

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCHES: '1-2', NEW DELHI**

**BEFORE SRI J.SUDHAKAR REDDY, ACCOUNTANT MEMBER
AND SRI AMIT SHUKLA, JUDICIAL MEMBER**

**IN ITA No. 7078/Del/2014
AY: 2010-11**

<p>Open Solutions Software Services Pvt. Ltd., 46, Aradhana Chanakya Puri, South Delhi New Delhi 110066 PAN: AAACO 7542 G</p>	Vs.	<p>DCIT Circle 19(1) C R Building New Delhi</p>
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(Appellant)

(Respondent)

Appellant by : Sh. Sachit Jolly, Adv.
Respondent by : Sh. T.M.Shiva Kumar, CIT(DR)

Date of hearing : 22.03.2017

Date of pronouncement: 17.04.2017

ORDER

PER AMIT SHUKLA, JUDICIAL MEMBER:

The aforesaid appeal has been filed by the assessee against final assessment order dated 25.11.2014, passed u/s 143(3) r.w.s. 144(13) of the Income Tax Act, 1961 (the Act), in pursuance of direction given by the Dispute Resolution Panel(DRP)-II, New Delhi u/s 144(5) vide order dated 29.10.2014 for the A.Y. 2010-2011.

2. The assessee is mainly aggrieved by transfer pricing adjustment of Rs.3,59,52,769/- made on provision of software development research and related services.

3. Before us the Ld.Counsel for the assessee had not pressed most of the grounds and has only confined to exclusion of four comparable, viz.,:-

- i. Infosys Ltd.
- ii. Wipro Technology Services Ltd.
- iii. Persistent Systems Ltd.
- iv. Third Ware Sales Ltd.

Accordingly, our finding and adjudication would be qua the four comparables only.

4. The brief facts of the case are that the assessee, M/s Open Solutions Services Pvt. Ltd is rendering software development research and other related services to its parent company, 'Open Solutions Inc.', USA, (Associated Enterprise) and is a captive service provider. As per the service agreement, for rendering of such services, the assessee is compensated at cost plus 15% mark-up. The brief profile and functions of the assessee has been described by the Ld.Transfer Pricing Officer (TPO) in his order in the following manner:-

'Open Solution India (OSI) is involved in development of computer software and provision of related services. OSI was setup as a separate entity in India to provide software development, research and other services to OS Inc., OSI is involved in developing software components that can be integrated into OS Inc.'s new products or improvisations and other customization

requirements on existing products. In addition, OSI is also slated to develop and maintain software utilities and test suites for software components developed locally and by OS Inc. Being primarily a software research & development centre, OSI has been setup to primarily establish and developed considerable expertise in the areas of electronic design, synthesis, system setting, verification technologies, software engineering, and product validation. It is slated to build up a core team that would works towards the development of core competencies. Core competency development in various areas is essential for effective sales and marketing of OSI's services.'

3.1 For the transaction of provision of software development, research related services was at Rs.38,40,88,682/- the profit level indicator (PLI) was taken as operating profit/operating cost (OP/OC) which was arrived at 11.87% in the following manner:-

Nature of transaction	Sales (Rs.)	Operating cost (OC)(Rs.)	Operating profit (OP) (Rs)	OP/OC %
Provision of software development, research and related services	38,40,88,682	34,33,39,424	4,07,49,258	11.87

To bench mark the said margin, the assessee in its transfer pricing study adopted "transactional net margin method" (TNMM) as the most appropriate method and PLI as OP/OC. The assessee selected 14 comparable companies in software development service segment whose arithmetic mean was arrived at 11.91% and hence it was declared that assessee's margins were at arm's length. When required by the TPO to furnish the updated margins of the comparables on the basis of current year data, the

assessee submitted 12 comparable companies whose arithmetic mean was arrived at 7.83%. However, the Ld.TPO rejected the entire transfer pricing study of the assessee and after applying fresh filters undertook his own search of comparables and carried out fresh transfer pricing analysis. After detailed discussion and inviting assessee's objection, he shortlisted in as much as 21 comparables with arithmetic mean of 27.44% as against the PLI of 11.87%. Accordingly an adjustment of Rs.5,49,05,106/- was made. After the stage of DRP, the revised arm's length adjustment was worked out at Rs.3,59,57,769/-.

4. Now before us as stated above the assessee has mainly challenged the following four comparables selected by the TPO and affirmed by the DRP:-

- i) Infosys Ltd. (46.13%)
- ii) Wipro Technology Services Ltd.
- iii) Persistent Systems Ltd. (15.56%)
- iv) Third Ware Sales Ltd. (42.28%)

(i) **Infosys Ltd.**

4.1 The main contention of the Ld.Counsel before us for challenging the inclusion of Infosys Ltd. is that, *firstly*, Infosys Ltd. is functionally different from the assessee, because it is into various diversified field ranging between product conceptualisation, core design, research and development, marketing, sales and post sales services, none of which is performed by the assessee; *secondly*, the asset profile of the Infosys Ltd. consists of significant brand and intangibles which is

evident from the fact that intangibles are more than Rs.1,00,000 crores, whereas in case of assessee it is none; *thirdly*, Infosys Ltd. assumes huge entrepreneurial risk, market risk, commercial risk, project liability risk, technology risk and credit risk, whereas assessee is risk mitigated captive service provider; and *lastly*, it was pointed out that the turnover of the Infosys is Rs.21,140 crores; sales, advertisement and brand building expenses are over Rs.25 crores; and research & development expenses are Rs.437 crores. As compared to the Infosys Ltd., the assessee being captive service provider is completely confined to software development services for the A.E. There are no intangibles and no research & development expenditure. Hence, the Infosys Ltd. cannot be compared with that of the assessee. In support of the said proposition, strong reliance was placed on the judgment of Hon'ble Delhi High Court in the case of **CIT vs. Agnity India Technologies Pvt. Ltd. reported in 219 Taxmann.26 (2013)**. It was also pointed out before us that in the Assessment Year 2011-12, the ld. DRP itself has excluded Infosys Ltd. for comparability analysis; and further in the case of assessee's group company, i.e., Fiserve India, vide order dt. 26.6.2015 in ITA no.6737/Del/2014, this company has been held to be incomparable with the companies providing software development services as capital service providers.

4.2 On the other hand the Ld. CIT D.R. strongly relied upon the order of the TPO as well as the DRP and submitted that Infosys Ltd. is too into software development, and, therefore, over all functional profile matches with the assessee.

5. After considering the rival submissions and on perusal of the impugned orders, we find that on FAR analysis, Infosys Ltd. cannot be held to be comparable with an entity like assessee which is a captive service provider. As mentioned above the functional profile of Infosys Ltd is highly diversified like, right from product conceptualisation, core design, research & development to marketing and sales of products, all are done by Infosys Ltd.; whereas no such function is carried out by the assessee. The Infosys Ltd is full fledged risk bearing entrepreneur whose turnover is more than Rs.21,000 crores. This definitely has huge impact on FAR analysis, especially on asset side and risk analysis. For e.g., brand equity and intangibles of Infosys Ltd. are more than Rs.1,00,000 crores which goes to show that this Company derives substantial portion of its profits from its brand value and hence such a giant company cannot be compared with the assessee which does not have any significant intangibles and is a risk mitigated entity. Apart from that, as pointed out by the Ld. Counsel, research and development expenses and sales and advertisement expenses far exceeds the assessee's turnover. All these factors fails the comparability test. The Hon'ble Delhi High Court in the case of CIT vs. Agnity India Technologies (supra) have made distinction of various FAR factors between Infosys Ltd. and contract software development service provider. Thus, in view of our discussions as above and following the ratio and the principle laid down by the Hon'ble Delhi High Court, we direct the TPO/AO to remove 'Infosys Ltd' from the final list of comparables.

(ii) **Wipro Technology Services Ltd.**:-

6. Regarding the exclusion of Wipro Technology Services Ltd., it has been pointed out by the Ld.Counsel before us that, this company had an extra ordinary event during the year and hence it should not be selected as comparable. It was explained that this company was part of the Citi Group and rendered services to various entities of the Citi Group worldwide and was known as 'City Technology Services Ltd' and with effect from 21.1.2009; this company was acquired by 'Wipro Ltd' and was subsequently renamed as 'Wipro Technology Services Ltd'. Further as part of the acquisition it was agreed that the company will be provided business of at least \$500 million over a period of 6 years by the Citi Group. This pre-arrangement between Citi group and Wipro Ltd. would make the subsequent rendition of services by the company to the Citi group as deemed international transaction u/s 92B(2) of the Act; and accordingly, this income should be included in the RPT threshold, thereby making the company as an unviable comparable. Ld. Counsel submitted that in terms of Section 92B (2) of the Act, rendition of service by an enterprise (Wipro Technology Services) to a non-associated enterprise (Citi group in the present case) as part of an understanding between the AE (Wipro) and the non-AE (Citi group) would be treated as a deemed international transaction for the purposes of Chapter X of the Act. In the present case also this comparable has only rendered services to the Citi Group as per the memorandum of service agreement (MSA) between Wipro Technology Services Ltd. and the Citi Group, and, therefore, the entire revenues of this comparable are on account of related party transactions. If such

revenues are added then this comparable company fails the filter criteria of 25% of related party transactions (R.P.T.) as applied by TPO. In support reliance was placed by him on the decision of this Tribunal in the assessee's group company, i.e., 'Cash Edge India Pvt.Ltd.' in ITA 64/Del/2015 order dated 23.9.2015 for the A.Y. 2010-11 and such an order has been confirmed by the Hon'ble Delhi High Court vide order dated 4.5.2016.

6.1 On the other hand Ld. CIT D.R. strongly relied upon the finding of the AO and DRP that it is not an extra ordinary event and does not affect the profit margins of the comparable company. Moreover the Wipro Ltd. and Citi group are not related party transactions, and, therefore, after the Wipro Ltd. has acquired this company in the earlier year, it cannot be held that related party transaction filter would be applicable in the A.Y. 2010-11.

7. We have heard the rival submissions and also perused the relevant finding given in the impugned orders as well as the material referred to and relied upon before us. One of the main ground for exclusion of this company is that it fails the criteria of 25% of RPT filter for the reason that its entire revenue is on account of related party transactions. As pointed out by the Ld. Counsel prior to 20.01.2009, 'Wipro Technology Services Ltd.' was part of City group and was known as 'City Technology Services Ltd.' (CTS) which provided services to the Citi Group. With effect from 20.01.2009, Wipro Ltd. acquired the entire 100% holding of 'Citi Technology Services Ltd' which was subsequently

renamed as 'Wipro Technology Services Ltd.' As a pre-arrangement, Wipro Ltd made an agreement with Citi Group Inc. for acquiring of a City group interest in CTS and signed Master Service Agreement with Citi Group Inc., for the delivery of similar technology, infrastructure, services and application, development and maintenance service for the period of 6 years, which was provided by erstwhile CTS. The MSA provided that at least \$500 million in service revenues over the period of contract should be paid. This prearrangement between the Citi group and Wipro Ltd. would make the subsequent rendition of services by this company to the Citi group fall within the meaning of deemed international transaction as defined u/s 92B(2) which reads as under.

“S.92B(2): A transaction entered into by an enterprise with a person other than an associated enterprise shall, for the purposes of sub section (1), be deemed to be a transaction entered into between two associated enterprises, if there exists a prior agreement in relation to the relevant transaction between such other person and the associated enterprise, or the terms of the relevant transaction are determined in substance between such other person and the associated enterprise.”

The aforesaid provision clearly envisages that, if a transaction has been entered into by an enterprise with unrelated party, then for the purpose of Section 92B(1) it is deemed to be transaction entered into between related parties (two A.Es) if there exists prior agreement in relation to the relevant transaction between third party and the A.E. In other words, as per terms of Section

92B(2), even if the transaction is between unrelated party and an enterprise, then, it would be deemed to be an international transaction if there was any prior agreement between the related parties on the basis of which present transaction is being undertaken. Here in the present case it is the precisely the same situation, because there was a prior agreement between the City group and City Technology Services Ltd. who were related party, that is, at that time the transaction was between two A.Es, hence related party transaction. Later on, when one of the A.E. was acquired by an unrelated party, i.e., Wipro Ltd., then also if any revenue is received from Citi Group on account of such prior agreement or pre- arrangement, then it is deemed to be an international transaction and once that is so then due to RPT filter this company would fail the test of such a filter, because admittedly entire revenue of this company is on account of RPT. Thus, we agree with the contentions of the Ld.Counsel that this company cannot be taken as a comparable for bench marking assessee's margin.

(iii) Persistent Systems Ltd.:-

8. Before us the Ld.Counsel submitted that Persistent Systems Ltd. (PSL) is functionally dissimilar from the assessee, because this company is not only into software development services but also into software products like, Wave Relay(R), Android Kit, Integration Board Gen4, Quad Radio Router, Tracking Antenna System, Management Tools, Cloud Relay, Firefighting Kit etc. Moreover no segmental details are available in the annual report of the said company for both the activities. Apart from that the

domestic sales of this company is Rs. 30.4 crores as compared to 'nil' of the assessee and commission paid to agents on sales is at Rs. 3.31 crores, which indicates or demonstrate that, this company has substantial income from sales. Further in the case of group company of the assessee which is in the same line of business, i.e., Fiserve India in ITA 6737/Del/2014 the Tribunal has excluded this comparable and such an order of the Tribunal has now been confirmed by the Hon'ble Delhi High Court vide judgment dated 7.10.2016 in ITA 602/2016. Further in another group company's case, i.e. Cash Edge India Pvt.Ltd. (order dt. 23.9.2015 in ITA 64/Del/15) for the A.Y. 2010-11 again this company was held to be incomparable. This judgement of the Tribunal too has been confirmed by Hon'ble High Court vide order in ITA 279/2015.

8.1 On the other hand the Ld.D.R. drew our attention to functional analysis of PSL pointing out that in the course of its software development functions it gets into product development segment also. Here in case of assessee also once the concept of the product is determined, then A.E. contracts with the assessee to execute the design and software development products on a module/part of the final product. Thus, to say that during the course of its providing software development services there is no element of product would not be a correct statement. The overall functions performed by the PSL is exactly the same and there is no trading by the said company. This company is also into outsource software product development. Hence, this comparable company has rightly been included by the TPO.

9. We have heard the rival submissions, perused relevant findings given in the impugned order as well as the material referred to before us. From a perusal of the annual report of PSL it is seen that this company deals with various products and it has been stated that it has realised more than 3000 products in the last five years and it is leader in the world of outsource software product development. The break-up of income under the head “software services and products” both exports and domestic, it is seen that there is no segmental information as to how much is the revenue from software services and how much is from the products. This is evident from a detailed report given at page 46 of the paper book. In absence of such segmental information it is very difficult to come to a conclusion as to whether the margin of this company also includes the sale of products. Moreover, as pointed out by Id. Counsel, commission paid to agents on sales is also indicative of the fact that there are sale of products. Thus, we find it very difficult to include such a comparable into the basket of comparables for bench marking the assessee’s margin and, accordingly, we direct the TPO to exclude this comparable from the list of comparable companies.

(iv) Thirdware Solutions Ltd.:-

10. Before us the Ld.Counsel submitted that this company is engaged in various kinds of activities like sale of licences, software services and revenues from subscription. Further there is no segmental data to work out the separate margin from software services. The schedule of income it can be gathered that

sales is mainly from exports from SEZ and STPI units; revenue from subscription; sale of licences; and software services. Thus, such a comparable cannot be included in the comparability analysis. He further submitted that this comparable company has been rejected in the case of Fiserve India (supra) which has been affirmed by the Hon'ble High Court also.

10.1 On the other hand the Ld. CIT D.R. strongly relied upon the order of the TPO as well as the DRP and pointed out that DRP has made an observation that its income from IT and software services is more than 75% of operating income.

11. After considering the rival submissions and on perusal of relevant material referred to before us, we find that under the head "sales" the following items have been disclosed:-

a)Exports from SEZ units –	Rs.47,58,40,447/-
b)Exports from STPI unit –	Rs.11,20,90,633/-
c)Revenue from subscription –	Rs.1,53,13,736/-
d)Sale of licences –	Rs.1,51,38,618/-
e)Sale of software services –	Rs.5,72,23,072/-

	Rs. 67,56,06,505/-
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From the above it is not clear as to what constitutes the sale of exports, whether it is product or software development services. Revenue from subscription and sale of licence also indicate that there is income from products also which would indicate different business model and consequently the profit margin. Without any

proper segmental information regarding revenues from software development and software products, it would be very difficult to accept that the proper comparability analysis can be carried out with the assessee which is purely providing software development services. Apart from above it is noticed that in the case of Fiserve, this comparable company has been excluded precisely on the same ground and the said order of the Tribunal stands affirmed by the Hon'ble High Court also. Accordingly, we direct the TPO to exclude the said comparable from the list of comparables.

12. In view of our finding given above, we direct the TPO to carry out the comparability analysis from the final list of comparables and bench mark the assessee's margin so as to arrive at appropriate arm's length price.

13. In ground nos. 17 and 18, the following grounds have been raised by the assessee.

"17. That the AO and DRP erred in not accepting the revised computation of book profits under the provisions of section 115 JB of the Act filed during the course of assessment proceedings and declining to reverse the positive adjustments of provision for gratuity amounting to Rs.17,18,466/- and provision for leave encashment amounting to Rs.12,38,655/- made inadvertently in the original computation of book profit.

18. Without prejudice, the AO and DRP erred in not appreciating that the claims of provision for gratuity and provision for leave encashment are ascertained liabilities made on the basis of actuarial valuation. Further AO and DRP failed to appreciate that on the aforesaid relief had been granted to the appellant in earlier A.Ys on identical facts."

14. At the outset, the Ld.Counsel pointed out that the A.O. and the DRP has not accepted revised computation of book profit, only on the ground that the assessee has not filed any revised return of income for making such a claim. In coming to this conclusion the AO had strongly relied upon the decision of Hon'ble Supreme Court in the case of Goetz India Ltd. vs. CIT reported in 284 ITR 323, however even the DRP has rejected the claim on same ground which is not correct. On the other hand Ld. DR relied upon the order of DRP.

15. After hearing both the parties and on perusal of the impugned orders, we find that the assessee has filed a revised computation of book profit as per the provision of Sec.115JB during the course of assessment proceedings, claiming that provision for gratuity and leave encashment forming part of the audited financial statements, was ascertained liabilities as it was recognised on the basis of actuarial valuation and is not in the nature of unascertained liabilities as referred in *Explanation* to Sec 115 JB of the Act. The AO has declined to delete the said adjustment and did not accept the assessee's revised computation on the ground that the assessee has not filed the revised return of income. Even though the A.O. could not have entertained the said claim but it does not impinge upon the appellate authorities to entertain such a claim if all the facts are there on record. This has been so clarified by the Hon'ble Supreme Court itself in the case of Goetz India Ltd. (supra). Thus, we remit this matter back to the file of the AO to consider the assessee's claim and if the claim is found admissible under

the provisions of the law, then he shall allow the same after giving assessee opportunity to explain its case.

16. In the result appeal of the assessee is partly allowed.

Order pronounced in the Open Court on...17...April, 2017.

Sd/-

(J.SUDHAKAR REDDY)
ACCOUNTANT MEMBER

Sd/-

(AMIT SHUKLA)
JUDICIAL MEMBER

Dated: the.....March, 2017

• *Manga*

Copy forwarded to: -

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT

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By Order,

Asst. Registrar