TPO has erred in including 'R Systems' as functionally comparable company to the Appellant, while doing the comparability analysis. The Appellant submits that R Systems is not comparable to the Appellant for the following reasons:

- It is functionally not comparable
- It is engaged in brand building
- It has different financial year ending

Ground No. 10.4.6: Tata Elxsi Limited ('Tata Elxsi') should be rejected as a comparable:

The Appellant submits that the Ld. TPO has erred in including 'Tata Elxsi' as functionally comparable company to the Appellant, while doing the comparability analysis. The Appellant submits that Tata Elxsi is not comparable to the Appellant for the following reasons:

- It is engaged in product design and engineering services; and
- It is engaged in Research & Development activity resulting into creation of Intellectual Property Rights

Ground No. 10.4.7: Lucid Software ('Lucid') should be rejected as a comparable:

The Appellant submits that the Ld. TPO has erred in including 'Lucid' as functionally comparable company to the Appellant, while doing the comparability analysis. The Appellant submits that Lucid is not comparable to the Appellant as it is engaged in product development activities.

Ground No. 10.4.8: Bodhtree Consulting Ltd ("Bodhtree") should be rejected as a comparable

The Appellant submits that the Ld. TPO has erred in including 'Bodhtree' as functionally comparable company to the Appellant, while doing the comparability analysis. The Appellant submits that Bodhtree is not comparable to the Appellant for the following reasons:

- It provides software solutions in the data cleansing and healthcare
- It is engaged in Software development

Ground No. 10.4.9: Accel Transmatics Limited ("Accel Transmatics") should be rejected as a comparable

The Appellant submits that the Ld. TPO has erred in including 'Accel Transmatics' as functionally comparable company to the Appellant, while doing the comparability analysis. The Appellant submits that Accel Transmatics is not comparable to the Appellant for the following reasons:

- It is engaged in product development;
- It is engaged in research and development activities
- The software division possess IPR which was sold during the year;
- It displays highly fluctuating margins indicating that the segmental financials are highly unreliable for comparability.

Ground No. 10.4.10 : Megasoft Limited ("Megasoft") should be rejected as a comparable

The Appellant submits that the Ld. TPO has erred in including 'Megasoft' as functionally comparable company to the Appellant, while doing the comparability analysis. The Appellant submits that 'Megasoft' is not comparable to the Appellant for the following reasons:

- It fails the related party transaction filter of 15%
- It is predominantly software product company and holds Intellectual Property

- *It has made strategic acquisitions during, the year*
- *It has different financial year ending*

Ground No. 10.4.11 : Flextronics Software Systems Limited ("Flextronics") should be rejected as a comparable

*The Appellant submits that the Ld. TPO has erred in including *Flextronics as functionally comparable company to the Appellant, while doing the comparability analysis. The Appellant submits that 'Flextronics' is not comparable to the Appellant for the following reasons:*

- *The annual accounts of the Flextronics is of fifteen months and thus incomparable*
- *It is engaged in sale of products*
- *It is engaged in Research & Development activity and creates Intellectual Property rights*
- *It has made strategic acquisitions during the year"*

2. Brief facts of the case are as under:

Assessee filed its return of income for year under consideration on 13/11/06 declaring income of Rs.22,98,86,248/-. The same was processed under section 143 (2) and statutory notices was subsequently issued to assessee, in response to which, representative of assessee appeared before Ld.AO and filed requisite details as called for.

3. Ld.AO observed that assessee has 3 units, enjoying benefit of section 10 A known as EHTP Units-I and II and Software unit, besides a domestic unit. It was observed by Ld.AO that assessee had debited an amount of Rs.44,31,074/-towards communication charges, which formed part of deduction claimed under section 10A. Ld.AO was of opinion that, as per *Clause (iv) of Explanation 2 to Section 10A*, export turnover for purposes of claiming deduction, does not include freight, telecommunication charges, insurance attributable to the delivery of the articles or things or computer software outside

India or expenses if any incurred in foreign exchange in providing technical services outside India. Ld.AO accordingly disallowed sum of Rs.44,31,074/-.

4. Thereafter, Ld.AO observed that assessee entered into international transaction with its associated enterprises, and therefore for determining arms length price of international transaction, case was referred to Ld.TPO. Ld.TPO upon receipt of reference called for economic analysis of international transaction entered into by assessee.
5. From documentation so filed, it was observed that, assessee was a subsidiary of American Power Conversion Corporation, U.S., primarily engaged in manufacture of power protection equipment and undertakes trading of UPS and accessories. Ld.TPO observed that, assessee primarily exported by way of sales to its associated enterprises and also had sales of manufactured products in the domestic market within India.
6. In the TP study, it has been submitted that AE provides all technical support services in the nature of software application development and maintenance and research and development in the nature of software design and testing services. Ld.TPO observed that assessee entered into following international transactions with its associated enterprise:

| Description | Amount (Rs.) |
|---|-----------------------|
| <i>Import of raw materials & Components</i> | <i>127,54,06,961</i> |
| <i>Export of Manufactured UPS</i> | <i>1344,79,58,216</i> |
| <i>Royalty</i> | <i>6,92,64,977</i> |
| <i>Cross charge by APC Group (paid)</i> | <i>42,41,753</i> |
| <i>Cross charge by APC India (received)</i> | <i>10,03,07,680</i> |

7. Ld.TPO observed that assessee paid a sum of Rs.6,92,64,977/-as royalty to its AE. From TP study, Ld.TPO observed that each of the manufacturing subsidiaries of AE entered into non-exclusive license agreement with AE, for license of technology and trademark intangibles, for using in manufacturing, and royalty was payable on such revenues from sale of products in their local territories. Ld.TPO observed that assessee during the year under consideration entered into similar exclusive license agreement with its AE, according to which, royalty at 4.5 % was payable on domestic sale of manufactured products by assessee in local markets within India. It has been submitted that, it is the AE who owns all intellectual property rights, trademarks, patents, copyrights, trade secrets, confidential business information, inventions, discoveries and know-how is, manufacturing and product processes and techniques, research and development information, copyrightable works and all other proprietary rights.
8. Ld.TPO on perusal of submissions advances by assessee concluded that assessee did not prove any tangible benefit derived by paying royalty for the so-called superior technology and that any independent enterprise would like to pay royalty for to access superior technology, only if the same results in either reduction of cost or improved profitability. It was therefore concluded by Ld.TPO that in the instant case, loss incurred in domestic segment was mainly due to payment of

royalty, which otherwise would not be paid between two independent enterprises, dealing at arms length.

9. Ld.TPO thus determined ALP of royalty as 'nil". He thus proposed adjustment of Rs.6,92,64,977/- as value of these transaction in uncontrolled conditions.

10. **Software development services**

Ld.TPO observed that during the year assessee rendered technical support services to its AE's, against which revenue amounting to Rs.7,30,12,000/-was received. It was observed that in the TP study assessee has used TNMM as the most appropriate method, with the PLI of OP/TC and determined margin of assessee to be at 10.01%. Assessee selected following 36 comparables in transfer pricing study with an average margin of 12.06%, and since assessee's margin was within the range of +/-5%, transaction with its AE's was considered to be at arms length.

| Sl.No. | Company Name | Unadjusted Margins FY 2005-06 |
|--------|--|----------------------------------|
| 1 | 3 i Infotech Limited | 6.42% |
| 2 | Akshay Software Technologies Limited | 8.24% |
| 3 | Aztec Software & Technology Services Limited | 13.94% |
| 4 | Bangalore Softsell Limited | 4.37% |
| 5 | Bristlecone India Limited | -2.92% |
| 6 | Compucom Software Limited | 16.00% |
| 7 | Datamatics Limited | -5.87% |
| 8 | Encore Software Limited | -33.94% |
| 9 | Flextronics Software Systems Limited | 32.69% |
| 10 | Four Soft Limited | 22.27% |
| 11 | Future Software Limited | 2.88% |
| 12 | Gebbs Infotech Limited | 23.69% |
| 13 | Goldstone Technologies Limited | 7.48% |
| 14 | Infosys Technologies Limited | 41.29% |

| | | |
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| 15 | <i>Intertec Communications Limited</i> | 46.07% |
| 16 | <i>K P I T Cummins Infosystems Limited</i> | 13.69% |
| 17 | <i>Lanco Global Systems Limited</i> | 12.26% |
| 18 | <i>Larsen & Toubro Infotech Limited</i> | 8.09% |
| 19 | <i>Maars Software International Limited</i> | 4.27% |
| 20 | <i>Melstar information Technologies limited</i> | -0.15% |
| 21 | <i>Mphasis BFL Limited</i> | 52.87% |
| 22 | <i>Orient Information Technology Limited</i> | 14.76% |
| 23 | <i>Quintegra Solutions Limited</i> | 8.59% |
| 24 | <i>R S Software (India) Limited</i> | 7.65% |
| 25 | <i>S I P Technologies and F>morts Limited</i> | -58.70% |
| 26 | <i>Sasken Communication Technologies Limited</i> | 14.50% |
| 27 | <i>Sasken Network Systems Limited</i> | 16.19% |
| 28 | <i>Satyam Computers Services Limited</i> | 29.27% |
| 29 | <i>Software Technology Group International Limited</i> | 15.39% |
| 30 | <i>Sonata Software Limited</i> | 15.31% |
| 31 | <i>Subex Systems Limited</i> | 6.39% |
| 32 | <i>Transworld Infotech Limited</i> | 26.34% |
| 33 | <i>Tyche Industries Limited</i> | 10.62% |
| 34 | <i>V J I L Consulting Limited</i> | 6.56% |
| 35 | <i>V M F Softech Limited</i> | 18.70% |
| 36 | <i>Visualsoft Technologies Limited</i> | 29.02% |
| | <i>Mean</i> | 12.06% |
| | <i>Maximum</i> | 52.87% |
| | <i>Minimum</i> | -58.70% |

11. Ld.TPO on examination of TP documentation filed by assessee was of the opinion that assessee is mainly into offshore research and development service provider and these services are akin to software development services. Ld.TPO accordingly rejected 19 comparables selected by assessee and selected 7 comparables. In the finalist of comparables by Ld.TPO there were other comparables, with an average margin of 20.68% which were included as under:

| Sl.No. | Company Name | Unadjusted Margins FY 2005-06 |
|---------------|---|--------------------------------------|
| 1 | <i>Aztec Software Ltd</i> | 18.09% |
| 2 | <i>Geometric Software Limited (Segment)</i> | 6.70% |
| 3 | <i>iGate Global Solutions Ltd (Segment)</i> | 15.61% |
| 4 | <i>Infosys Limited</i> | 40.38% |
| 5 | <i>KALS Information Systems Limited (Segment)</i> | 39.75% |
| 6 | <i>Mindtree Consulting Limited</i> | 14.67% |
| 7 | <i>Persistent Systems Limited</i> | 24.67% |
| 8 | <i>R Systems International Limited (Segment)</i> | 22.20% |
| 9 | <i>Sasken Communications Limited (Segment)</i> | 13.90% |
| 10 | <i>Tata Elxsi Limited (Segment)</i> | 27.65% |
| 11 | <i>Lucid Software Limited</i> | 8.92% |
| 12 | <i>Mediasoft Solutions Private Limited</i> | 6.29% |
| 13 | <i>R S Software (India) Ltd</i> | 15.69% |
| 14 | <i>SIP Technologies & Exports Limited</i> | 3.06% |
| 15 | <i>Bodhtree Consulting Ltd</i> | 15.99% |
| 16 | <i>Accel Transmatics Ltd (Segment)</i> | 44.07% |
| 17 | <i>Synfosys Business Solutions Ltd</i> | 10.61% |
| 18 | <i>Megasoft Ltd</i> | 52.74% |
| 19 | <i>Lanco Global Solutions Ltd</i> | 5.27% |
| 20 | <i>Flextronics Software Systems Ltd (Segment)</i> | 27.24% |
| | Arithmetic mean | 20.68% |

12. Ld.TPO thus proposed adjustment under this segment amounting to Rs.70,78,623/-.
13. Aggrieved by adjustment proposed by Ld.TPO, assessee raised objections before DRP, who upheld the view of Ld. TPO.
14. On receipt of DRP directions, Ld.AO passed final impugned assessment order, wherein total transfer pricing addition amounted to Rs.7,63,43,600/- and deduction claimed by assessee under section 10A of the Act, was restricted to Rs.56,87,840/-, thereby disallowing communication expenses claimed by assessee amounting to Rs.44,31,0474/-.
- Aggrieved by order passed by Ld.AO, assessee is in appeal before us now.

15. Ld.AR submitted that **Ground No. 1 and 2** are general in nature, and therefore do not require any adjustment.
16. **Ground No. 3-7** is in respect of the treatment of royalty paid by assessee to its AE by the authorities below is.
17. Contentions raised by Ld.AR is that, assessee in its manufacturing activity, uses various marketing intangibles, technology intangibles, process manuals and standards, quality standards etc which is owned by its AE-UK. It has been submitted that assessee also has access to subsequent product improvements and development through licensing agreement, received by assessee enables assessee to update technological development in the market. He submitted that vide this license agreement entered into by assessee with its AE, also allows assessee to sell such manufactured products in India in domestic market. Ld.AR further submitted that on such sale in domestic market, assessee is to pay 4.5% of the net revenues earned as per the terms and conditions of the exclusive license agreement to AE. He thus submitted that assessee while benchmarking payment of royalty, used CUP as most appropriate method, referring to page 59 of TP documentation filed, Ld.AR then pointed out that in TP order Ld. TPO wrongly held that assessee applied TNMM as most appropriate method for benchmarking transaction, which is evident from page 9 of TP order. It has been submitted that Ld.TPO while concluding his remark on this issue proceeded on the footing that TNMM has been used as most appropriate method.

18. Before DRP, it has been acknowledged that assessee used CUP as most appropriate method to determine arm's length rate of royalties paid to AE.
19. Ld.AR submitted that, both authorities below proceeded on the footing that, no evidence has been provided by assessee to prove tangible benefit derived from AE for which royalty has been paid by assessee. Referring to pages 323-367 of paper book, Ld.AR submitted that additional evidences has been placed which includes documents to establish that assessee is a licensed manufacturer, that products manufactured by assessee cannot be carried out without technological and R & D assistance from its AE, details establishing actual receipt of technical knowhow from its AE, against which royalty has been paid, details to prove that IPRs and know-how received from AE are confidential property of AE being guidelines, directions, screenshots etc, that helps assessee to manufacture the products. It has been submitted that these documents were not placed before authorities below and therefore requires consideration. Ld.CIT DR supported Ld.AR, that based upon these documents, the issue needs to be reconsidered for establishing actual nature of payments made by assessee.
20. We have perused submissions advanced by both sides in the light of the records placed before us. It is observed that assessee placed substantial evidence which was not before the authorities below for consideration. We are therefore inclined to set aside this issue back to Ld.TPO/AO, for determination

of this issue in the light of these documents vis-a-vis exclusive license agreement entered into by assessee with its AE, as per which royalty has been paid. Ld.TPO is directed to verify details, and if necessary, called for any further documents in order to establish true nature of transaction regarding payment of royalties by assessee and consider the claim of assessee as per law.

21. **Accordingly these grounds raised by assessee stands allowed for statistical purposes.**
22. **Ground No. 8-10 and additional** has been raised by assessee challenging addition made by Ld.AO on account of arms length price computed for software design and development service segment being technical support services provided by assessee to its AE's. At the outset, it has been submitted that only issue is regarding inappropriate comparables selected by Ld.TPO. Primary allegations regarding comparables is that, they are functionally dissimilar with assessee and does not fulfill filters applied by TPO himself.
23. Ld.AR submitted that following are the comparables that has been objected by assessee for its inclusion:
 - Aztec Software and Exports
 - Infosys Technologies Ltd
 - KALS Information Systems Ltd
 - Persistent Systems Ltd
 - Tata Elxi Ltd
 - Bodhtree Consulting Ltd.
 - Accel Transmatic Ltd (Seg.)

- Flextronics Software Systems Ltd (Seg.)
- Megasoft Ltd.

24. Before we go into compatibility analysis of these comparables with that of assessee, it is *sine qua non* to understand functions performed, assets owned and risks assumed by assessee under this segment.

25. **Functions performed:**

Functional analysis

- Information and specifications

The technical support services performed by APC India are based on the instructions and specifications provided by APCC US. There are regular interactions with APCC US regarding project specifications and obtaining certain clarifications/information on the projects provided by APCC US to APC India.

- Technical assistance and clarifications

We understand that APCC US provides technical assistance, information and certain technical clarifications in the provision of technical support services provided by APC India. There are regular weekly updates by the IDC to APCC US on the status of the projects/activity assigned by APCC US.

- Training

APC India provides both internal and external training to its employees. These training programs could be organized either in the US or in India.

- Design and software development

APC India does not develop software products for sale in open market. It caters to the specific needs of APCC US and its associated enterprises worldwide that help exploiting new opportunities by harnessing knowledge of business processes with proven skills in applying technology.

- Technical support and maintenance activity

APC India provides internal technical support services which includes creating, maintaining or enhancing APC company-wide internal use software infrastructure.

- Billing and collection

APC India is responsible for raising invoices and their subsequent collection.

26. **Assets Owned:**

It has been submitted in TP study that, assessee does not own any significant intangible assets. It only has technical manpower employed and trained by company being most important assets along with furniture fixtures computer peripherals etc.

Risks assumed

• Market Risk

With respect to risks associated with success or failure, the entire technical support services of APC India are driven based on the specifications received from APCC US for the provision of services. APC India does not assume any risk with respect to the ultimate success or failure of the development activities. Also, in case the technical support services provided by APC India do not meet the specifications mentioned by APCC US, it is sent back for rework.

• Foreign exchange Risk

APC India invoices APCC US in dollars to be settled at a later date. Since there is a time gap between the invoice date and the date of realization of the invoice, APC India would be subjected to foreign exchange risk. Therefore, it bears a foreign exchange risk on its receivables.

• Credit and collection Risk

We understand that APC India provides technical support services to its associated enterprises and accordingly, would not bear credit and collection risk.

• Service liability Risk

With respect to the technical support services provided, APC India does not bear any significant risks since it provides internal technical support services which includes creating, maintaining or enhancing APC company-wide internal use software infrastructure. There is no market risk or service liability risk to APC India.

Intangibles

APC India does not own any significant intangible assets. Further, any intangible assets developed by APC India in the provision of technical support services would be owned by APCC US.”

It is submitted that, as assessee is a captive service provider and is compensated at cost +10%, it does not bear any risks

like market risk, financial risk, credit and collection risk and service liability risk. The only risk that would be assumed by assessee is in terms of foreign exchange risk as revenue received by assessee is in foreign exchange.

27. In our considered opinion, comparability is to be carried out on broad object of benchmarking international transaction and according to the law laid down under section 92B of the Act, read with rule 10 B (2) Income tax Rules, 1963. Comparables must be similar in material aspects and must be compared on the basis of the products/services characteristics, functions undertaken, assets used and risk assumed. Merely because certain comparables has been upheld for its exclusion/inclusion by various decisions, does not *ipso facto* lead to exclusion/inclusion in a given set of facts. In our considered opinion, exclusion/inclusion of any comparables must be strictly analysed on basis of FAR, in accordance with rule 10 B (2). We also are of opinion that comparables selected must be for the relevant year which is to be compared and unless contemporaneous data as section 92D read with Rule 10 D (4), is not available for the relevant year, multiple year data should not be used. With aforesaid understanding, let us analyse comparables alleged to be excluded by assessee before us.
28. Based upon above FAR analysis, we shall now undertake compatibility tests of assessee with comparables under objection for inclusion.

29. At the outset, Ld.AR submits that for year under consideration, in the event, following comparables are considered for exclusion, assessee would be within acceptable arms length margin.

- Infosys technologies Ltd
- KALS Information Systems Ltd
- Tata Elxi Ltd
- Allsec transmatic Ltd
- Megasoft limited

30. In respect of remaining comparables, Ld.AR submitted that liberty may be granted to argue their exclusion in appropriate circumstances.

31. **Infosys technologies Ltd**

It has been submitted that this comparable has been included by Ld.TPO, and is functionally different with that of assessee. He submitted that this comparable is dealing in both services and products had is involved in huge research and development activities. Ld.AR submitted that, this comparable owns substantial intangibles thereby making it very different from a captive service provider who caters only to its AE and their customers, on cost plus basis. On the contrary, Ld. CIT DR placed reliance upon the view taken by authorities below.

32. We have perused submissions advanced by both sides in the light of the records placed before us. It is observed that this comparable has a high turnover with the huge margin of 40.3% as compared to 9% earned by assessee. The turnover filter fixed by Ld.TPO does not satisfy for inclusion of this

comparable. Further it is observed that this comparable owns huge intangibles, as it undertakes, research and development activities, owns branded/proprietary products. Whereas, in case of assessee, is contract service provider for its AE's. Further that in the process of software development, in the event any intangibles are created, the same is exclusively owned by AE. Under such circumstances we do not find appropriate for this comparable to be included to determine arms length price. **Accordingly we direct Ld.TPO to exclude this comparable from the final list.**

33. **KALS Information Systems Ltd:**

It has been submitted that this comparable has been included by Ld.TPO though it is functionally dissimilar with that of assessee. Ld.AR submitted that this comparable is engaged in development of software and software products and also has a training centre for drop software professionals or online projects. Ld. CIT DR placed reliance upon the observations of authorities below and prayed for its inclusion. We have perused submissions advanced by both sides in the light of the records placed before us. Excellent from the audited accounts and annual reports placed in the paper book in respect of this comparable it is observed that this company is engaged in development of software and software products since its inception. Further it is observed that in the year 2000 this company has been converted into a public limited company which itself makes it not a fit comparable with assessee who is a captive service provider to its AE is only in

respect of technical assistance. **Accordingly we direct this company to be excluded from the final list of comparables.**

34. **Tata Elxi Ltd (Seg.):**

It has been submitted that this comparable has been included by Ld.TPO, even though it is functionally not similar with that of assessee. Ld.AR submitted that this company is engaged in research and development activities which results in creation of intellectual property rights. Ld. CIT DR supported observations of authorities below and prayed for its inclusion. We have perused submissions advanced by both sides in the light of the records placed before us. It is observed that this comparable caters basically in providing software development services wherein, huge intangibles are generated owned by this comparable. It is also observed that this comparable is a group concern of TATA, which makes it to be economically different with that of assessee's who undertakes limited risks and provides technical assistance to its AE's in products developed for AE. We do not find this comparable to be functionally similar in any manner whatsoever with that of assessee. **Accordingly we direct this comparable to be excluded from the final list.**

35. **Accel Transmatic Ltd (Seg.):**

It has been submitted that this comparable has been included by Ld.TPO even though this functionally dissimilar with that of assessee. He further submitted that this comparable has sold its intellectual property rights in "Prodigy" and receives

royalties on sale of software. Ld.AR thus submitted that the segment applied by Ld.TPO itself is not identical with that of assessee. Ld. CIT DR placed reliance upon the observations of authorities below and prayed for its inclusion. We have perused submissions advanced by both sides in the light of records placed before us. It is observed that Ld.TPO used segmental information in respect of products of this comparable. However, from various products developed by this comparable, it is observed that, they are not into contract software development, which is the case of assessee, developing software for its AE only, for which assessee is remunerated on cost +10% markup. Further that in the process of software development, in the event any intangibles are created, the same is exclusively owned by AE. As we have already analyse the functions and the risks assumed, it is observed that assessee do not even undertake the pricing risk as the prices are decided by its AE only. Under such circumstances we do not find it functionally similar even though taking the segmental details of sale of products as there is a huge difference in the products sold by this comparable with that of assessee.

36. **Accordingly, we direct Ld.TPO to exclude this comparable from the final list.**

37. **Megasoft Ltd.:**

It has been submitted that this comparable has been included by Ld.TPO. Ld.AR submitted that the information collected by Ld.TPO is by issuing notice under section 133 (6) of the act.

He has further submitted that information so paid by Ld. TPO varies with that of the information that is available on the public domain. He submitted that under such circumstances these comparable should be excluded as there is no clarity regarding the functions performed, the assets owned and the risks assumed by this comparable. Ld. CIT DR though supported the observations of authorities below could not controvert therefore stated submissions advanced by Ld.AR. We have perused submissions advanced by both sides in the light of the records placed before us.

It is observed that at page 386 of paper book volume 1 and page 3040 of paper book volume 5 details regarding the activities carried out by this comparable has been placed. And we observe that there is contradictions in the facts mentioned in the audited financial reports and annual reports vis-a-vis the information collected by Ld.TPO under section 133 (6). We are therefore of considered opinion that this comparable should not be used as there exists contradictions in the details available on public domain vis-a-vis the information gathered by Ld.TPO under section 133 (6).

38. **Accordingly, we direct Ld.TPO to exclude this comparable from the final list.**
39. We also mention that, not considering of other comparables alledged by assessee does not ipso fact lead to upholding their inclusion, as with exclusion of comparables considered herein above, assessee falls into +/- 5% range. However, we grant

liberty to assess to allege other comparables, not considered by us in an appropriate instance.

40. **Accordingly we allow Ground no.8-10 along with additional grounds raised in respect of comparables discussed herein above.**

41. **Grounds 11-13**

These grounds has been raised by assessee, is in respect of exclusion of telecommunication expenses while computing deduction under section 10 A of the act upheld by Ld. CIT (A). Ld.AR placed reliance upon the decision of *Hon'ble Karnataka High Court* in case of *CIT vs Tata Elxsi Ltd* reported in 349 ITR 98 and submitted that this issue stands covered in favour of assessee. On the contrary, Ld.CIT DR placed reliance upon the order passed by Ld.AO. We have perused submissions advanced by both sides in the light of the records placed before us. It is observed that, *Hon'ble Karnataka High Court* in case of *CIT vs Tata Elxsi Ltd(supra)* on identical issue held that telecommunication expenses is to be included while computing deduction under section 10 A of the act as it is directly linked with earning of income. Ld CIT DR has not brought before us any contradictory/distinguishable facts in respect of present case before us. Respectfully following *Hon'ble Karnataka High Court* in case of *CIT vs Tata Elxsi Ltd(supra)*, we direct Ld.AO to include telecommunication expenses while computing exempt income u/s10A of the Act.

Accordingly the grounds raised by assessee stands allowed.

42. **Ground nos.14-15** are consequential in nature and therefore do not require adjudication.

43. **In the result appeal filed by assessee stands allowed as indicated herein above.**

Order pronounced in the open court on 07th day of June, 2019.

Sd/-
(J. SUDHAKAR REDDY)
Accountant Member

Sd/-
(BEENA PILLAI)
Judicial Member

Bangalore,
Dated, the 07th June, 2019.
/MS/

Copy to:

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|---------------|------------------------|
| 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.