

**IN THE INCOME TAX APPELLATE TRIBUNAL  
BANGALORE BENCH ' B '**

**BEFORE SHRI VIJAY PAL RAO, JUDICIAL MEMBER AND  
SHRI INTURI RAMA RAO, ACCOUNTANT MEMBER**

I.T. (T.P) A. Nos.1247/Bang/2011 & 34/Bang/2012  
(Assessment Years : 2005-06 & 2007-08)

M/s. Microchip Technology (India) Pvt. Ltd.,  
No.149-B, EPIP, 1<sup>st</sup> Phase, Indl. Area,  
Whitefield, Bangalore.  
PAN AABCM 9868J

.... Appellant.

Vs.

Asst. Commissioner of Income Tax,  
Circle 12(1), Bangalore.

..... Respondent.

I.T. (T.P) A. No.40/Bang/2012  
(Assessment Year : 2005-06)  
(By Revenue)

Assessee By : Shri Shyam Ramadhyani,C.A.  
Revenue By : Ms. Neera Malhotra, CIT (D.R)

Date of Hearing : 25.10.2016.

Date of Pronouncement : 31.10.2016.

**O R D E R**

**Per Shri Vijay Pal Rao, J.M. :**

These cross appeals for the Assessment Year 2005-06 are directed against the order dt.9.11.2011 of Commissioner of Income Tax (Appeals)-IV, Bangalore and the assessee has filed an appeal for the Assessment

Year 2007-08 against the assessment order dt.26.9.2011 passe under Section 143(3) r.w.s. 144C of the Income Tax Act, 1961 (in short 'the Act') in pursuant to the directions of the Dispute Resolution Panel (in short 'DRP') dt.;13.9.2011.

2. First we take up the assessee's appeal for the Assessment Year 2005-06 wherein the assessee has raised the following grounds :

- “1. On the facts and circumstances of the case, the learned Commissioner of Income Tax (Appeals) – III, Bangalore erred in not appreciating the contentions of the assessee that the price charged by it to its associated enterprises satisfied the arms length test envisaged in Chapter X of the Income Tax Act, 1961 (Act) and that no additions were required.*
- 2. On the facts and circumstances of the case, the learned Commissioner of Income Tax (Appeals) – III, Bangalore erred in not appreciating the contentions of the assessee that it is a captive software development unit of its parent company and that there were differences in functions performed, assets employed and risks assumed as compared to independent software services companies and adjustments were required to take into account such differences.*
- 3. On the facts and circumstances of the case, the learned Commissioner of Income Tax (Appeals) – III, Bangalore erred in not appreciating the contentions of the assessee that the rates of depreciation on fixed assts adopted by it were higher than those followed by comparable companies and that adjustments were required to the cost base adopted while determining the arms length price.*
- 4. On the facts and circumstances of the case, the learned Commissioner of Income Tax (Appeals) – III, Bangalore erred in not appreciating the contentions of the assessee that the hourly billing rates charged by it to its associated enterprise were comparable to that charged by certain software companies and on this ground alone, ought to have accepted that the fees*

*charged by it to its associated enterprise satisfied the arms length test envisaged in Chapter X of the Act and that no additions were required.*

- 5 *On the facts and circumstances of the case, the learned Commissioner of Income Tax (Appeals) – III, Bangalore erred in not allowing necessary deduction of 5% in term of proviso to section 92C(2) of the Act.”*

The assessee is engaged in providing of chip designs and development services to M/s. Microchip Technologies Inc., USA and marketing support services to M/s. Microchip, Netherlands. The assessee is reimbursed at cost plus 12% in respect of software development services and cost plus 10% in respect of market support services. The dispute before us is only with respect to the software development services provided to the parent company at USA. The TPO has selected 17 comparable companies for determining the Arm's Length Price ('ALP') :

Sl. No.	Company Name	Sales (Rs.cr.)	OP to Total Cost%
1	Bodhtree consulting ltd	3.87	24.85
2	Lanco Global Systems ltd	6.11	13.65
3	Exensys Software Solutions ltd	7.3	70.68
4	Sankhya Infotech ltd	12.99	27.39
5	Sasken Network Systems ltd	14.44	16.64
6	Four soft ltd	15.94	22.98
7	Thirdware Solution limited	29.11	66.09
8	R S Software (India) Ltd	81.69	8.07
9	Geometric Software Solutions Co.ltd	95.44	20.34
10	Tata Elxsi Limited (seg)	146.46	24.35
11	Visual soft Technologies ltd (seg)	185.43	23.52
12	Sasken communicaton Technologies ltd(seg)	189.05	14.42
13	Igate(seg.)	406	4.32
14	Flextronics (seg)	457.45	32.19
15	L&T Infotech	562.45	10.33
16	Satyam	3464.2	29.44
17	Infosys	6859.7	42.83
	<b>avg.</b>		<b>26.59%</b>

3. After allowing the working capital adjustment of 1.15% the adjusted average PLI was computed at 25.44%. Accordingly, the TPO proposed an upward adjustment under Section 92CA of Rs.82,26,807. The assessee challenged the action of the TPO before the CIT (Appeals) however the CIT (Appeals) has confirmed the action of the TPO.

3.1 Before us, the learned Authorised Representative of the assessee has submitted that the assessee's turn over is less than Rs.7 Crores which is not in dispute therefore even if the comparable companies having

more than 10 times turnover of the assessee are consideration for turnover filter then the companies selected by the TPO at Sl. Nos.8 to 17 will be excluded by applying the turnover filter of 10 times. In support of his contention, he has relied upon the decision dt.31.03.2016 of this Tribunal in the case of **Income Tax Officer Vs. M/s. Maxim India Integrated Circuit Design Pvt. Ltd.** in IT(TP)A No.28/Bang/2012.

4. On the other hand, the Id. DR has relied upon the orders of the authorities below and submitted that when this issue of turnover filter of 10 times of the assessee's turnover was not raised before the authorities below then this cannot be raised at this stage.

5. We have considered the rival submissions and relevant material on record. It is pertinent to note that the TPO has applied turnover slab of Rs.1 crore to Rs.200 crores for excluding some of the companies, whereas there is an inherent difficulty in applying such a turnover slab of Rs.1 crore to Rs.200 crores because the said classification on the basis of slab of the turnover gives unrealistic results, as an entity having Rs.1 crore turnover can be compared with any entity having Rs.200 crores turnover, but at the same time an entity having Rs.200 crores turnover cannot be compared with an entity having Rs.201 crores turnover. Thus,

as it is clear from the above illustration that it gives ambiguous result as two entities having difference of Rs.1 crore cannot be considered as comparable, whereas on the other hand difference of Rs.199 crores can be considered as comparable company. Therefore, such classification of comparables on the basis of Rs.1 Crore to Rs.200 Crores of turnover is not appropriate and acceptable. The turnover, no doubt, is a relevant factor to be taken into account, but there should be some proper and reasonable parameter to apply the difference of turnover between the assessee and the comparable which may be a reasonable multiple. This Tribunal in case of ITO Vs. Maxim India Integrated Circuit Design Pvt. Ltd. (supra) has taken a similar view as under. Accordingly, by applying the turnover filter of 10 times to the turnover of the assessee's on both sides the following 10 companies are directed to be excluded from the set of comparables as not satisfying the turnover filter of 10 times of the turnover of the assessee.

<b>Sl. No.</b>	<b>Name of Company</b>
1.	R S Software (India) Ltd.
2.	Geometric Software Solutions Co. Ltd.
3.	Tata Elxsi Ltd. (Seg.)
4.	Visual Soft Technologies Ltd. (Seg.)
5.	Sasken Communication Technologies Ltd. (Seg.)
6.	iGate Global Solutions

7.	Flextronics (Seg.)
8.	L&T Infotech Ltd.
9.	Satyam
10.	Infosys

6. The assessee has also sought exclusion of 5 more companies namely (i) Bodhtree Consulting Ltd., (ii) Exensys Software Solutions Ltd., (iii) Sankhya Infotech Ltd., (iv) Four Soft Ltd. and (v) Thirdware Solutions Ltd. on functional dissimilarity.

7. We have heard the learned A.R. as well as learned D.R. and considered the relevant material on record. The Id. AR has relied upon the decision dt.18.3.2016 of the co-ordinate bench of this Tribunal in the case of McAfee Software India Pvt. Ltd. Vs. ITO dt.18.3.2016 in IT(TP)A No.1388/Bang/2011 and submitted that all these five companies were considered by the co-ordinate bench and found that these are not functionally comparable with the software development services provider like the assessee.

8. On the other hand, the Id. DR has relied upon the orders of the authorities below.

9. Having considered the rival submissions, we note that the co-ordinate bench of this Tribunal in the case of Mc Afee Software India Pvt. Ltd. Vs. ITO (supra) has considered the functional comparability of the five companies as under :

“ Bodhtree Consulting Ltd.,:

10.3. This company was retained by Ld.CIT(A) but Assessee objects on the basis of functionality. However, as seen from the orders of Co-ordinate Benches in the case of ITO Vs. M/s. Sunquest Information Systems (India) Private Limited, in IT(TP)A No. 1302/Bang/2011 dt. 11-06-2015 (supra) as well as DCIT Vs. Toshiba embedded Software (I) Pvt. Ltd., in IT(TP)A No. 1/Bang/2012 dt. 10-05-2013, Bodhtree Consulting Ltd., was accepted as a comparable. However, in the case of Cordys Software India P. Ltd., in ITA No. 1451/Hyd/2010 dt. 13-06-2014 (Where one of us, AM is the author) has considered in detail and excluded the same for the following reasons: "1. Bodhtree Consulting Ltd.

The learned counsel submitted that this company should be rejected under the following TPO's filters:

- Related party transactions filter: As per schedule 4 of the balance sheet, the company has investments in Perigon, LIC, USA and as per the response u/s 133(6); the company has export sales to Perigon LIC, USA of Rs. 133.90 lakhs, being 34.68% of the total turnover.
- Functionally different filter: The company in its response to notice u/s 133(6) has stated that it provides e-paper solutions, data cleansing software, website development and other customized software and also state that the e-paper solutions and data cleansing services would come under the category of IT enabled services".

IT(TP)A Nos. 04/Bang/2012 & 1388/Bang/2011 Considering the above, we direct that the above company has to be excluded on the reason of RPT of more than 25% and functionality. Lanco Global Systems Ltd., :

10.4. This company even though included by TPO and has not been objected to by Assessee, was rejected by the CIT(A) on the reason of low profit margin. This is not a valid ground. Only continuous loss making companies are being excluded from the comparability. If this argument was accepted, the high profit making companies are also to be excluded. This is not the purpose for which TP analysis is being undertaken. Therefore, keeping the principles laid down by the Special Bench of ITAT in the case of Maersk Global Centers

(India) P.Ltd 43 Taxmann.com 100 Mumbai(SB), we, consider the same as comparable and retain it in the list. Sankhya Infotech Ltd., Thirdware Solution Ltd., & Tata Elxsi Ltd., : 10.5. These three companies are rejected as comparables on functionality in the case of ITO Vs. M/s. Sunquest Information Systems (India) Private Limited, in IT(TP)A No. 1302/Bang/2011 dt. 11-06-2015 (supra) (paras 19- 20, 22-26, 27-30 restively) and in the case of Cordys Software India P. Ltd., in ITA No. 1451/Hyd/2010 dt. 13-06-2014 (supra) at Para No. 13. The analysis by the Co-ordinate Benches is as under:

IT(TP)A Nos. 04/Bang/2012 & 1388/Bang/2011 "Sankhya Infotech Limited ('Sankhya')

19. It was submitted by the learned counsel for the Assessee that Sankhya is engaged in the business of development of software products & services and training. The company focuses on the development of niche products for the transport and aviation industry. However, segmental information in relation to the above mentioned activities is not available in public domain. Therefore, as Sankhya engages itself in products and services as well as software training, it cannot be considered as a comparable of the Appellant. The products developed and owned by Sankhya are listed below:

(1) SILICONTM Training Suite of Products: The products are a comprehensive enterprise wide training platform that covers the entire spectrum of training in a paperless environment. It comprises of four products:-

- SILICONTM LMS (Training Management Information)
- SILICONTM QT (Online Assessment System)
- SILICONTM LCMS (Learning Content Management System)
- IRMAQTM : This is an integrated resource planning, management tracking system exclusively developed for Airline operations. It is an end-to-end solution for all Flight Operations.
- Sakai CLE : This is a widely used and popular open source LMS used in many leading educational institutions and corporate. The relevant extract from the Annual report substantiating that the company also engages in different activities is reproduced below:

"2. Activities The company as engaged in the business of development of Software Products & Services and training. The production of software is not capable of being expressed in any generic unit and hence it is not possible to give the information as required by certain clauses of paragraphs 3.4C and 4 D of Part II of Schedule VI of the Companies Act, 1956."

The Delhi Tribunal in [ITO v. Colt Technology Services India Pvt. Ltd.](#) (judgment dated 23.10.2012 in ITA No. 609I/Del/2011 for the assessment year 2005-06) has held that the said company is not a comparable to the Assessee therein which was also in the business of software development.

IT(TP)A Nos. 04/Bang/2012 & 1388/Bang/2011

20. The submissions made by the learned counsel for the Assessee are considered. The activities set out above and the decision of the Delhi ITAT rendered in the context of a software development company such as the Assessee makes it amply clear that this company Sankhya cannot be regarded as a comparable. The same is directed to be excluded from the list of comparable companies.

22. We have considered his submission and find that the ITAT Hyderabad Bench on identical facts, held that the aforesaid two companies viz., Four Soft Ltd., and Thirdware Solutions Ltd., are not comparable companies in Software Development Services companies. The following were the relevant observations:- "15.4. FOURSOFIT LIMITED : This comparable is objected on the same reason as this company is involved in product development and owns products namely 4S eTrans and 4S eLog. These products are used in Sun Microsystems Inc, in an Application Verification Kit Certified for Enterprises and Assessee have been investing continuously on product developments. Since Assessee is in the product development, having I.P. rights, the same is not comparable. 15.5. THIRDFWARE SOFTWARE SOLUTIONS LIMITED :

This company is objected to by the Assessee on the reason that the said Thirdware Software Solutions Ltd. is engaged in sale of software licence and related services and not a service provider. Referring to the annual report, it was submitted that this comparable was rejected by the ITAT, Pune in the case of Egain Communications Ltd. This company having revenue from product license and earning extraordinary profit due to intangible owns. 15.6. These three comparable above Flextronics Software Limited, Foursoft Limited and Thirdware Software Solution Limited were analysed by the Coordinate Bench of the Tribunal in the case of Intoto Software Solutions Pvt. Ltd. (supra) wherein it has been held as under :

"23. The other companies which are objected to by the Assessee are Flextronics Software Limited, Foursoft Limited and Thirdware Software Solution Limited. As far as these three companies are concerned, the learned Counsel appearing on behalf of the Assessee submitted that they are into both software as well as product development. He submitted that the TPO has taken note of the fact these companies are also into product development but has selected these companies as comparables by applying the filter of more than 70% of its revenue being from software development services. The learned Counsel submitted that the functions of these companies are different from the Assessee who was into sole activity of software development for its associated enterprise. He submitted that the TPO has allocated

the expenditure in the proportion of the revenue of these IT(TP)A Nos. 04/Bang/2012 & 1388/Bang/2011 companies from software services and software products and has adopted the figure as segmental margin of the company and has taken these companies as comparables. He submitted that by taking the proportionate expenditure, the correct financial results would not emerge. He submitted that nothing prevented the Assessing Officer/TPO from obtaining the segmental details from the respective comparable companies before adopting them as comparable companies and before taking the operating margin for arriving at the arms length price. He submitted that wherever the segmental details are not available, then the said companies should not be taken as comparables. For this purpose, he placed reliance upon the decision of the Bangalore Tribunal in the case of First Advantage Offshore Services Pvt. Ltd. vs. The DCIT in ITA.No.1252/Bang/2010 wherein these companies were directed to be excluded from the list of comparables.

23. The learned D.R. however, supported the Orders of the authorities below.

24. Having heard both the parties and having gone through the material on record, we find that the TPO at page 37 of his order has brought out the differences between a product company and a software development services provider. Thus, it is clear that he is aware of the functional dissimilarity between a product company and a software development service provider. Having taken note of the difference between the two functions, the Assessing Officer ought not to have taken the companies which are into both the product development as well as software development service provider as comparables unless the segmental details are available. Even if he has adopted the filter of more than 75% of the revenue from the software services for selecting a comparable company, he ought to have taken the segmental results of the software services only. The percentage of expenditure towards the development of software products may differ from company to company and also it may not be proportionate to the sales from the sale of software products. Under [section 133\(6\)](#) of the I.T. Act, the TPO has the power to call for the necessary details from the comparable companies. It is seen that the Assessing Officer/TPO as exercised this power to call for details with regard to the various companies. As seen from the annual report of Foursoft Limited which is reproduced at page 7 of the TPO's Order, the said company has derived income from software licence also and AMCs.

25. As far as Thirdware Software Solution Limited is concerned, we find from the information furnished by the said company that though the said company is also into product development, there are no software products that the company invoiced during the relevant financial year and the financial results are in respect of services only. Thus, it is clear that there is no sale of software products during the year but the said company might have incurred expenditure towards the development of the software products.

26. As far as Flextronics Software Limited is concerned, we find that at page 90 of his Order, the TPO has also observed that the said company has incurred expenditure for selling of products and has incurred R & D expenditure for development of the products. The above facts clearly demonstrate that there is functional dissimilarity between the Assessee and these companies and without making adjustment for the dissimilarities brought out by the TPO himself, these companies cannot be taken as comparable companies. The method adopted by the TPO to allocate expenditure proportionately to the software development services and software product activity cannot be said to be correct and reasonable. Wherever, the Assessing Officer/TPO cannot make suitable adjustment to the financial results of the comparable companies with the Assessee company to bring them on par with the Assessee, these companies are to be excluded from the list of comparables. Therefore, we direct the Assessing Officer/TPO to exclude these three companies from the list of comparables.

27. The learned counsel for the Assessee submitted before us that TATA Elxsi Ltd., a comparable company out of the 10 excluded by the CIT(A) by applying RPT filter and which gets included in the comparable companies because of 15% RPT being adopted as threshold limit for excluding companies for the purpose of comparability. It was his submission that this company will however, have to be excluded as this company was held to be not comparable with an Assessee such as the Assessee in the present case providing software development services by the ITAT Hyderabad Bench in the case of CNO IT Services (India) Pvt. Ltd. (Formerly known as Consec Data Services (India) Pvt. Ltd.) Hyderabad vs. DCIT, Circle 1(2) Hyderabad, in ITA.No.1280/Hyd/2010 Assessment Year 2005- 2006 order dated 12.2.2014.

28. We have considered his submission and find that the ITAT Hyderabad Bench on identical facts, held on comparability of TATA Elxsi Ltd. as follows: "15.7. TATA ELXSI LIMITED : The objection of the Assessee is that TATA Elxsi operating two segments -system communication services and software development services. The TPO accepted the software development services segment in his T.P. analysis and Assessee's objection is that the software development services segment itself comprises of three subservices namely (a) product design services (b) design engineering services and (c) visual computing labs. It was submitted that these services are not akin to Assessee software services and segmental information of only product design services could have been accepted by the TPO as a comparable but not the entire software development service. Since company's operations are functionally different as such, the same is not comparable. Further, Assessee is also objecting on the basis of intangible scale of operations. The coordinate bench in the case of Intoto (supra) considered the issue as under in para 22:

"22 Tata Elxsi Limited : As regards this company, the learned Counsel appearing on behalf of the Assessee, filed before us the reply of Tata Elxsi Limited to the Addl. CIT (Transfer Pricing), Hyderabad, wherein the concerned IT(TP)A Nos. 04/Bang/2012 &

1388/Bang/2011 Officer has been informed that Tata Elxsi Limited is specialised Embedded Software Development Service Provider and that it cannot be compared with any other software development company. It was submitted that because of the specialisation and also because of diverse nature of its business, it is very difficult to scale-up the operations of Tata Elxsi Limited. In view of this, Tata Elxsi Limited has informed that it is not fair to use its financial numbers to compare it with any other company. The communication dated 25th August, 2009 to the TPO is placed before us. As this communication was not before the TPO at the time of transfer pricing adjustment we deem it fit and proper to remand this issue also to the file of the TPO to reconsider adopting this company as the comparable in the light of observations of this company to the TPO in the case of another Assessee. In the result, the Assessing Officer/TPO is directed to reconsider the issue in accordance with law, after affording a reasonable opportunity of being heard to the Assessee."

Keeping the Assessee's objections and the decisions of the Coordinate Bench, prima facie, we are of the view that TATA Elxsi Limited is functionally different and has incomparable size to that of the Assessee. Further, we are unable to verify whether the segmental profits adopted by the TPO pertain to entire software development services or pertain to limited service akin to Assessee services. Since, these aspects are not clear from the data furnished before us, we direct the TPO to examine and in case, the segmental profits of a particular service is not available, then, to exclude the TATA Elxsi Limited from the list of comparables. Accordingly, this issue is restored to the file of TPO for examination and to decide in accordance with law and facts, after affording reasonable opportunity of being heard to Assessee."

29. Though the issue has been set aside to the AO in the aforesaid decision, the ITAT Hyderabad in the case of NTT Data India Enterprise Application Services Pvt.Ltd., ITA No.1612/Hyd/2010 order dated 23.10.2013 and in a subsequent ruling in the case of Invensys Development Centre (India) Pvt.Ltd., ITA No.1256/Hyd/2010 order dated 28.2.2014, held that TATA Elxsi is not functionally comparable with that of a software development service provider such as the Assessee.

30. In view of the aforesaid decision rendered on identical facts and circumstances, we are of the view that TATA Elxsi Ltd., should be excluded from the list of comparable companies.

"13. Similarly, the other cases, Bodhtree consulting Ltd, Four Soft Ltd, Infosys,, Sankhya Infotech Ltd., Thirdware Solutions Ltd, Tata Elexi (seg) etc, are also to be excluded as they are considered and analysed in various cases relied on about functionality and why the same are not comparable to the companies like Assessee. Bodhtree consulting Ltd also fails RPT filter as contended. In view of this, we are not IT(TP)A Nos. 04/Bang/2012 & 1388/Bang/2011 discussing above comparables in detail, but, suffice to say that Assessee's submissions are valid. The AO is directed to exclude the above comparables and re- work out the arm's length margin accordingly. The

ground No.8 and additional ground raised by Assessee are considered as allowed".

In view of the above, the above three companies are to be excluded. Sasken Network Systems Ltd., R S Software (India) Ltd., Visualsoft Technologies Ltd., and Sasken Communication Technologies Ltd., 10.6 Since there is no objection from Assessee and was selected by TPO, the above companies are retained.

Four Soft Ltd., 10.7. The objection by Assessee is that this company is a product company. was analysed and accepted in the case of ITO Vs. M/s. Sunquest Information Systems (India) Private Limited, in IT(TP)A No. 1302/Bang/2011 dt. 11-06-2015 (supra) para 22. It was held that the said company ahs derived income from software license and AMCs. Since functionality was already analysed, respectfully following the Co-ordinate Benches also, the same was to be excluded.

i. Intoto Software India Pvt. Ltd., ITA No. 1196/Hyd/2010; ii. Cordys Software India P. Ltd., ITA No. 1451/Hyd/2010 IT(TP)A Nos. 04/Bang/2012 & 1388/Bang/2011 Geometric Software Solutions Company Ltd.,:

10.8. Even though this company was accepted as comparable in ITO Vs. M/s. Sunquest Information Systems (India) Private Limited, in IT(TP)A No. 1302/Bang/2011 dt. 11-06-2015 (supra) and Cordys Software India P. Ltd., in ITA No. 1451/Hyd/2010 dt. 13-06-2014 (supra) and was not objected to, we find that the Co-ordinate Bench at Banalore in the case of DCIT Vs. Toshiba embedded Software (I) Pvt. Ltd., in IT(TP)A No. 1/Bang/2012 dt. 10-05-2013 has considered that this is in product devolopement. We have perused the TPO's order. In page 85 and 86 of the order, this comparable was analysed. TPO records that there are product sales to the extent of 18%. Segmental profits are not available. On assumptions, this company was retained. We are of the opinion that being a product based company, the same is not strictly comparable to a service company like Assessee. In the absence of segmental profit of service income, we have to exclude the same. Following the decision in the case of DCIT Vs. Toshiba embedded Software (I) Pvt. Ltd., in IT(TP)A No. 1/Bang/2012 dt. 10-05-2013 (supra), this company is accordingly excluded.

Igate Global Solutions Ltd., & L&T Infotech:

10.9. These two companies are found comparable in many orders of the Co-ordinate Benches, but excluded on the basis of turnover filter of Rs. 200 Crores limit in ITO Vs. M/s. Sunquest Information Systems (India) Private Limited, in IT(TP)A No. 1302/Bang/2011 dt. 11-06-2015 (supra), we have IT(TP)A Nos. 04/Bang/2012 & 1388/Bang/2011 considered the same. Assessee's turnover is about 63 Crores. The turnover of Igate Global Solutions Ltd., (Seg) is about 405 crores and L & T Infotech Ltd is of 562 Crores. This is with the range of ten times the upper limit. Moreover, Assessee Counsel has not pressed on turnover

filter of Rs. 200 Crores. Therefore, these two are retained. Flextronics Software Systems Ltd.,:

10.10. This company was objected to on functional dissimilarity. This was considered in ITO Vs. M/s. Sunquest Information Systems (India) Private Limited, in IT(TP)A No. 1302/Bang/2011 dt. 11-06-2015 (supra) as under:

"26. As far as Flextronics Software Limited is concerned, we find that at page 90 of his Order, the TPO has also observed that the said company has incurred expenditure for selling of products and has incurred R & D expenditure for development of the products. The above facts clearly demonstrate that there is functional dissimilarity between the Assessee and these companies and without making adjustment for the dissimilarities brought out by the TPO himself, these companies cannot be taken as comparable companies. The method adopted by the TPO to allocate expenditure proportionately to the software development services and software product activity cannot be said to be correct and reasonable. Wherever, the Assessing Officer/TPO cannot make suitable adjustment to the financial results of the comparable companies with the Assessee company to bring them on par with the Assessee, these companies are to be excluded from the list of comparables. Therefore, we direct the Assessing Officer/TPO to exclude these three companies from the list of comparables". Respectfully following, we exclude the same."

By following the order of the co-ordinate bench, we direct the A.O./TPO to exclude these five companies namely (i) Bodhtree Consulting Ltd., (ii) Exensys Software Solutions Ltd., (iii) Sankhya Infotech Ltd., (iv) Four Soft Ltd. and (v) Thirdware Solutions Ltd. After exclusion of 10 companies on the ground of having turnover more than 10 times than the assessee and 5 companies as functionally not comparable only two companies are left which are as under :

- i) Lanco Global Systems Ltd.
- ii) Sasken Communication Technologies Ltd. (Seg.)

Accordingly, the TPO/A.O. is directed to recomputed the ALP by considering the benefit as per the proviso to section 92C.

10. The revenue in the cross appeal has raised only the issue regarding exclusion of expenses from the export turnover as well as total turnover while computing the deduction under Section 10A of the Act.

10.1 We have heard the rival submission and perused the material on record. The Hon'ble Karnataka High Court in the case of CIT v M/s Tata Elxsi Ltd. & Others 349 ITR 98 (Kar) had held that while computing the exemption u/s 10A, if the export turnover in the numerator is to be arrived at after excluding certain expenses, the same should also be excluded from the total turnover in the denominator. The relevant finding of the Hon'ble jurisdictional High Court reads as follows:-

*".....Section 10A is enacted as an incentive to exporters to enable their products to be competitive in the global market and consequently earn precious foreign exchange for the country. This aspect has to be borne in mind. While computing the consideration received from such export turnover, the expenses incurred towards freight, telecommunication charges, or 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 the technical services outside India should not be included. However, the word total turnover is not defined for the purpose of this section. It is because of this omission to define 'total turnover', the word 'total turnover' falls for interpretation by this Court;*

*.....In section 10A, not only the word 'total turnover' is not defined, there is no clue regarding what is to be excluded while arriving at the total turnover.*

*However, while interpreting the provisions of section 80HHC, the courts have laid down various principles, which are independent of the statutory provisions. There should be uniformity in the ingredients of both the numerator and the denominator of the formula, since otherwise it would produce anomalies or absurd results. Section 10A is a beneficial section which intends to provide incentives to promote exports. In the case of combined business of an assessee, having export business and domestic business, the legislature intended to have a formula to ascertain the profits from export business by apportioning the total profits of the business on the basis of turnovers. Apportionment of profits on the basis of turnover was accepted as a method of arriving at export profits. In the case of section 80HHC, the export profit is to be derived from the total business income of the assessee, whereas in section 10-A, the export profit is to be derived from the total business of the undertaking. Even in the case of business of an undertaking, it may include export business and domestic business, in other words, export turnover and domestic turnover. To the extent of export turnover, there would be a commonality between the numerator and the denominator of the formula. If the export turnover in the numerator is to be arrived at after excluding certain expenses, the same should also be excluded in computing the export turnover as a component of total turnover in the denominator. The reason being the total turnover includes export turnover. The components of the export turnover in the numerator and the denominator cannot be different. Therefore, though there is no definition of the term 'total turnover' in section 10A, there is nothing in the said section to mandate that, what is excluded from the numerator that is export turnover would nevertheless form part of the denominator. When the statute prescribed a formula and in the said formula, 'export turnover' is defined, and when the 'total turnover' includes export turnover, the very same meaning given to the export turnover by the legislature is to be adopted while understanding the meaning of the total turnover, when the total turnover includes export turnover. If what is excluded in computing the export turnover is included while arriving at the total turnover, when the export turnover is a component of total turnover, such an interpretation would run counter to the legislative intent and impermissible. Thus, there is no error committed by the Tribunal in following the judgements rendered in the context of section 80HHC in interpreting section 10A when the principle underlying both these provisions is one and the same".*

In the light of the above binding precedents, we do not find any error or illegality in the impugned order of CIT (Appeals) qua this issue.

11. Other grounds of the revenue's appeal are common to the grounds raised in the assessee's appeal regarding applicability of turnover filter as applied by the CIT (Appeals). Since we have decided the issue of turnover filter as 10 times to the turnover of the assessee on both sides therefore, the order of the CIT (Appeals) on this issue stands modified.

**For the A.Y. 2007-08.**

12. The assessee has raised the following grounds :

**1**

**Assessment and reference to Transfer Pricing Officer are bad in law**

- a) The final order issued by the Assistant Commissioner of Income Tax– Circle 12(1) [‘ACIT’ or ‘AO’], is bad on facts and in law, and is in violation of the principles of natural justice.

Without prejudice to the above, the order issued by the AO is bad in law insofar as the fact that the AO did not issue to Microchip Technology (India) Private Limited (‘the Appellant or ‘the Company’), a show cause notice, as per proviso to section 92C(3) of the Income-tax Act, 1961 [‘the Act’].

- b) The AO has erred in law in making a reference to the Transfer Pricing Officer ['TPO'], *inter alia*, since he has not recorded an opinion that any of the conditions in section 92C(3) of the Act, were satisfied in the instant case. The AO also erred in not following the provision contained in section 92CA(1) of the Act.

**2 The fresh comparable search undertaken by the TPO is bad in law**

- a) The TPO/AO erred on facts and in law in conducting a fresh benchmarking analysis using non contemporaneous data and substituting the Appellant's analysis with fresh benchmarking analysis on his own conjectures and surmises.
- b) On the facts and in the circumstances of the case and in law, the TPO/AO erred in not demonstrating that the motive of the Appellant was to shift profits outside of India by manipulating the prices charged in its international transactions which is a pre – requisite condition to make any adjustment under the provision of Chapter X of the Act.

**3 Comparability analysis adopted by the TPO/AO for determination of arm's length price**

- a) The TPO/AO grossly erred on facts in benchmarking the transactions of the captive 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-à-vis* comparable companies.
- b) The TPO/AO erred on facts in rejecting the comparable companies arrived at in the Transfer Pricing Study.
- c) The TPO/AO erred in law in applying arbitrary filters to arrive at a fresh set of companies as comparables to the Appellant, without establishing functional analysis.
- d) The TPO/AO also erred on facts in arbitrarily accepting companies without considering the turnover and size of the Appellant and comparables.
- e) The TPO/AO grossly erred in law in deviating from the uncontrolled party transaction definition as per the Income-tax Rules and arbitrarily applying a 25% related party criteria in accepting / rejecting comparables.

- f) The TPO/AO also erred on facts and in law in arbitrarily rejecting companies with different year ending (i.e., other than 31 March 2007) and inconsistently applying such filter.
- g) The TPO/AO grossly erred on facts in arbitrarily rejecting companies having software development revenue less than 75% of total operating revenue and inconsistently applying such filter, without considering the specific segmental results.
- h) The TPO/AO also erred on facts in arbitrarily rejecting companies based on their financial results without considering functional comparability.
- i) The TPO/AO erred on facts and in law in considering a set of 'secret data', i.e. data which was not available in public domain, in arriving at a fresh set of companies using his power under section 133(6), which is grossly unjustified.

**4 Erroneous data used by the TPO/AO**

- a) The AO/TPO has 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.
- b) The AO/TPO erred in law in not applying the multiple-year data while computing the margin of alleged comparable companies.

**5 Non-allowance of appropriate adjustments to the comparable companies, by the TPO/AO**

- a) The TPO/AO erred in law and on facts in not allowing appropriate adjustments under Rule 10B to account for, *inter alia*, differences in (a) accounting practices, (b) marketing expenditure, (c) research and development expenditure and (d) risk profile between the Appellant and the comparable companies.
- b) The Dispute Resolution Panel ('DRP') erred in law and on facts in not giving cognizance of the adjustment claimed by the Appellant on account of difference in capacity utilization of the Appellant and the comparable companies.

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

The TPO/AO erred in law in not granting the benefits of proviso to section 92C(2) of the Act available to the Appellant.

**7 Deduction under section 10A of the Act**

- a) On the facts and in the circumstances of the case, the learned AO has erred in reducing the foreign travel expenditure amounting to Rs. 13,475,077 from the export turnover while computing the deduction under section 10A of the Act, irrespective of the fact that the same are incurred for training of personnel and for the purpose of business meetings/discussions outside India and not for rendering of technical services outside India.
- b) On the facts and in the circumstances of the case, the learned AO has erred in reducing the telecommunication expenses of Rs. 6,610,777 from the export turnover while computing the deduction under section 10A of the Act, irrespective of the fact that such expenses are incurred for regular business and commercial activities and only a portion of the said expenses are attributable to the delivery of computer software outside India.
- c) Without prejudice to the above, on the facts and in the circumstances of the case, the learned AO has erred in reducing the foreign travel expenses amounting to Rs. 13,475,077 and telecommunication expenses amounting to Rs. 6,610,777 only from export turnover without correspondingly reducing the said expenses from the total turnover.

**8 Interest under section 234B of the Act**

The learned AO has erred in levying interest under section 234B of the Act amounting to Rs. 4,007,944.

**9 Refund**

The learned AO has erred in holding that an amount of Rs. 46,930 has been refunded to the Appellant under section 143(1) of the Act, when no such refund was issued.

**10 Interest under section 234D of the Act**

The learned AO has erred in levying interest under section 234D of the Act amounting to Rs. 7,035 when no refund has been issued to the Appellant.

**11 Penalty under section 271(1)(c)**

The learned AO has erred in initiating penalty proceedings under section 271(1)(c) of the Act.

**12 Directions issued by the DRP**

- a) The DRP has erred in law and facts in not taking cognizance of the objections filed by the Appellant in relation to the draft assessment order issued by the AO/ TP order.
- b) The Honorable DRP further erred in confirming the draft order of the AO/TPO.

**13 Relief**

The Appellant craves leave to add to or alter, by deletion, substitution or otherwise, the above grounds of appeal, at any time before or during the hearing of the appeal.

13. As regards the TP Adjustment, the TPO considered 26 companies as comparables as under :

Sl No	Name of the company	Sales (Rs. Cr.)	Operating profit to total Cost
1	Accel Transmatic Ltd (Seg)	9.68	21.11%
2	Avani Cimcon Technologies Ltd (seg)	3.55	52.59%
3	Celestial Labs Ltd	14.13	58.35%
4	Datamatics Ltd	54.51	1.38%
5	E-Zest Solutions Ltd	6.26	36.12%
6	Flextronics Software Systems Ltd (seg)	848.66	25.31%
7	Geometric Ltd (seg)	158.38	10.71%
8	Helios and Matheson Information Technology Ltd	178.38	36.63%
9	iGate Global Solutions Ltd	747.27	7.49%
10	Infosys Technologies	13149	40.30%
11	Ishir Infotech Ltd	7.42	30.12%
12	KALS Information Systems Ltd (seg)	2.00	30.55%
13	LGS Global Ltd (Lanco Global Solutions Ltd	45.39	15.75%
14	Lucid Software Ltd	1.70	19.37%
15	Mediasoft Solutions Ltd	1.85	3.6%

16	Megasoft Ltd (seg)	139.33	60.23%
17	Mindtree Ltd	590.35	16.90%
18	Persistent Systems Ltd	293.75	24.52%
19	Quintegra Solutions Ltd	62.72	12.56%
20	R S Software (India) Ltd	101.04	13.47%
21	R Systems International Ltd (seg)	112.01	15.07%
22	Sasken Communication Technologies Ltd (seg)	343.57	22.17%
23	SIP Technologies & Exports Ltd	3.80	13.90%
24	Tata Elxsi Ltd (seg)	262.58	26.51%
25	Thirdware Solutions Ltd	36.08	25.12%
26	Wipro Ltd (seg)	9616.09	33.65%

14. At the time of hearing the Id. AR has pointed out that out of the 26 comparable companies, 9 companies will be excluded by applying the turnover filter of 10 times. The Id. AR has submitted that for the Assessment Year 2007-08, the assessee's turnover is Rs.16.35 Crores and therefore the companies which are having more than Rs.164 Crores turnover should be excluded.

15. The Id. DR has relied upon the order of the TPO/A.O and submitted that the turnover has no role in determining the comparability and margins of the comparable companies.

16. We have considered the rival submissions and relevant material on record. Since this issue is common to the issue for the Assessment Year

2005-06, therefore by applying the multiple of 10 on both sides, the companies who are having the turnover of more than Rs.164 Crores are as under :

Sl.No.	Name of Company
1.	Flextronics Software Systems Ltd. (Seg.)
2.	Helios & Matheson Information Technology Ltd.
3.	iGate Global Solutions Ltd.
4.	Infosys Technologies Ltd.
5.	Mindtree Ltd.
6.	Persistent Systems Ltd.
7.	Sasken Communication Technologies Ltd. (Seg.)
8.	Tata Elxsi Ltd. (Seg.)
9.	Wipro Ltd. (Seg.)

Accordingly, the above 9 companies are directed to be excluded from the set of comparables.

16.1 The assessee is also seeking exclusion of two more companies namely **Geometric Ltd. (Seg) & Ishir Infotech Ltd.** on the ground of RPT more than 15% and further in case of **Ishir Infotech Ltd.** the employee cost is less than 25%. In support of his contention, the Id. AR of the assessee has relied upon the decision of the co-ordinate bench of this Tribunal in the case of CSR India Pvt. Ltd. Vs. ITO 31 taxmann.com 265 and order dt.16.10.2015 in IT(TP)A No.1321/Bang/2011 in the case of

Meritor LVS India (P.) Ltd. Vs. ACIT. The Id. AR has further submitted that the assessee is also seeking exclusion of the other 7 companies and correct margin in respect of Mega Soft Ltd. He has pointed out that the comparability of all these companies have been considered by the co-ordinate bench of this Tribunal in the case of Meritor LVS India (P.) Ltd. Vs. ACIT (supra).

17. On the other hand, the Id. DR has relied upon the orders of the authorities below.

18. Having considered the rival submissions as well as relevant material on record, we note tha an identical set of 26 comparables was considered by the co-ordinate bench of this Tribunal in the case of Meritor LVS India Ltd. (supra). The Tribunal has considered the comparability of these companies in para 12 to 14 as under :

“ 12. We have perused the orders and heard the rival contentions. Assessee is seeking exclusion of 16 comparables out of 26 companies selected by the TPO. For this it has placed reliance on the decision of coordinate bench in the case of Hewlett- Packard (India) Globalsoft P. Ltd, (supra). We find that issues before this Tribunal in the case of Hewlett-Packard (India) Globalsoft P. Ltd, (supra) was also with regard to software development services segment, that too for the very same assessment year. Services rendered by both the assessee as well as HPIGPL fell within the software development services segment, and therefore in our opinion the decision of the coordinate bench in Hewlett- Packard (India) Globalsoft P. Ltd, supra) can be taken as a good precedent. Findings of the Tribunal in the case Hewlett- Packard (India) Globalsoft P. Ltd, (supra) in so far as the comparables sought to be excluded by the assessee were as under :

**1) “Celestial Labs Ltd.**

42. As far as this company is concerned, the stand of the assessee is that it is absolutely a research & development company. In this regard, the following submissions were made:-

- In the Director's Report (page 20 of PB-II), it is stated that "the company has applied for Income Tax concession for in-house R&D centre expenditure at Hyderabad under section 35(2AB) of the Income Tax Act."
- As per the Notes to Accounts - Schedule 15, under "Deferred Revenue Expenditure" (page 31 of PB-II), it is mentioned that, "Expenditure incurred on research and development of new products has been treated as deferred revenue expenditure and the same has been written off in 10 years equally yearly installments from the year in which it is incurred."

An amount of Rs. 11,692,020/- has been debited to the Profit and Loss Account as "Deferred Revenue Expenditure" (page 30 of PB-II). This amounts to nearly **8.28 percent** of the sales of this company.

It was therefore submitted that the acceptance of this company as a comparable for the reason that it is into pure software development activities and is not engaged in R&D activities is bad in law.

43. Further reference was also made to the decision of the Mumbai Bench of the Tribunal in the case of Teva Pharma Private Ltd. v. Addl. CIT – ITA No.6623/Mum/2011 (for AY 2007-08) in which the comparability of this company for clinical trial research segment. The relevant extract of discussion regarding this company is as follows:

**"The learned D.R. however drew our attention to page-389 of the paper book which is an extract from the Directors report which reads as follows:**

*"The Company has developed a de novo drug design tool "CELSUITE" to drug discovery in, finding the lead molecules for drug discovery and protected the IPR by filing under the copy if sic (of) right/patent act. (Apprised and funded by Department of Science and Technology New Delhi) based on our insilico expertise (applying bio-informatics tools). The Company has developed a molecule to treat Leucoderma and multiple cancer and protected the IPR by filing the patent. The patent details have been discussed with Patent officials and the response is very favorable. The cloning and purification under wet lab procedures are under progress with our collaborative Institute, Department of Microbiology, Osmania University, Hyderabad. In the industrial biotechnology area, the company has signed the Technology transfer agreement with IMTECH CHANDIGARH (a very reputed CSIR organization) to manufacture and market initially two Enzymes, Alpha Amylase and Alkaline Protease in India and overseas. The company is planning to set up a biotechnology facility to manufacture industrial enzymes. This facility would also include the research laboratories for carrying out further R & D activities to develop new candidates' drug molecules and license them to Interested Pharma and*

*Bio Companies across the GLOBE. The proposed Facility will be set up in Genome Valley at Hyderabad in Andhra Pradesh.'*

***According to the learned D.R. celestial labs is also in the field of research in pharmaceutical products and should be considered as comparable. As rightly submitted by the learned counsel for the Assessee, the discovery is in relation to a software discovery of new drugs. Moreover the company also is owner of the IPR. There is however a reference to development of a molecule to treat cancer using bio-informatics tools for which patenting process was also being pursued. As explained earlier it is a diversified company and therefore cannot be considered as comparable functionally with that of the Assessee. There has been no attempt made to identify and eliminate and make adjustment of the profit margins so that the difference in functional comparability can be eliminated. By not resorting to such a process of making adjustment, the TPO has rendered this company as not qualifying for comparability. We therefore accept the plea of the Assessee in this regard."***

44. *It was submitted that the learned DR in the above case vehemently argued that this company is into research in pharmaceutical products. The ITAT concluded that this company is owner of IPR, it has software for discovery of new drugs and has developed molecule to treat cancer. In the ultimate analysis, the ITAT did not consider this company as a comparable in clinical trial segment, for the reason that this company has diverse business. It was submitted that, however, from the above extracts it is clear that this company is not into software development activities, accordingly, this company should be rejected as a comparable being functionally different.*

45. *From the material available on record, it transpires that the TPO has accepted that up to AY 06-07 this company was classified as a Research and Development company. According to the TPO in AY 07-08 this company has been classified as software development service provider in the Capitaline/Prowess database as well as in the annual report of this company. The TPO has relied on the response from this company to a notice u/s.133(6) of the Act in which it has said that it is in the business of providing software development services. The Assessee in reply to the proposal of the AO to treat this as a comparable has pointed out that this company provides software products/services as well as bioinformatics services and that the segmental data for each activity is not available and therefore this company should not be treated as comparable. Besides the above, the Assessee has point out to several references in the annual report for 31.3.2007 highlighting the fact that this company was develops biotechnology products and provides related software development services. The TPO called for segmental data at the entity level from this company. The TPO also called for description of software development process. In response to the request of the TPO this company in its reply dated 29.3.2010 has given details of employees working in software development but it is not clear as to whether any segmental data was given or not. Besides the above there is no other detail in the TPO's order as to the nature of*

*software development services performed by the Assessee. Celestial labs had come out with a public issue of shares and in that connection issued Draft Red Herring Prospectus (DRHP) in which the business of this company was explained as to clinical research. The TPO wanted to know as to whether the primary business of this company is software development services as indicated in the annual report for FY 06-07 or clinical research and manufacture of bio products and other products as stated in the DRHP. There is no reference to any reply by Celestial labs to the above clarification of the TPO. The TPO without any basis has however concluded that the business mentioned in the DRHP are the services or businesses that would be started by utilizing the funds garnered though the Initial Public Offer (IPO) and thus in no way connected with business operations of the company during FY 06-07. We are of the view that in the light of the submissions made by the Assessee and the fact that this company was basically/admittedly in clinical research and manufacture of bio products and other products, there is no clear basis on which the TPO concluded that this company was mainly in the business of providing software development services. We therefore accept the plea of the Assessee that this company ought not to have been considered as comparable.”*

**2) “E-Zest Solutions Ltd.**

*14.1 This company was selected by the TPO as a comparable. Before the TPO, the assessee had objected to the inclusion of this company as a comparable on the ground that it was functionally different from the assessee. The TPO had rejected the objections raised by the assessee on the ground that as per the information received in response to notice under section 133(6) of the Act, this company is engaged in software development services and satisfies all the filters.*

*14.2 Before us, the learned Authorised Representative contended that this company ought to be excluded from the list of comparables on the ground that it is functionally different to the assessee. It is submitted by the learned Authorised Representative that this company is engaged in ‘e-Business Consulting Services’, consisting of Web Strategy Services, I T design services and in Technology Consulting Services including product development consulting services. These services, the learned Authorised Representative contends, are high end ITES normally categorised as knowledge process Outsourcing (‘KPO’) services. It is further submitted that this company has not provided segmental data in its Annual Report. The learned Authorised Representative submits that since the Annual Report of the company does not contain detailed descriptive information on the business of the company, the assessee places reliance on the details available on the company’s website which should be considered while evaluating the company’s functional profile. It is also submitted by the learned Authorised Representative that KPO services are not comparable to software development services and therefore companies rendering KPO services ought not to be considered as comparable to software development companies and relied on the decision of the co-ordinate bench in*

*the case of Capital IQ Information Systems (India) (P) Ltd. in ITA No.1961(Hyd)/2011 dt.23.11.2012 and prayed that in view of the above reasons, this company i.e. e-Zest Solutions Ltd., ought to be omitted from the list of comparables.*

*14.3 Per contra, the learned Departmental Representative supported the inclusion of this company in the list of comparables by the TPO.*

*14.4 We have heard the rival submissions and perused and carefully considered the material on record. It is seen from the record that the TPO has included this company in the list of comparables only on the basis of the statement made by the company in its reply to the notice under section 133(6) of the Act. It appears that the TPO has not examined the services rendered by the company to give a finding whether the services performed by this company are similar to the software development services performed by the assessee. From the details on record, we find that while the assessee is into software development services, this company i.e. e-Zest Solutions Ltd., is rendering product development services and high end technical services which come under the category of KPO services. It has been held by the co-ordinate bench of this Tribunal in the case of Capital I-Q Information Systems (India) (P) Ltd. Supra that KPO services are not comparable to software development services and are therefore not comparable. Following the aforesaid decision of the co-ordinate bench of the Hyderabad Tribunal in the aforesaid case, we hold that this company, i.e. e-Zest Solutions Ltd. be omitted from the set of comparables for the period under consideration in the case on hand. The A.O. /TPO is accordingly directed.”*

### **3) Infosys Technologies Ltd.**

*12.1 This was a comparable selected by the TPO. Before the TPO, the assessee objected to the inclusion of the company in the set of comparables, on the grounds of turnover and brand attributable profit margin. The TPO, however, rejected these objections raised by the assessee on the grounds that turnover and brand aspects were not materially relevant in the software development segment.*

*12.2 Before us, the assessee contended that this company is not functionally comparable to the assessee and in this context has cited various portions of the Annual Report of this company to this effect which is as under :-*

*(i) The company has an Intellectual Property (IP) Cell to guide its employees to leverage the power of IP for their growth. In 2008, this company generated over 102 invention disclosures and filed an aggregate 10 patents in India and the USA. Till date this company has filed an aggregate of 119 patent applications (pending) in India and USA out of which 2 have been granted in the US.*

*(ii) This company has substantial revenues from software products and the break-up of the software product revenues is not available.*

(iii) This company has incurred huge research and development expenditure to the tune of approximately Rs.200 Crores.

(iv) This company has a revenue sharing agreement towards acquisition of IPR in AUTOLAY, a commercial software product used in designing high performance structural systems.

(v) The assessee also placed reliance on the following judicial decisions :-

(a) ITAT, Delhi Bench decision in the case of Agnity India Technologies India Pvt. Ltd. (ITA No.3856/Del/2010) and

(b) Trilogy E-Business Software India Pvt. Ltd. (ITA No.1054/Bang/2011)

12.3 Per contra, opposing the contentions of the assessee, the learned Departmental Representative submitted that comparability cannot be decided merely on the basis of scale of operations and the operating margins of this company have not been extraordinary. In view of this, the learned Departmental Representative supported the decision of the TPO to include this company in the list of comparable companies.

12.4 We have heard the rival submissions and perused and carefully considered the material on record. We find that the assessee has brought on record sufficient evidence to establish that this company is functionally dis-similar and different from the assessee and hence is not comparable and the finding rendered in the case of Trilogy E-Business Software India Pvt. Ltd. (supra) for Assessment Year 2007-08 is applicable to this year also. The argument put forth by assessee's is that Infosys Technologies Ltd is not functionally comparable since it owns significant intangible and has huge revenues from software products. It is also seen that the break up of revenue from software services and software products is not available. In this view of the matter, we hold that this company ought to be omitted from the set of comparable companies. It is ordered accordingly."

#### **4) KALS Information Systems Ltd.**

"46. As far as this company is concerned, the contention of the assessee is that the aforesaid company has revenues from both software development and software products. Besides the above, it was also pointed out that this company is engaged in providing training. It was also submitted that as per the annual report, the salary cost debited under the software development expenditure was Q 45,93,351. The same was less than 25% of the software services revenue and therefore the salary cost filter test fails in this case. Reference was made to the Pune Bench Tribunal's decision of the ITAT in the case of Bindview India Private Limited Vs. DCI, ITA No. ITA No 1386/PN/10 wherein KALS as comparable was rejected for AY 2006-07 on account of it being functionally different from software companies. The relevant extract are as follows:

*“16. Another issue relating to selection of comparables by the TPO is regarding inclusion of Kals Information System Ltd. The assessee has objected to its inclusion on the basis that functionally the company is not comparable. With reference to pages 185-186 of the Paper Book, it is explained that the said company is engaged in development of software products and services and is not comparable to software development services provided by the assessee. The appellant has submitted an extract on pages 185-186 of the Paper Book from the website of the company to establish that it is engaged in providing of I T enabled services and that the said company is into development of software products, etc. All these aspects have not been factually rebutted and, in our view, the said concern is liable to be excluded from the final set of comparables, and thus on this aspect, assessee succeeds.”*

*Based on all the above, it was submitted on behalf of the assessee that KALS Information Systems Limited should be rejected as a comparable.*

*47. We have given a careful consideration to the submission made on behalf of the Assessee. We find that the TPO has drawn conclusions on the basis of information obtained by issue of notice u/s.133(6) of the Act. This information which was not available in public domain could not have been used by the TPO, when the same is contrary to the annual report of this company as highlighted by the Assessee in its letter dated 21.6.2010 to the TPO. We also find that in the decision referred to by the learned counsel for the Assessee, the Mumbai Bench of ITAT has held that this company was developing software products and not purely or mainly software development service provider. We therefore accept the plea of the Assessee that this company is not comparable.”*

**5) & 6) M/S.Ishir Infotech Ltd. And Lucid Software Ltd :**

*“20. As far as comparable companies listed at Sl.No.11 & 14 of the final list of comparable companies chosen by the TPO viz., M/S.Ishir Infotech Ltd. And Lucid Software Ltd., is concerned, this Tribunal in the case of First Advantage Offshore Services Pvt.Ltd. Vs. DCIT IT (TP) No.1086/Bang/2011 for AY 07-08 held that the aforesaid companies are not comparable companies in the case of software development services provider. The nature of services rendered by the Assessee in this appeal and the Assessee in the case of First Advantage Offshore Services Pvt.Ltd.(supra) are one and the same. This fact would be clear from the fact that the very same 26 companies were chosen as comparable in the case of the Assessee as well as in the case of First Advantage Offshore Services Pvt.Ltd.(supra). The following were the relevant observations in the case of First Advantage Offshore Services Pvt.Ltd.(supra):*

22. *The learned counsel for the assessee submitted that these two companies are also to be excluded from the list of comparables on the basis of the finding of this Tribunal in the case of Mercedes Benz Research & Development India Pvt. Ltd. dt 22.2.2013, wherein at pages 17 and 22 of its order the distinctions as to why these companies should be excluded are brought out. He submitted that the facts of the case before us are similar and, therefore, the said decision is applicable to the assessee's case also.*

23. *The learned DR however objected to the exclusion of these two companies from the list of comparables. On a careful perusal of the material on record, we find that the Tribunal in the case of Mercedes Benz Research & Development India Pvt. Ltd. (cited supra) has taken a note of dissimilarities between the assessee therein and Lucid Software Ltd. As observed therein Lucid Software Ltd. company is also involved in the development of software as compared to the assessee, which is only into software services. Similarly, as regards Ishir Infotech Ltd., the Tribunal has considered the decision of the Tribunal in the case of 24/7 Co. Pvt. Ltd to hold that Ishir Infotech is also out-sourcing its work and, therefore, has not satisfied the 25% employee cost filter and thus has to be excluded from the list of comparables. As the facts of the case before us are similar, respectfully following the decision of the co-ordinate bench, we hold that these two companies are also to be excluded.*

21. *Respectfully following the decision of the Tribunal referred to above, we direct the AO/TPO to exclude the aforesaid companies from the final list of comparable companies for the purpose of determining ALP."*

## **7) Wipro Limited**

*"13.1 This company was selected as a comparable by the TPO. Before the TPO, the assessee had objected to the inclusion of this company in the list of comparables on several grounds like functional dis-similarity, brand value, size, etc. The TPO, however, brushed aside the objections of the assessee and included this company in the set of comparables.*

*13.2 Before us, the assessee contended that this company is functionally not comparable to the assessee for several reasons, which are as under :*

*(i) This company owns significant intangibles in the nature of customer related intangibles and technology related intangibles and quoted extracts from the Annual Report of this company in the submissions made.*

*(ii) The TPO had adopted the consolidated financial statements for comparability purposes and for computing the margins, which contradicts the TPO's own filter of rejecting companies with consolidated financial statements.*

13.3. *Per contra, the learned Departmental Representative supported the action of the TPO in including this company in the set of comparables.*

13.4.1 *We have heard both parties and carefully perused and considered the material on record. We find merit in the contentions of the assessee for exclusion of this company from the set of comparables. It is seen that this company is engaged both in software development and product development services. There is no information on the segmental bifurcation of revenue from sale of product and software services. The TPO appears to have adopted this company as a comparable without demonstrating how the company satisfies the software development sales 75% of the total revenue filter adopted by him. Another major flaw in the comparability analysis carried out by the TPO is that he adopted comparison of the consolidated financial statements of Wipro with the stand alone financials of the assessee; which is not an appropriate comparison.*

13.4.2 *We also find that this company owns intellectual property in the form of registered patents and several pending applications for grant of patents. In this regard, the co-ordinate bench of this Tribunal in the case of 24/7 Customer.Com Pvt. Ltd. (ITA No.227/Bang/2010) has held that a company owning intangibles cannot be compared to a low risk captive service provider who does not own any such intangible and hence does not have an additional advantage in the market. As the assessee in the case on hand does not own any intangibles, following the aforesaid decision of the co-ordinate bench of the Tribunal i.e. 24/7 Customer.Com Pvt. Ltd. (supra), we hold that this company cannot be considered as a comparable to the assessee. We, therefore, direct the Assessing Officer/TPO to omit this company from the set of comparable companies in the case on hand for the year under consideration."*

**8) Accel Transmatic Ltd.**

48. *With regard to this company, the complaint of the assessee is that this company is not a pure software development service company. It is further submitted that in a Mumbai Tribunal Decision of Capgemini India (F) Ltd v Ad. CIT 12 Taxman.com 51, the DRP accepted the contention of the assessee that Accel Transmatic should be rejected as comparable. The relevant observations of DRP as extracted by the ITAT in its order are as follows:*

*"In regard to Accel Transmatics Ltd. the assessee submitted the company profile and its annual report for financial year 2005-06 from which the DRP noted that the business activities of the company were as under.*

*(i) Transmatic system - design, development and manufacture of multi function kiosks  
Queue management system, ticket vending system*

*(ii) Ushus Technologies - offshore development centre for embedded software, net work system, imaging technologies, outsourced product development*

*(iii) Accel IT Academy (the net stop for engineers)- training services in hardware and networking, enterprise system management, embedded system, VLSI designs, CAD/CAM/BPO*

*(iv) Accel Animation Studies software services for 2D/3D animation, special effect, erection, game asset development.*

*4.3 On careful perusal of the business activities of Accel Transmatic Ltd. DRP agreed with the assessee that the company was functionally different from the assessee company as it was engaged in the services in the form of ACCEL IT and ACCEL animation services for 2D and 3D animation and therefore assessee's claim that this company was functionally different was accepted. DRP therefore directed the Assessing Officer to exclude ACCEL Transmatic Ltd. from the final list of comparables for the purpose of determining TNMM margin."*

*49. Besides the above, it was pointed out that this company has related party transactions which is more than the permitted level and therefore should not be taken for comparability purposes. The submission of the Id. counsel for the assessee was that if the above company should not be considered as comparable. The Id. DR, on the other hand, relied on the order of the TPO.*

*50. We have considered the submissions and are of the view that the plea of the assessee that the aforesaid company should not be treated as comparables was considered by the Tribunal in Capgemini India Ltd (supra) where the assessee was software developer. The Tribunal, in the said decision referred to by the Id. counsel for the assessee, has accepted that this company was not comparable in the case of the assessee engaged in software development services business. Accepting the argument of the Id. counsel for the assessee, we hold that the aforesaid company should be excluded as comparables."*

*20. Respectfully following the decision of the Tribunal in similar set of facts, these companies are directed to be excluded from the list of comparables."*

## **9) Avani Cimcon Technologies Ltd.**

*"39. As far as this company is concerned, the plea of the Assessee has been that this company is functionally different from the assessee. Based on the information available in the company's website, which reveals that this company has developed a software product by name "DXchange", it was submitted that this company would*

have revenue from software product sales apart from rendering of software services and therefore is functionally different from the assessee. It was further submitted that the Mumbai Bench of the Tribunal to the decision in the case of *Telcordia Technologies Pvt. Ltd. v. ACIT – ITA No.7821/Mum/2011* wherein the Tribunal accepted the assessee's contention that this company has revenue from software product and observed that in the absence of segmental details, Avani Cincom cannot be considered as comparable to the assessee who was rendering software development services only and it was held as follows:-

“7.8 Avani Cincom Technologies Ltd. ('Avani Cincom'):

Here in this case also the segmental details of operating income of IT services and sale of software products have not been provided so as to see whether the profit ratio of this company can be taken into consideration for comparing the case that of assessee. In absence of any kind of details provided by the TPO, we are unable to persuade ourselves to include it as comparable party. Learned CIT DR has provided a copy of profit loss account which shows that mainly its earning is from software exports, however, the details of percentage of export of products or services have not been given. We, therefore, reject this company also from taking into consideration for comparability analysis.”

It was also highlighted that the margin of this company at 52.59% which represents abnormal circumstances and profits. The following figures were placed before us:-

Particulars	FYs 05-06	06-07	07-08	08-09
Operating Revenue	21761611	35477523	29342809	
28039851				
Operating Expns.	16417661	23249646	23359186	31108949
Operating Profit	5343950	12227877	5983623	(3069098)
Operating Margin	32.55%	52.59%	25.62%	- 9.87%

40. It was submitted that this company has made unusually high profit during the financial year 06-07. The operating revenues increased 63.03% which indicates that it was an extraordinary year for this company. Even the growth of software industry for the previous year as per NASSCOM was 32%. The growth rate of this company was double the industry average. In view of the above, it was argued that this company ought to have been rejected as a comparable.

41. We have given a careful consideration to the submissions made on behalf of the Assessee and are of the view that the same deserves to be accepted. The reasons given by the Assessee for excluding this company as comparable are found to be acceptable. The decision of ITAT (Mumbai) in the case of *Telcordia Technologies Pvt. Ltd. v. ACIT (supra)* also supports the plea of the assessee. We therefore accept the plea of the Assessee to reject this company as a comparable.”

**10) Flextronics Software Systems Ltd (seg) :**

“26. Now taking up the question of exclusion of Flextronics Software Systems Ltd (seg), it is true that the decision of Motorola Solutions (India) P. Ltd (supra) also was for the very same year and also on software development services sector. This Tribunal held as under :

“97.2 For a company to be included in the list of comparables, it is necessary that credible information is available about the company. Unless this basic requirement is fulfilled, the company cannot be taken as a comparable. It is true that Id. TPO is entitled to obtain information u/s 133(6), the object of which is primarily only to supplement the information already available on record, but not, as rightly submitted by Id. Counsel for the assessee, to replace the information. If there is a complete contradiction between the information obtained u/s 133(6) and annual report then the said information cannot be substituted for the information contained in annual report. We, therefore, are in ITA No. 5637/D/2011 149 agreement with Id. counsel for the assessee that this company cannot be included as a comparable in the set of comparables selected by Id. TPO on account of clear contradiction between contents of annual report and information obtained u/s 133(6).

27. Rule 10D(3) specifies the information and documents that are to be maintained by a person who is entering into international transactions. These are official publications, published accounts or those which are in public domain except for agreements and contracts to which assessee is privy. Once the annual report of a company is for a year different from the financial year ending 31<sup>st</sup> March, then without doubt, it will cease to be a good comparable, unless the information received in pursuance to a notice u/s.133(6) of the Act from such company, is reconciled with the figures available in such annual report.

28. In the case of Flextronics Software Systems Ltd (seg), no doubt the annual report was for the year ending 31.03.2007. However it was only for a nine months period. No reconciliation was attempted by the lower authorities between the figures given in such annual report with the figures which were made available by the said company to the TPO pursuant to notice issued to them u/s.133(6) of the Act. No doubt at page 123 of TP order, TPO has stated that the software development service revenues were more than 75% based on the following figures :

Revenue mix: Customer – activity-wise distribution:

Particulars	2007 (Rs. million)	%	2006 (Rs. Million)	%
Services-related parties	198	2.3	72	1.17
Services – others	7,368	85.51	4,854	78.72
Products-related parties	10	0.12	10	0.17
Products – others	896	10.4	970	15.74
BPO	129	1.5	214	3.47
Goods and others	15	0.17	45	0.73
Total Sales	8,616	100	6,165	100

*But how this segmentation was done by the TPO and the reconciliation of the said segmentation with the annual report of the assessee was never attempted or done. In such a situation we are of the opinion that Flextronics Software Solutions Ltd (seg) could not be considered as a proper comparable. We direct exclusion thereof.”*

**11) Helios & Matheson Information Technology Ltd :**

*“16. The next point made out by the assessee is with regard to the inclusion of items at (9) and (11) namely Helios & Matheson Information Technology Ltd., and KALS Information Solutions Ltd. (Seg). The primary plea raised by the assessee to assail the inclusion of the aforesaid two companies from the list of comparables is to be effect that they are functionally incomparable and therefore, are liable to be excluded. In sum and substance, the plea set up by the assessee is that both the aforesaid concerns are engaged in development and sale of software products which is functionally different from the services undertaken by the assessee in its IT-services segment.*

*17. As per the discussion in para 6.3.2. of the order of the TPO, the reason advanced for including KALS Information Systems Ltd., is to the effect that the said concern’s application software segment is engaged in the development of software which can be considered as comparable to the assessee company. The said concern is engaged in two segments namely application software segment and Training. As per the TPO, the application software segment is functionally comparable to the assessee as the said concern is engaged in software services. The stand of the assessee is that a perusal of the Annual Report of the said concern for F.Y. 2006-07 reveals that the application software segment is engaged in the business of sale of software products and software services. The assessee pointed out this to the TPO in its written submissions, copy of which is placed in the Paper book at page 420.3 to 420.4. The assessee further pointed out that there was no bifurcation available between the business of sale of software products and the business of software services, and therefore, it was not appropriate to adopt the application software segment of the said concern for the purposes of comparability with the assessee’s IT-Services Segment. The TPO however, noticed that though the application software segment of*

*the said concern may be engaged in selling of some of the software products which are developed by it, however, the said concern was not into trading of software products as there were no cost of purchases debited in the Profit & Loss Account. Though the TPO agreed that the quantum of revenue from sale of products was not available as per the financial statements of the said concern, but as the basic function of the said concern was software development, it was includible as it was functionally comparable to the assessee's segment of IT-Services.*

*18. Before us, apart from reiterating the points raised before the TPO and the DRP, the Ld. Counsel submitted that in the immediately preceeding assessment year of 2006-07, the said concern was evaluated by the assessee and was found functionally incomparable. For the said purpose, our reference has been invited to pages 421 to 542 of the Paper book, which is the copy of the Transfer Pricing study undertaken by the assessee for the A.Y. 2006-07, and in particular, attention was invited to page 454 where the accept reject matrix undertaken by the assessee reflected KALS Information Solutions Ltd. (Seg) as functionally incomparable. The Ld. Counsel pointed out that the aforesaid position has been accepted by the TPO in the earlier A.Y. 2006-07 and therefore, there was no justification for the TPO to consider the said concern as functionally comparable in the instant assessment year.*

*19. In our considered opinion, the point raised by the assessee is potent in as much as it is quite evident that the said concern has not been found to be functionally comparable with the assessee in the immediately preceding assessment year and in the present year also, on the basis of the Annual Report, referred to in the written submissions addressed to the lower authorities, the assessee has correctly asserted out that the said concern was inter alia engaged in sale of software products, which was quite distinct from the activity undertaken by the assessee in the IT Services segment. At the time of hearing, neither is there any argument put forth by the Revenue and nor is there any discussion emerging from the orders of the lower authorities as to in what manner the functional profile of the said concern has undergone a change from that in the immediately preceding year. Therefore, having regard to the factual aspects brought out by the assessee, it is correctly asserted that the application software segment of the said concern is not comparable to the assessee's segment of IT services.*

*20. With regard to the inclusion of Helios & Matheson Information Technology Ltd., the assessee has raised similar arguments as in the case of KALS Information Solutions Ltd. (Seg). We have perused the relevant para of the order of the TPO i.e., 6.3.21, in terms of which the said concern has been included as a comparable concern. The assessee pointed out that as in the case of KALS Information Solutions Ltd. (Seg), in the instant case also for A.Y. 2006-07 the said concern was found functionally incomparable by the assessee in its Transfer pricing study and the said position was not disturbed by the TPO. The relevant portion of the Transfer pricing*

*study, placed at page 432 of the Paper book has been pointed out in support. Considered in the aforesaid light, on the basis of the discussion in relation to KALS Information Solutions Ltd. (Seg), in the instant case also we find that the said concern is liable to be excluded from the list of comparables.”*

### **12) Persistent Systems Ltd.**

*“17.1.1 This company was selected by the TPO as a comparable. The assessee objected to the inclusion of this company as a comparable for the reasons that this company being engaged in software product designing and analytic services, it is functionally different and further that segmental results are not available. The TPO rejected the assessee's objections on the ground that as per the Annual Report for the company for Financial Year 2007-08, it is mainly a software development company and as per the details furnished in reply to the notice under section 133(6) of the Act, software development constitutes 96% of its revenues. In this view of the matter, the Assessing Officer included this company i.e. Persistent Systems Ltd., in the list of comparables as it qualified the functionality criterion.*

*17.1.2 Before us, the assessee objected to the inclusion of this company as a comparable submitting that this company is functionally different and also that there are several other factors on which this company cannot be taken as a comparable. In this regard, the learned Authorised Representative submitted that :*

*(i) This company is engaged in software designing services and analytic services and therefore it is not purely a software development service provider as is the assessee in the case on hand.*

*(ii) Page 60 of the Annual Report of the company for F.Y. 2007-08 indicates that this company, is predominantly engaged in ‘Outsourced Software Product Development Services’ for independent software vendors and enterprises.*

*(iii) Website extracts indicate that this company is in the business of product design services.*

*(iv) The ITAT, Mumbai Bench in the case of Telecordia Technologies India Pvt. Ltd.(supra) while discussing the comparability of another company, namely Lucid Software Ltd. had rendered a finding that in the absence of segmental information, a company be taken into account for comparability analysis. This principle is squarely applicable to the company presently under consideration, which is into product development and product design services and for which the segmental data is not available.*

*The learned Authorised Representative prays that in view of the above, this company i.e. Persistent Systems Ltd. be omitted from the list of comparables.*

*17.2 Per contra, the learned Departmental Representative support the action of the TPO in including this company in the list of comparables.*

*17.3 We have heard the rival submissions and perused and carefully considered the material on record. It is seen from the details on record that this company i.e. Persistent Systems Ltd., is engaged in product development and product design services while the assessee is a software development services provider. We find that, as submitted by the assessee, the segmental details are not given separately. Therefore, following the principle enunciated in the decision of the Mumbai Tribunal in the case of Telecordia Technologies India Pvt. Ltd. (supra) that in the absence of segmental details / information a company cannot be taken into account for comparability analysis, we hold that this company i.e. Persistent Systems Ltd. ought to be omitted from the set of comparables for the year under consideration. It is ordered accordingly.*

**13) Sasken Communication Technologies Ltd.:**

*“109. Ld TPO noticed that the company was rejected in the TP document on the ground that the company fails its filter of business review and R&D to sales was more than 3%. However, no reasons were given for the business review.*

*109.1 Ld. TPO pointed out that R&D to sales being more than 3% is not acceptable for which detailed discussion has already been made earlier. He further noticed that the company has software services segment and segmental results are available for software services. He further pointed out that on the basis of information obtained u/s 133(6), the company qualifies onsite revenue filter (onsite revenues were to the extent 27.27% of its export revenues). After considering the assessee's reply, Ld. TPO included this company in the list of comparables. Ld. counsel pointed out that this company has incurred significant expenditure on research and development activity the same being 6.07% of sales. He further submitted that the company had significant intangible inasmuch as it develops siskin branded products. The company owns IPR Further it was pointed out before TPO that during the year the company had acquired Botnia Hightech F. and its two subsidiaries and thus, it had under gone significant restructuring. However, Ld. TPO ignored these facts He relied on the following decisions:*

- *IQ Information System (I) Pvt. Ltd., ITA No. 1961/Hyd./2012 (para no. 11 & 23, page 25);*

- *Amerson Process Management India Pvt. Ltd., ITA No. 8118/Mum./2010 (para 16 page 15).*

110. *Ld. DR relied on the order of TPO and submitted that TPO considered the companies software services segment details only. 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.*

*If we follow the coordinate bench decision in the case of Motorola Solution (India) P. Ltd, Sasken Communication Technologies Ltd needs to be excluded. However, as mentioned by us at para 24 above, where the contested comparable formed part of assessee's own study, then the AO / TPO has to be given a chance for verification, in view of judgment of Hon'ble Punjab & Haryana High Court in the case of Quark Systems India P. Ltd (supra). Accordingly we remit the issue of comparability of Sasken Communication Technologies Ltd back to the AO / TPO for consideration afresh as per law. Ordered accordingly."*

#### **14) Tata Elxsi Ltd.**

14.1 *This company was a comparable selected by the TPO. Before the TPO, the assessee had objected to the inclusion of this company in the set of comparables on several counts like, functional dis-similarity, significant R&D activity, brand value, size, etc. The TPO, however, rejected the contention put forth by the assessee and included this company in the set of comparables.*

14.2 *Before us, it was reiterated that this company is not functionally comparable to the assessee as it performs a variety of functions under the software development and services segment namely*

*(a) Product design services*

*(b) Innovation design engineering and*

*(c) visual computing labs.*

*In the submissions made the assessee had quoted relevant portions from the Annual Report of the company to this effect. In view of this, the learned Authorised Representative pleaded that this company be excluded from the list of comparables.*

*14.3 Per contra, the learned Departmental Representative supported the stand o the TPO in including this company in the list of comparables.*

*14.4.1 We have heard both parties and carefully perused and considered the material on record. From the details on record, we find that this company is predominantly engaged in product designing services and not purely software development services. The details in the Annual Report show that the segment “software development services” relates to design services and are not similar to software development services performed by the assessee.*

*14.4.2 The Hon'ble Mumbai Tribunal in the case of Telecordia Technologies India Pvt. Ltd. V ACIT (ITA No.7821/Mum/2011) has held that Tata Elxsi Ltd. is not a software development service provider and therefore it is not functionally comparable. In this context the relevant portion of this order is extracted and reproduced below :-*

*“ .... 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 Authorised Representative 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 as fit for comparability analysis for determining the arm’s length price for the assessee, hence, should be excluded from the list of comparable portion.”*

*As can be seen from the extracts of the Annual Report of this company produced before us, the facts pertaining to Tata Elxsi have not changed from Assessment Year 2007-08 to Assessment Year 2008-09. We, therefore, hold that this company is not to be considered for inclusion in the set of comparables in the case on hand. It is ordered accordingly.”*

**15) Thirdware Solutions Ltd. (Segment) :**

*“15.1 This company was proposed for inclusion in the list of comparables by the TPO. Before the TPO, the assessee objected to the inclusion of this company in the list of comparables on the ground that its turnover was in excess of Rs.500 Crores. Before us, the assessee has objected to the inclusion of this company as a comparable for the reason that apart from software development services, it is in the business of product development and trading in software and giving licenses for use of software. In this regard, the learned Authorised Representative submitted that :-*

*(i) This company is engaged in product development and earns revenue from sale of licences and subscription. It has been pointed out from the Annual Report that the company has not provided any separate segmental profit and loss account for software development services and product development services.*

*(ii) In the case of E-Gain communications Pvt. Ltd. (2008-TII-04-ITAT-PUNE-TP), the Tribunal has directed that this company be omitted as a comparable for software service providers, as its income includes income from sale of licences which has increased the margins of the company.*

*The learned A.R. prayed that in the light of the above facts and in view of the afore cited decision of the Tribunal (supra), this company ought to be omitted from the list of comparables.*

*15.2 Per contra, the learned Departmental Representative supported the action of the TPO in including this company in the list of comparables.*

*15.3 We have heard the rival submissions and perused and carefully considered the material on record. It is seen from the material on record that the company is engaged in product development and earns revenue from sale of licenses and subscription. However, the segmental profit and loss accounts for software development services and product development are not given separately. Further, as pointed out by the learned Authorised Representative, the Pune Bench of the Tribunal in the case of E-Gain Communications Pvt. Ltd. (supra) has directed that since the income of this company includes income from sale of licenses, it ought to be rejected as a comparable for software development services.*

*In the case on hand, the assessee is rendering software development services. In this factual view of the matter and following the afore cited decision of the Pune Tribunal (supra), we direct that this company be omitted from the list of comparables for the period under consideration in the case on hand.”*

13. In so far as Megasoft Ltd, is concerned, findings of the Tribunal in the above case were as under :

Megasoft Ltd. :

24. This company was chosen as a comparable by the TPO. The objection of the assessee is that there are two segments in this company viz., (i) software development segment, and (ii) software product segment. The Assessee is a pure software services provider and not a software product developer. According to the Assessee there is no break up of revenue between software products and software services business on a standalone basis of this comparable. The TPO relied on information which was given by this company in which this company had explained that it has two divisions viz., BLUEALLY DIVISION and XIUS-BCGI DIVISION. Xius-BCGI Division does the business of product software. This company develops packaged products for the wireless and convergent telecom industry. These products are sold as packaged products to customers. While implementing these standardized products, customers may request the company to customize products or reconfigure products to fit into their business environment. Thereupon the company takes up the job of customizing the packaged software. The company also explained that 30 to 40% of the product software would constitute packaged product and around 50% to 60% would constitute customized capabilities and expenses related to travelling, boarding and lodging expense. Based on the above reply, the TPO proceeded to hold that the comparable company was mainly into customization of software products developed (which was akin to product software) internally and that the portion of the revenue from development of software sold and used for customization was less than 25% of the overall revenues. The TPO therefore held that less than 25% of the revenues of the comparable are from software products and therefore the comparable satisfied TPO's filter of more than 75% of revenues from software development services. The basis on which the TPO arrived at the PLI of 60.23% is given at page-115 and 116 of the order of the TPO. It is clear from the perusal of the same that the TPO has proceeded to determine the PLI at the entity level and not on the basis of segmental data.

25. In the order of the TPO, operating margin was computed for this company at 60.23%. It is the complaint of the assessee that the operating margins have been computed at entity level combining software services and software product segments. It was submitted that the product segment of Megasoft is substantially different from its software service segment. The product segment has employee cost of 27.65% whereas the software service segment has employee cost of 50%. Similarly, the profit margin on cost in product segment is 117.95% and in case of software service segment it is 23.11%. Both the segments are substantially different and therefore comparison at entity level is

without basis and would vitiate the comparability (submissions on page 381 to 383 of the PB-I). It was further submitted that Megasoft Limited has provided segmental break-up between the software services segment and software product segment (page 68 of PB-II), which was also adopted by the TPO in his show cause notice (Page 84 of PB-I). The segmental results i.e., results pertaining to software services segment of this company was:

Segmental Operating Revenues	Rs.63,71,32,544
Segmental Operating Expenses	Rs.51,75,13,211
Operating Profit	Rs.11,96,19,333
OP/TC (PLI)	23.11%

26. It was reiterated that in the given circumstances only PLI of software service segment viz., 23.11% ought to have been selected for comparison.

27. It was further submitted that the learned TPO in case of other comparable, similarly placed, had adopted the margins of only the software service segment for comparability purposes. Consistent with such stand, it was submitted that the margins of the software segment only should be adopted in the case of Megasoft also, in contrast to the entity level margins.

28. Computation of the net margin for Mega Soft Ltd. Is therefore remitted to the file of the TPO to compute the correct margin by following the direction of the Tribunal in the case of Trilogy E-Business Software India Pvt.Ltd.”

23. Respectfully following the decision of the Tribunal referred to above, we direct the AO/TPO to compute the correct margin of Mega Soft Ltd., as directed by the Tribunal in the case of First Advantage Offshore Services Pvt.Ltd. (supra).

Accordingly we hold that Megasoft Ltd can be considered as a good comparable after segmentation as directed in the above order is done.

14. Accordingly, following the above order we direct exclusion of Celestial Labs Ltd, E-Zest Solutions Ltd, Infosys Technologies Ltd, Kals Information Systems Ltde (seg), Lucid Software Ltd, Wipro Ltd (seg), Accel Transmatic Ltd (seg), Avani Cimcon Technologies Ltd, Flextronics Software Systems Ltd (seg), Helios & Matheson Information Technology Ltd, Ishir Infotech Ltd, Persistent Systems Ltd, Sasken Communication Technologies Ltd (Seg), Tata Elxsi Ltd (seg) and Thirdware Solutions Ltd. In so far as Megasoft Solutions Ltd is concerned, we direct the AO / TPO to rework its segmental results and consider its comparability only with regard to the software development services segment. Ordered accordingly.”

Accordingly, following the order of the co-ordinate bench of this Tribunal, we direct the A.O./TPO to exclude the following companies from the set of comparables :

Sl.No.	Name of Company
1.	Accel Transmatic Ltd. (Seg.)
2.	Avani Cincom Technologies Ltd.
3.	Celestial Labs Ltd.
4.	E-Zest Solutions Ltd.
5.	Ishir Infotech Ltd.
6.	KALS Information Systems Ltd. (Seg.)
7.	Thirdware Solutions Ltd.

19. As regards the **Mega Soft Ltd.**, the TPO is directed to consider the segmental results and correct amount of margin as directed by the co-ordinate bench. After exclusion of the comparables as directed by us, the A.O./TPO is directed to recompute the ALP by considering the remaining 8 comparables and correct margin in respect of Mega Soft Ltd. Needless to say the benefit under proviso to section 92C shall be considered.

20. The assessee has also raised an additional ground as under :

ø2.0 On the facts and circumstances of the case, there is no justification for the Assessing Officer for not allowing necessary deduction for a sum of Rs.1,11,98,582/- (division eligible for relief under section 10A ó Rs.81,89,903/- and division not eligible for relief under section 10A ó Rs.30,08,679/-) representing cost of stock options and RSUs granted to the employees of the Company by MTI the holding company or in the alternative for a sum of

Rs/13,91,337.- when amounts were paid by the company to its parent company on vesting of the relevant stock options / RSUs.

- 3.0 The Assessing Officer erred in not following the ratio of the decision of the honourable Income Tax Appellate Tribunal, Special Bench in the case of Biocon Limited 115 TTJ 649 and the Bangalore bench of the honourable Income Tax Appellate Tribunal in case of Novo Nordisk India (Pvt) Ltd. Vs. Deputy Commissioner of Income Tax 12(2), Bangalore. The Assessing Officer ought to have appreciated that the said amount is in the nature of employee compensation expenditure, is not a capital expenditure and has been expended wholly for the business of the company.ö

21. The Id. AR of the assessee has submitted that the assessee did not claim the deduction for a sum paid in respect of Employee Stock Option which was paid by the assessee to its parent company in lieu of the shares allotted to the employees of the assessee under Employees Stock Option Scheme. The Id. AR has submitted that for the Assessment Year 2008-09, the Tribunal vide its order dt.30.8.2016 in ITA No.1586/Bang/2012 has decided this issue in favour of the assessee. Accordingly, the assessee has raised this additional ground for allowing the claim of deduction regarding Employees Stock Compensation paid to the parent company. The Id. AR has relied upon the decision of the Hon'ble Supreme Court in the case of NTPC Ltd. Vs. CIT 229 ITR 383 and submitted that when the issue has already been decided by the Tribunal for the Assessment Year 2008-09, therefore on identical facts the claim of the assessee be allowed for the year under consideration.

22. On the other hand, the Id.DR has vehemently opposed to the admission of the additional ground and submitted that for the Assessment Year 2008-09 the assessee claimed the deduction in respect of employee stock option compensation which was disallowed by the Assessing Officer whereas for the year under consideration the assessee did not claim any such deduction and therefore the relevant facts were not examined by the Assessing Officer.

23. We have considered the rival submissions as well as the relevant material on record. There is no dispute that for the year under consideration the assessee did not claim the deduction in respect of the payment made to the parent company on account of Employees Stock Option and compensation. However we find that an identical issue has been considered in assessee's own case for the Assessment Year 2008-09 and it was held that it is an allowable deduction. Therefore, so far as the issue of allowability of the deduction is concerned it has been decided in favour of the assessee by this Tribunal by following the decision of the Special Bench in the case of Biocon Ltd. 115 TTJ 649. However since the relevant to details of the claim has not been examined by the Assessing Officer and further the apportionment of the expenditure between 10A

and non-10A units is also required to be examined and verified.

Therefore the claim of the assessee has to be apportioned between units eligible under Section 10A and the units which is not eligible for the deduction under Section 10A and then it has to be allowed against the respective income of the separate units. In view of the above facts and circumstances of the case, we set aside this issue to the record of the Assessing Officer for a limited purpose of verification and examination of the relevant record regarding apportionment of the amount between the 10A unit and non-10A unit.

24. In the result, the cross appeals for the A.Y. 2005-06 as well as the appeal of the assessee for the A.Y. 2007-08 AE partly allowed.

Order pronounced in the open court on the 31st day of Oct., 2016.

Sd/-  
**(INTURI RAMA RAO)**  
Accountant Member

Sd/-  
**(VIJAY PAL RAO)**  
Judicial Member

Bangalore,  
Dt. 31.10.2016.

\*Reddy gp