

**IN THE INCOME TAX APPELLATE TRIBUNAL
“B” BENCH : BANGALORE**

**BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT
AND SHRI JASON P BOAZ, ACCOUNTANT MEMBER**

IT(TP)A No.611/Bang/2013
Assessment year : 2004-05

The Deputy Commissioner of Income Tax, Circle-2(1)(1), Bangalore.	Vs.	M/s CGI Information Systems and Management Consultants Pvt. Ltd., (Successor in the interest of M/s Logica Pvt. Ltd.), E City, Tower-2, 95/1 & 95/2, Electronic City Phase 1 (West), Bangalore-560 100.
APPELLANT		RESPONDENT

Appellant by	:	Ms. Neera Malhotra, CIT (DR)
Respondent by	:	Shri T Suryanarayana, Advocate

Date of hearing	:	19.08.2019
Date of Pronouncement	:	28.08.2019

ORDER

Per N.V. Vasudevan, Vice President :

This is an appeal by the Revenue against the order dated 25.2.2013 of the Commissioner of Income Tax (Appeal) - IV, Bangalore relating to asst. year 2004-05.

2. The revised grounds of appeal raised by the Revenue reads as follows:-

“1. The order of the Learned CIT(Appeals), in so far as it is prejudicial to the interest of

revenue, is opposed to law and the facts and circumstances of the case.

2. The learned CIT(A) erred in excluding M/s. L&T Infotech Ltd., M/s Satyam Computers Ltd., and Infosys Technology Ltd as comparables in the segment holding that the size and turnover of the company are deciding factors for treating a company as a comparable.

3. The Ld. CIT(A) erred in excluding Sat Investeck Ltd from the list of comparables on the basis of abnormal profit without defining what constitutes abnormal profit filter and how the same is determined. In the light of decision of Hon'ble Delhi High Court in the case of Chryscapital Investment Advisors (India)(P) Ltd. Vs DCIT [2015] 56 taxmann.com 41(Delhi) wherein it is held that "mere fact that an entity makes high/extremely high profits/losses does not ipso facto lead to its exclusion from list of comparables for purpose of determination of ALP" comparable selected by the TPO may be upheld.

4. The Ld. CIT(A) erred in holding that persistent losses of the company do not disqualify a company for being treated as a comparable without appreciating the fact that the same is designed to eliminate companies which are not in line with the trend of growth witnessed in the software industry.

5. The Ld.CIT(A) has erred in rejecting the employee cost filter applied by the TPO and consequently erred in holding that M/s. OmniAx's Software Ltd. (Astro Bio Systems Ltd.), which has low employee cost is a comparable for software development services.

6. The CIT(A) erred, on the facts and in the circumstances of the case, in holding that M/s.

Bodhtree Consulting Ltd. and Kushagra Software Ltd. cannot be taken as comparables, without appreciating the fact that the companies qualify all the qualitative and quantitative filters applied by the TPO in selection of this companies as comparables.

7. The CIT(A) erred in directing the AO to recompute the deduction allowable u/s 10A of the I.T.Act after reducing the telecommunication charges of Rs. 1,34,63,702/- from total turnover also.

8. The CIT(A) erred in not appreciating the fact that there is no provision in section 10A which requires the concerned expenses are required to be reduced from the export turnover as per the clause(iv) of the Explanation to section 10A, to be reduced from the total turnover also.

9. The CIT(A) erred in not appreciating the fact that the jurisdictional High Court's decision relied upon by it has not been accepted by the department and an appeal has been filed before Hon'ble Supreme Court which is still pending.

10. For these and such other grounds that may urged at the time of hearing, it is humbly prayed that the order of the CIT(A) be reversed and that of the Assessing Officer be restored.

11. The appellant craves leave to add, to alter, to amend or to delete any of the grounds that may be urged at the time of hearing of the appeal.”

3. Ground Nos.1, 10 and 11 are general in nature and calls for no adjudication.

4. Ground Nos.2 to 6 are grounds with regard to determination of Arms Length Price (ALP) in respect of international transaction of rendering Software Development Services (SWDS) by the assessee to its associated enterprises (AE).

5. Grounds 7 to 10 raised by the Revenue are with regard to the computation of deduction u/s 10A of the Act.

6. We shall first deal with the ground with regard to determination of arms length price. The assessee is a company engaged in the business of rendering SWD Services. During the relevant previous year, the assessee provided SWD Services to its associated enterprise. The assessee received a consideration of Rs.61,07,78,834/- for rendering SWD Services to its AE. To substantiate the assessee's claim that the price paid in the international transactions to the AE is at arm's length, the assessee filed transfer pricing analysis in which the assessee adopted Transaction Net Margin Method (TNMM) as most appropriate method (MAM) for determining ALP. The profit Level Indicator (PLI) chosen for the purpose of comparison was operating profit on total cost (OP/TC). The assessee's OP/TC was as follows:-

B.1. Net margin on cost earned by the Respondent for software development services (as computed by the TPO):

Operating Income	Rs.61,07,78,834/-
Operating Cost	Rs.54,87,55,935/-
Operating Profit (Op. Income – Op. Cost)	Rs.6,20,22,899/-
Operating/Net margin (OP/TC)	11.30%

7. The assessee had chosen 77 comparable companies and the average arithmetic profit margin of those companies was comparable with that of the assessee and it was claimed by the assessee that the price charge in the international transaction was at arms length price. The TPO however rejected 59 comparable companies chosen by the assessee and retained the remaining 18 companies. The companies ultimately retained by the TPO and the computation of arms length price and addition to be made to the total income on account of determination of ALP is as follows:-

B.6. Comparables selected by the TPO and their arithmetic mean:

Sl. No.	Comparables Selected by TPO	NCP Margins as per TPO Order (%) (WC-Unadj)
1.	A B M Knowledgeware Ltd.	17
2.	Akshay software technologies Ltd.	9
3.	Bodhtree Consulting Ltd.	24
4.	E-Star Infotech Ltd.	16
5.	Goldstone technologies Ltd.	9
6.	Helios & Matheson information technology Ltd.	28
7.	Infosys Technologies Ltd.	40
8.	Infotech Enterprises Ltd.	11
9.	Kushagra software Ltd.	38.7
10.	Lanco Global Systems Ltd.	9
11.	L&T Infotech Ltd.	9.2
12.	Netvista information technology Ltd.	20
13.	Orient information technology Ltd.	15
14.	Sat investeck Ltd.	126
15.	Satyam Computer Services Ltd.	28
16.	Sun Beam Infotech Ltd.	2
17.	VJIL consulting Ltd.	8
18.	Systemlogic solutions Ltd.	34
Arithmetical Mean		24.66

B.7. Computation of arm's length price by the TPO and the adjustment made:

Arm's Length Mean Margin	24.66 %
Less: Working Capital Adjustment (ad-hoc value of 2%)	2.00 %
Adjusted mean margin of the comparables	22.66 %
Operating Cost	Rs.54,87,55,935/-
Arm's Length Price (ALP) 122.66 % of Operating Cost	Rs.67,31,04,030/-
Price Received	Rs.61,07,78,834/-
Short fall being adjustment u/s. 92CA	Rs.6,23,25,196/-

8. Aggrieved by the aforesaid addition made by the AO on the recommendations of the TPO, assessee filed appeal before the CIT(A). The CIT(A) excluded M/s L&T Infotech Ltd., M/s Satyam Computers Ltd., and Infosys Technologies Ltd., on the ground that these companies had huge turnover and could not be compared with the assessee. The CIT(A) also excluded SAT Investeck Ltd., from the list of comparable companies on the ground that the company made abnormal profit. The CIT(A) also included M/s Omni Ax's Software Ltd., (Astro Bio Systems Ltd). The CIT(A) also excluded M/s Bodh Tree Consulting Ltd., Kushagra Software Ltd., from the list of comparable companies chosen by the TPO. The Revenue is aggrieved by the aforesaid action of the CIT(A) and hence has raised grounds Nos. 2 to 6 before the Tribunal.

9. We have heard the rival submissions. As far as ground No.2 raised by the Revenue is concerned the question boils down on application of turnover filter in choosing comparable companies.

10. As far as excluding the companies on the basis of turnover is concerned, the issue has been settled in several decisions of the Tribunal and has been elaborately discussed by this Tribunal in the

case of *Autodesk India Pvt. Ltd. v. DCIT in IT(TP)A No.540 & 541/Bang/2013*, order dated 06.07.2018. The Tribunal in this decision after review of entire case laws on the subject, considered the question, whether companies having turnover more than 200 crores upto 500 crores has to be regarded as one category and those companies cannot be regarded as comparables with companies having turnover of less than 200 crores, the Tribunal held as follows:-

“17.7. We have considered the rival submissions. The substantial question of law (Question No.1 to 3) which was framed by the Hon'ble Delhi High Court in the case of Chryscapital Investment Advisors (India) Pvt.Ltd., (supra) was as to whether comparable can be rejected on the ground that they have exceptionally high profit margins or fluctuation profit margins, as compared to the Assessee in transfer pricing analysis. Therefore as rightly submitted by the learned counsel for the Assessee the observations of the Hon'ble High Court, in so far as it refers to turnover, were in the nature of obiter dictum. Judicial discipline requires that the Tribunal should follow the decision of a non-jurisdiction High Court, even though the said decision is of a non-jurisdictional High Court. We however find that the Hon'ble Bombay High Court in the case of CIT Vs. Pentair Water India Pvt.Ltd. Tax Appeal No.18 of 2015 judgment dated 16.9.2015 has taken the view that turnover is a relevant criterion for choosing companies as comparable companies in determination of ALP in transfer pricing cases. There is no decision of the jurisdictional High Court on this issue. In the circumstances, following the principle that where two views are available on an issue, the view favourable to the Assessee has to be adopted, we respectfully follow the view of the Hon'ble Bombay High Court

on the issue. Respectfully following the aforesaid decision, we uphold the order of the DRP excluding 5 companies from the list of comparable companies chosen by the TPO on the basis that the 5 companies turnover was much higher compared to that the Assessee.

17.8. In view of the above conclusion, there may not be any necessity to examine as to whether the decision rendered in the case of Genisys Integrating (supra) by the ITAT Bangalore Bench should continue to be followed. Since arguments were advanced on the correctness of the decisions rendered by the ITAT Mumbai and Bangalore Benches taking a view contrary to that taken in the case of Genisys Integrating (supra), we proceed to examine the said issue also. On this issue, the first aspect which we notice is that the decision rendered in the case of Genisys Integrating (supra) was the earliest decision rendered on the issue of comparability of companies on the basis of turnover in Transfer Pricing cases. The decision was rendered as early as 5.8.2011. The decisions rendered by the ITAT Mumbai Benches cited by the learned DR before us in the case of Willis Processing Services (supra) and Capegemini India Pvt.Ltd. (supra) are to be regarded as per incurium as these decisions ignore a binding co-ordinate bench decision. In this regard the decisions referred to by the learned counsel for the Assessee supports the plea of the learned counsel for the Assessee. The decisions rendered in the case of M/S.NTT Data (supra), Societe Generale Global Solutions (supra) and LSI Technologies (supra) were rendered later in point of time. Those decisions follow the ratio laid down in Willis Processing Services (supra) and have to be regarded as per incurium. These three decisions also place reliance on the decision of the Hon'ble Delhi High Court in the case of Chriscapital Investment (supra). We have already held that the decision rendered in the

case of Chriscapital Investment (supra) is obiter dicta and that the ratio decidendi laid down by the Hon'ble Bombay High Court in the case of Pentair (supra) which is favourable to the Assessee has to be followed. Therefore, the decisions cited by the learned DR before us cannot be the basis to hold that high turnover is not relevant criteria for deciding on comparability of companies in determination of ALP under the Transfer Pricing regulations under the Act. For the reasons given above, we uphold the order of the CIT(A) on the issue of application of turnover filter and his action in excluding companies by following the ratio laid down in the case of Genisys Integrating (supra)."

11. Consequently, we hold that there is no merit in ground No.2 raised by the Revenue.

12. As far as ground No.4 raised by the Revenue is concerned it is undisputed before us that no company was excluded or included by applying the filter of persistent losses and therefore ground No.4 does not arise out of the order of the CIT(A) and hence dismissed.

13. As far as Ground No.3 raised by the Revenue is concerned, the company Sat Investeck Ltd., was chosen as comparable company by the assessee. Before the CIT(A) objected to inclusion of this company on the ground that this company was developing software products. The assessee also submitted that the annual report of this company mentioned that the assessee has discontinued business of software development from 20/12/2004 and taken up international marketing as a core activity. The CIT(A) excluded this company by making the following observations in paragraph 97 of its order which reads as follows:-

“97. I have considered the appellant’s argument. Further, the TPO in her remand report dated June 24, 2011 has accepted Appellant’s contention of exclusion Sat Investeck Ltd. due to controlled nature of services rendered. As I have already directed that this company may be excluded from the list of comparables in view of its abnormal profit margin of 126%, further contentions about the company’s functionally differentiation and RPT do not require further consideration.”

14. It can be seen from the aforesaid order of the CIT(A) that the CIT(A) has excluded this company from the list of comparable companies on 2 grounds namely that the services rendered were of different nature and it had abnormal profits. In ground No.3, the Revenue has challenged the order of the CIT(A) only on the basis of exclusion by the CIT(A) on the ground of abnormal profits. Since there is no challenge to exclusion of this company on the other grounds stated by the CIT(A) in his order, we are of the view that ground No.3 would not require adjudication. Even otherwise the law is settled that abnormal profits *per se* is not a ground to exclude companies from the list of comparable companies, if they are functionally comparable. However, if the abnormality of profits is due to peculiar circumstances then such companies should be excluded from the list of comparable companies. We are therefore of the view that there is no merit in ground No.3 raised by the Revenue.

16. As far as ground Nos.5 and 6 are concerned it is the plea of the Revenue that the assessee sought exclusion of these 2 companies only in the appeal before the CIT(A) and remand report had not been called from the AO on the grounds stated by the assessee before the CIT(A) for exclusion of these companies. In

these circumstances we feel it proper to set aside the order of CIT(A) and remand the issue to the TPO for fresh consideration after due opportunity to the assessee.

17. Ground Nos.7 to 9 raised by the assessee is with regard to computation of deduction u/s 10A of the Act.

18. The Assessee in the grounds of appeal Nos.7 to 9 projected its grievance regarding the action of the learned Assessing Officer and CIT(A) in excluding, while computing deduction u/s.10A of the Act, the items of expenditure set out in the grounds of appeal from the export turnover on the ground that these expenses are attributable to delivery of software outside India from the export turnover. It is the plea of the Assessee that at all times during the relevant previous year, it was engaged in development of computer software and not in rendering any technical services. Without prejudice to its contention that the aforesaid sums should not be excluded from the export turnover while computing deduction u/s.10A of the Act, the Assessee has also made an alternate prayer that expenses that are reduced from the export turnover should also be reduced from the total turnover and in this regard has placed reliance on the decision of the Hon'ble Karnataka High Court in the case of *CIT v. Tata Elxsi Ltd [2012] 349 ITR 98 (Karn)*,

19. We have heard the ld. counsel for the assessee and the ld. DR on the issues raised in this regard. Taking into consideration the decision rendered by the Hon'ble High Court of Karnataka in the case of *CIT v. Tata Elxsi Ltd [2012] 349 ITR 98 (Karn)*, we are of the view that it would be just and appropriate to direct the Assessing

Officer to exclude the charges referred to in Gr.No.10 referred to above both from export turnover and total turnover, as has been prayed for by the assessee in the alternative. In view of the acceptance of the alternative prayer, we are of the view that no adjudication is required on the ground whether the aforesaid sums are required to be excluded from the export turnover. Moreover, the order of the Hon'ble Karnataka High Court has been upheld by the Hon'ble Supreme Court in the case of *CIT v. HCL Technologies Ltd. in Civil Appeal No.8489-98490 of 2013 & Ors. dated 24.04.2018*. Consequently ground Nos. 7 to 9 are dismissed.

20. In the result appeal filed by the Revenue is partly allowed for statistical purposes.

Pronounced in the open court on **28th August, 2019.**

Sd/-

(JASON P BOAZ)
Accountant Member

Sd/-

(N.V. VASUDEVAN)
VICE PRESIDENT

Bangalore
Dated, the 28th August, 2019
/Vms/

Copy to:

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

By

Assistant Registrar, ITAT, Bangalore

1. Date of Dictation
2. Date on which the typed draft is placed
before the dictating Member
3. Date on which the approved draft comes to Sr.P.S
.....
4. Date on which the fair order is placed
before the dictating Member
5. Date on which the fair order comes back to the
Sr. P.S.
6. Date of uploading the order on
website.....
7. If not uploaded, furnish the reason for doing so
.....
Dictation note enclosed
8. Date on which the file goes to the Bench Clerk
.....
9. Date on which order goes for Xerox &
endorsement.....
10. Date on which the file goes to the Head Clerk
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11. The date on which the file goes to the Assistant
Registrar for signature on the order
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12. The date on which the file goes to dispatch
section for dispatch of the Tribunal Order
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