

**IN THE INCOME TAX APPELLATE TRIBUNAL "K", BENCH
MUMBAI**

BEFORE SHRI M.BALAGANESH, AM

**&
SHRI RAVISH SOOD, JM**

**ITA No.372/Mum/2017
(Assessment Year :2010-11)**

M/s. Emerson Electric Company (India) Private Limited 301, Solitaire Corporate Park 151, M.V.Road Andheri (E) Mumbai – 400 093	Vs.	Deputy Commissioner of Income Tax Circle – 3(1) Aayakar Bhavan M.K.Road, Mumbai – 400 020
PAN/GIR No. AAACE12602B		
(Appellant)	..	(Respondent)

**ITA No.344/Mum/2017
(Assessment Year :2010-11)**

Deputy Commissioner of Income Tax Circle – 3(1) Aayakar Bhavan M.K.Road, Mumbai – 400 020	Vs.	M/s. Emerson Electric Company (India) Private Limited 301, Solitaire Corporate Park 151, M.V.Road Andheri (E) Mumbai – 400 093
PAN/GIR No. AAACE12602B		
(Appellant)	..	(Respondent)

Assessee by	Shri Dinesh Bafna, Shri Pratik Shah and Shri Nishant Shah
Revenue by	Shri Jeevantal Lavidiya and Shri Anand Mohan
Date of Hearing	23/08/2019
Date of Pronouncement	09/10/2019

आदेश / ORDER

PER M. BALAGANESH (A.M):

These cross appeals in ITA Nos.372/Mum/2017 & 344/Mum/2017 for A.Y.2010-11 arise out of the order by the Id. Commissioner of Income Tax (Appeals)-56, Mumbai in appeal No.CIT(A)-56/TP/DCIT-3(1)/2016-17/63-E dated 30/09/2016 (Id. CIT(A) in short) against the order of assessment passed u/s.143(3) r.w.s. 144C(13) of the Income Tax Act, 1961 (hereinafter referred to as Act) dated 11/04/2014 by the Id. Dy. Commissioner of Income Tax – 3(1), Mumbai (hereinafter referred to as Id. AO). Since, the issues involved are identical in all these appeals, they are taken up together and disposed off by this common order for the sake of convenience.

ITA NO.372/Mum/2017 (A.Y.2010-11) Assessee Appeal

2. The only issue to be decided in this appeal of the assessee is as to whether the Id. CIT(A) was justified in upholding the action of the Id. AO in proportionately allocating the head office expenses while computing the profit eligible for deduction u/s.10A / 10B of the Act.

3. We have heard the rival submissions. Both the parties before us fairly conceded that this issue has been remanded back to the file of the Id. AO for fresh adjudication in A.Y.2009-10 by the order of this Tribunal for the A.Y.2009-10 in ITA No.4142/Mum/2018 dated 25/09/2017 wherein it was held as under:-

“13. We have heard both the parties and considered the materials available on record. The AO has allocated head office expenses proportionately for units claiming exemption u/s 10A / 10B, on the basis of the turnover of the units. According to the AO, the assessee has parked

its head office expenses for the units generating taxable income without any valid reasons for not allocating expense to the units claiming exemption u/s 10A / 10B. The assessee claims that head office expenditure in no way connected to the units claiming exemption u/s 10A / 10B and the units are functioning independently. Therefore, the AO was incorrect in allocating head office expenses to the units claiming exemption u/s 10A / 10B. We do not find any merits in the arguments of the assessee for the reason that on perusal of the details of expenditure incurred by the assessee it is difficult to accept explanation of the assessee that head office expenditure has no relevance to the units claiming exemption u/s 10A / 10B. The assessee is having four units based at various locations which were controlled through its headquarter. The expenditure incurred by head office like travel and conveyance, communication expenses, legal and professional charges and rates and taxes definitely is having relevance to its total business. Therefore, we are of the view that the AO was right in allocating head office expenses to the units eligible for claiming exemption u/s 10A / 10B of the Act. We further observe that there is merit in the argument of the assessee that only net expenses of head office should be allocated to the units claiming exemption u/s 10A / 10B, because the assessee is generating other income like interest on fixed deposit and rent which may have some bearing on the functioning of its units claiming exemption u/s 10A / 10B. Therefore, we are of the view that the issue needs to be re-examined by the AO in the light of the submissions of the assessee. Hence, we set aside the issue to the file of AO and direct him to consider the issue afresh after affording opportunity of hearing to the assessee.”

3.1. Respectfully following the said decision, we deem it fit and appropriate to remand this issue to the file of the Id. AO for denovo adjudication and to decide in accordance with law. Needless to mention that the assessee be given reasonable opportunity of being heard. Accordingly, the grounds raised by the assessee are allowed for statistical purposes.

IT(TP)A No.344/Mum/2017 – 2010-11 (Revenue Appeal)

4. Revenue has raised the following grounds:-

(i) *"Whether on the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in directing to exclude companies namely M/s Infosys Ltd., M/s Larsen and Turbo Infotech Limited and M/s Wipro Limited from the final set of comparable due to large scale of operations without giving any finding as to what should be the range of turnover of*

companies for selecting as comparables considering the assessee's turnover of Rs. 22.29 crores from software development services segment and also erred in not applying the filter of large scale of operations to the other companies selected as comparables by the TPO particularly M/s LGS Global Ltd., M/s Sasken Communication Technologies Ltd. and M/s Mindtree Ltd., which had large scale of operations in comparison to the software development segment of the assessee?"

(ii) "Whether on the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in directing to exclude companies namely M/s Thirdward Solutions Ltd., M/s Persistent Systems Limited, M/s Tata Elxsi Limited and M/s Kals Information Systems Ltd. from the final set of comparables for benchmarking assessee's international transaction of provision of software development services segment even though these companies are functionally comparables to the software development services provided by the assessee?"

(iii) "Whether on the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in directing to grant working capital adjustment to the assessee?"

(iv) "Whether on the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in not adjudicating on the functional comparability M/s Teledata Marine Solutions Ltd. (software development & sales segment) with the software development service segment of the assessee and also erred in not directing the TPO to exclude it from the final set of comparables ignoring the fact that said company has line of products and also segmental profitability is not available on standalone basis. Applying same qualitative filters, the Ld. CIT(A) has directing to exclude few companies such as M/s Kals, M/s Thirdware Solutions on the ground that these are engaged in development of software products and segmental profitability is not available?"

(v) "Whether on the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in allowing the claim of the assessee for service tax refund for eligible units u/s 10A when it is held that such income does not form part of the net profit of eligible units as held by the A.O.?"

The appellant prays that the order of the CIT(A) on the above ground be set aside and that of the A.O. be restored.

The appellant craves leave to amend or alter any grounds or add a new ground which may be necessary."

5. The brief facts of this appeal are that Emerson India was incorporated in 1995 to support Emerson groups businesses seeking to enter and build presence in India, particularly in the area of sourcing and procurement. Emerson India is a wholly owned subsidiary of Emerson Electric Mauritius limited which is a wholly owned subsidiary of Emerson USA (ultimate parent company). Emerson India has 5 primary segments namely process management (value and measurement devices), appliance and tools (hand tools, fans, electrostatic air cleaners, and electric waste disposal), climate technologies (compressors, thermostat and related equipment), industrial automation (motors and drives) and network Power (Power convergent and distribute equipment and networking products). Emerson India conducts his business through its head office located in Mumbai and different business divisions in Bangalore, Pune etc.

5.1. As per the Transfer Pricing Study Report (TPSR), the international transactions reported by the assessee are as under:-

S.No.	Description of the transactions	Amount (Rs.)
1.	Purchase of raw materials	4,31,98,744
2.	Purchase of finished goods	1,39.85,262
3.	Receipt of sales commission	46,44,934
4.	Provision of engineering and related services	208,78,36,974
5.	Provision of IT support and related services	22,61,62,710

6.	Provision of software development and related services	22,29,12,328
7.	Provision of facilitation support services	3,39.17,838
8.	Import of capital assets	1,12,74.302
9.	Broadband Connectivity charges	1,10,19,538
10.	Reimbursement of expenses	2,02,20,517
11.	Recovery of expenses	31,55,04,848

5.2. The assessee company had entered into international transaction with its AEs in respect of provision of software development and related services. The operating margin of the assessee from its software development segment was 8.03% which was worked out as under:-

Particulars		Rs.
Operating Income	(A)	22,29,12,328
Less: Operating expenses		20,83,41,962
Operating Profit (OP)	(B)	1,65,70,366
OP/TC	(B)/(A)	8.03%

5.3. The arm's length price of the international transactions representing software services provided to the AEs was determined by applying the Transactional Net Margin Method (TNMM) as the Most Appropriate

Method (MAM). The operating profit to total cost ratio was considered as the Profit Level Indicator (PLI) in TNMM analysis. The assessee in its benchmarking analysis considered certain comparables engaged in the similar segment and arrived at the average PLI of the comparables at 13.18%. The assessee pleaded that since the price charged in its international transactions in respect of software segment was within the +/-5% band, the price charged by the assessee was claimed to be at arm's length. The Id. TPO observed that the PLI of the comparables was arrived by the assessee by considering the weighted average margin of two years data for the F.Yrs.2007-08 and 2008-09. The Id. TPO, among other filters, adopted turn over filter to eliminate companies which had average sales of less than Rs.1 Crore during the financial year 2009-10. The turnover of the assessee company from a software segment was Rs.22.29 Crores. The Id. TPO by applying turnover filter, considered all companies having turnover more than Rs.1 Crore while analyzing the benchmarking carried out by the assessee and for inclusion of the fresh comparables by him during the course of transfer pricing assessment. The Id. TPO rejected the adoption of multiple year data of average of two years in respect of comparables chosen by the assessee. The Id. TPO held that contemporaneous data i.e. data pertaining to F.Y.2009-10 alone had to be considered for the purpose of benchmarking. The Id. TPO, among other filters, disturbed the PLI chosen by the assessee. The PLI chosen by the assessee was operating profit / total cost. The Id. TPO adopted the PLI as operating profit / operating expenses. For this purpose, the non-operating income such as interest, dividends, provisions no longer required written back, the gain of sale of assets / investments, income from investments, foreign exchange gain, gain on revaluation of assets and other incomes not pertaining to operations were excluded from operating revenues by the Id. TPO. Similarly, the following expenses

which, in the opinion of the Id. TPO, are non-operating, were also sought to be excluded from operating expenses i.e. provisions other than provision for bad debts, loss of sale of assets / investments, loss on revaluation of assets, foreign exchange loss and other expenses not pertaining to operations. Similarly extraordinary expenses or income which does not recur every year like donations, preliminary expenses written off were not considered as part of operating expenses by the Id. TPO. After excluding certain comparables chosen by the assessee in the TP study report and after including certain fresh comparables for the purpose of benchmarking the international transaction of software development services provided to AE by the assessee, the final set of comparables chosen by the Id. TPO together with the respective margins were as under:-

s. No.	Company Name	Margins on single year bases (% } OP/TC
1	Akshay software technologies limited	-1.07
2	FCS Software Solutions Ltd.	49.03
3	LGS global Ltd (Lanco global systems limited)	11.96
4	Mindtree limited	16.13
5	Sasken Communication Technologies Ltd.	19.42
6	Synetairos Technologies Ltd.	18.02
7	Zensar Obt Technologies Ltd.	19.87
8	Teledata Marine Solutions Ltd., - Software development & sales	-2.98
9	Thirdware solutions Ltd.	33.93
10	Infosys Ltd.	45.01

11	Sonata software Ltd	35.32
12	Thinksoft Global Services Ltd.,	17.67
13	Larsen and Toubro Infotech limited	19.08
14	Persistent Systems Ltd	29.36
15	Wipro Ltd.	27.34
16	Tata Elxsi Ltd.	18.55
17	Bodhtree Consulting Ltd.	33.42
18	Kals Information Systems Ltd.	19.89
Total		409.91
Mean		22.77

5.4. The Id. TPO made an adjustment of Rs.3,05,36,495/- in respect of software development segment by working out as under:-

Particulars	Emerson Electric P&L of software development segment (as per TP study report)	Arm's length P&L (as per final set of comparable companies)
Income from software development activities	22,29,12,328	25,36,76,808
Total Cost (TC)	20,63,41,962	20,63,41,962
Operating Profit (OP)	1,65,70,366	4,73,34,846
OP/TC	8.03	22.77
Adjustment		3,05,36,495

6. Before the Id. CIT(A), assessee objected to rejection of its economic analysis by the Id. TPO and selection of new set of comparables, among other objections. The assessee also submitted that it is a captive service provider and therefore, economic adjustments including working capital adjustments are required to be made before arriving at the arm's length margin. The Id. CIT(A) appreciated the assessee's objections with respect to the comparables selected by the Id. TPO in the following categories:-

- i) Large-scale of operations
- ii) Fails TPO's own filters.
- iii) Functional dissimilarities

a) Large-scale of Operations

The Id. CIT(A) proceeded to address the exclusion of comparables selected by the Id. TPO based on the aforesaid broad parameters and observed as under:-

“7.13.2 The Appellant, in its IT segment, has a turnover of Rs. 22.29 crores. The Appellant has objected to selection of following comparables on the ground that these companies are engaged in large scale of operations compared to the Appellant:

- (i) Infosys Ltd*
- (ii) Larsen and Toubro Infotech Ltd ('L&T Ltd') and*
- (iii) Wipro Ltd*

7.13.3 The TPO has rejected the contentions of the Appellant in the case of Infosys Ltd and Wipro Ltd relying on the decision in the case of Wills Processing Services (I) Pvt Ltd (AY 2007-08) stating that the turnover has not impacted the margins since day of its inception.

7.13.4 In this regard, the Appellant in its submissions has heavily relied upon following jurisdictional decisions to support its case:

- Pentair Water India Pvt Ltd (Appeal No. 18/2015) (Bombay High Court)*
- UCB India Pvt Ltd (ITA No. 7691/Mum/2012)*
- Atos India Pvt Ltd (ITA No. 1467/Mum/2014)*

7.13.5 Further, the Appellant also highlighted that the Tribunal in the case of Willis Processing Services India Pvt Ltd pertaining to AY 2010-11, has departed from the earlier position in AY 2007-08 relied upon by the TPO in relation to high turnover in light of the Delhi High court decision in the case of Agnity India Technical Pvt Ltd.

7.13.6 The submissions made by the Appellant have been examined. On examining the Annual Reports, the turnover of the above comparable companies vis-avis that of the Appellant (being Rs. 22.29 crores) were observed to be as follows:

S. No	Name of comparable	Turnover in AY 2010-11	No. times of Appellant's turnover
(i)	Infosys Ltd	Rs. 21,140 crores	961 times
(ii)	L&T Ltd	Rs. 1,776 crores	81 times
(iii)	Wipro Ltd	Rs. 22,920 crores	1,041 times

7.13.7 The reliance placed by the Appellant on the Hon'ble Bombay High Court's decision in the case of Pentair Water India Pvt Ltd (supra) has been examined. I find that the Hon'ble Bombay High Court has upheld the Tribunal decision stating as follows:

"(7) HCL Comnet Si/stems & Services Ltd :- We find force in the submission of the Id. AR that this company cannot be a comparable as the turnover of this company is 260.18 crores while in the case of the Assesses, the turnover is around Rs.11 crores only. While making the selection of comparables, the turnover filter, in our opinion, has to be the basis for selection. A company having turnover of Rs.11 crores cannot be compared with a company which is having turnover of R\$.260 crores which is more than 23 times the turnover of the Assessee. This company cannot be regarded to be in equal size to the Assessee. We, accordingly, direct the AO to exclude this company out of the comparables.

(ii) Infosys BPO Ltd. :- In this case also we noted the turnover in respect of this Company is Rs.649.56 crores while the turnover of the Assessee company is around Rs. 11 crores which is much more than 65 times of the Assessee's turnover. We, therefore, do not find any illegality or infirmity in the order of CIT(A) in excluding this Company out of the comparables. Accordingly, we confirm the order of the CIT(A). (in) Wipro Ltd. :- After hearing the rival submissions, we noted that the

CIT(A) applying the turnover filter has excluded this company out of the . comparables. The turnover reported in the case of Wipro Ltd. Is Rs.939.78 crores while in the case of the Asseessee the turnover is around Rs. 11 crores. Therefore, on the basis of the turnover filter itself this company cannot be regarded to be comparable to the Asseessee company and accordingly, ive do not find any infirmity in the finding of CIT(A) while he excluded this company on the turnover criteria." (Emphasis supplied)

7.13.8.....

7.13.9.....

7.13.10 *Accordingly, companies such as Infosys Ltd, L&T Ltd and Wipro Ltd which have significantly high turnover and large scale of operations cannot be compared to the Appellant and therefore are to be excluded from the list of comparables. ”*

6.1. The Id. CIT(A) made specific observations for exclusion of Wipro Ltd and Infosys Ltd from the list of comparables by observing as under:-

“Wipro Ltd and Infosys Ltd

7.13.12 *Further, based on the detailed submissions filed, it is noted that the Appellant is operating at minimal risk basis and does not engage in any marketing functions as it caters only to its AEs. On the other hand, from the annual report (page 55 and 99 respectively), that Infosys Ltd and Wipro Ltd incur substantial expenses to the tune of Rs. 76 crores and Rs 250 crores respectively on advertising and brand building activities. Further, as highlighted by the Appellant in page 29, 30 and 57 of their submissions, both Infosys Ltd and Wipro Ltd undertake significant R&D activities own significant intangibles such as brands and patents. This indicates that Infosys Ltd and Wipro Ltd are -.-:'. market leaders with huge brand value associated with them. It has been brought to attention (pages 27, 28, 55 and 56 of the submission) that the Appellant is a limited risk software development services provider, primarily engaged in rendering services to its AEs, whereas Infosys Ltd and Wipro Ltd are operating their business as full-fledged entrepreneurs.*

7.13.13 *It is noted from page 18 of the annual report of Infosys Ltd that the company offers business solutions that span the entire software lifecycle encompassing technical consulting, design, development, re-engineering, maintenance, systems integration, package evaluation and implementation, testing and infrastructure management services. Further, from the annual report (page18), it is observed that Infosys Ltd also offers software products for banking industry and has developed in-house*

software products such as Finacle. It is brought to attention that the Appellant does not own intangibles nor does it invest in any R&D activities.

7.13.14 Similarly, as highlighted by the Appellant, it is observed from page 57 of annual report of Wipro Ltd that the company is engaged in diversified services such as technology infrastructure services, testing services, BPO, product engineering services etc.

7.13.15 Under these circumstances, I find that Infosys Ltd and Wipro Ltd are giants in their own areas of operations as they assume greater risks translating into higher profitability. Therefore, these giant sized companies with advantages such as brand, intangibles etc. cannot be compared to a company such as the Appellant which is a captive unit of its AEs assuming only limited risks.

6.2. The Id. CIT(A) in support of the aforesaid observations, placed reliance on the decision of this Tribunal in the case of Atos India Pvt. Ltd. in ITA No.1467/Mum/2014 and in the case of Telcordia Technologies India Pvt. Ltd reported in 22 Taxman.com 96 (Mum Trib.) among other decisions. With these observations, the Id. CIT(A) directed the Id. TPO to exclude Infosys Ltd, L & T Infotech Ltd. and Wipro Ltd from the list of comparables chosen by the Id. TPO.

b) Comparables chosen by the Id. TPO which fails filters applied by him in his order

6.3. The Id. CIT(A) observed that certain comparables which were included by the Id. TPO failed the filters applied by the Id. TPO itself in the following three broad parameters:-

- i) IT Service revenue is >75% of the total operating revenue
- ii) Revenue from export sales >75% of revenues
- iii) Related Party Transactions (RPT) <25% of operating revenue

6.3.1. The following comparables were sought to be excluded by the Id. CIT(A) based on the aforesaid parameters.

- FCS Software Solutions Ltd.
- Synetairos Technologies Ltd.
- Bodhtree Consulting Ltd.
- Sonata Software Ltd.
- Zensar Obt Technologies Ltd.

C) Functional Dissimilarities

6.4. The Id. CIT(A) observed as under:

“Functional dissimilarity

7.13.49 The Appellant has objected to inclusion of the following companies on the basis that they are functionally not comparable to the Appellant. In this regard, the Appellant's submissions and my observations are as follows:

(i) Thirdware Solutions Ltd ('Thirdware')

7.13.50 The Appellant has submitted extracts from the website to evidence that Thirdware is engaged in end to end solutions application implementation, management and development services with core competencies in areas of ERP, business intelligence, technology and sales force. These services are completely different from the services rendered by the Appellant wherein the software development activities undertaken by the Appellant are based on guidance and instructions from the AFs.

7.13.51 Further, the Appellant has submitted that Thirdware is engaged in developing a software product 'PAPA' since July 2009 which evidences that the company is engaged in substantial research and development activities and is diversifying into development and sale of software product unlike the Appellant. The Appellant has relied on the Hon'ble Pune Tribunal decision in the case of Approva Systems Pvt Ltd (TTA No. 1788 & 1803/PNJ/2013) in support of its arguments to exclude Thirdware as being functionally not comparable

7.13.52 *The submissions of the Appellant has been examined. It is observed from page 56 of the annual report that Thirdware i engaged in software product development. Therefore, I find force in the argument that Thirdware is not functionally comparable to the Appellant. Further, the Hon'ble Pune Tribunal decision in case of Approva Systems Pvt Ltd (supra) has been examined and it is observed that the Hon'ble Tribunal decision in Hyderabad Tribuni l decision in the case of Intoto Software India Pvt Ltd V ACIT has held that Thirdware is not comparable The relevant extracts from the decision is reproduced below.*

From the various decisions relied on by the Ld. counsel for the assessee we find Thirdware Solutions Ltd. has been rejected on the ground that it is functionally Dissimilar. The Hyderabad Bench of the Tribunal in the case of Intoto Software India Pvt. Ltd. Vs. ACIT and Viceversa in consolidated order dated 24-05-2013 for A. Y. 2005-06 and 2007-08 at para 26 of the order has observed as under:

"26. 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 softwreare 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."

29.2 In various other decisions also Thirdware Solutions Ltd. Has been rejected as a comparable on the ground that it is functionally dissimilar. We therefore find force in the submission of the Ld. Counsel for the assessee that Thirdware Solutions Ltd. should not be included as a comparable. We accordingly set-aside the order of the IT(A) and direct the Assessing Officer to exclude the same from the list of corn parables."

7.13.53 *Further, the Appellant has also submitted that Thirdware derives revenue from sources such as export from SEZ and STPI unit and the nature of the revenue is unavailable. The Appellant has relied on the Delhi Tribunal decision in the case of Sun Life India Service Centre Pvt. Ltd. [ITA No. 5799/ Del/2012] wherein Thirdware was rejected considering that the nature of revenue from STPI and SEZ units were unknown.*

7.13.54 In this regard, the contentions of the Appellant has been examined. It is noted from page 22 of the annual report that the revenue from software services is only Rs. 5.7 crores (i.e. 8.47% of operating revenue). It is observed that Thirdware predominantly derives its revenue from export from STPI and SEZ units (i.e. 87.02% of operating revenue). It is further observed that there is no information available in the annual report of Thirdware which indicates the nature of revenue from the exports from STPI and SEZ units. Therefore, I find force in the Appellant's arguments that in the absence of such information Thirdware's revenue from software service is only Rs. 51 crores and therefore is not comparable to the Appellant. The Hon'ble Delhi Tribunal decision in the case of Sun Life India Service Centre Pvt. Ltd (supra) relied on by the Appellant has been examined and it is observed that the Hon'ble Tribunal rejected Thirdware on the following grounds:

*"The Profit & Loss Account of this company is at page 107, which shows 'Sales & Other income'. Bifurcation of 'Sales / is available as per Schedule 12, which comprises of 'Sale of licence' amounting to Rs.39.16 lac, 'Software services' amounting to Rs.7.67 crore, 'Export from SEZ unit' amounting to Rs.26.39 crore, 'Export from STPI unit' amounting to Rs.16.88 crore and 'Revenue from subscription' amounting to Rs.92.93 lac. **These figures indicate that apart from the revenue from 'Software services' which is only to the tune of Rs.7.67 crore, this company earned total gross revenue from 'Sales' to the tune of Rs.52.27 crore including from export from SEZ/STPI units. When we consider the figures of this company on an entity level as have been adopted by the TPO for comparison, it becomes vivid that it ceases to be comparable with the assessee's 'Software development and maintenance support services' segment. The reason hardly needs any highlighting, being the income of this company also largely including revenues from exports from SEZ/STPI units apart from sale of licence. These distinguishing features make this company as noncom parable. We, therefore, order for the removal of this company from the list of comparables"***

7.13.55 In light of above facts and respectfully following the judicial precedents, the TPO is directed to exclude Thirdware.

(ii) Persistent Systems Ltd ("Persistent')

7.13.56 The Appellant has submitted that Persistent is engaged in Outsourced Software Product Development services wherein company partners with customers in investing in the product development, share risks with the customers co-own the

intellectual property and share the profits from the product sales. Further, the Appellant has referred to the annual report and stated that Persistent undertakes prototyping and assisting start-up companies in obtaining funding for the products and in case of large enterprises, the company becomes a key part of the product development, innovate through joint patents and owns up for the products' complete road map. The Appellant has also highlighted from the annual report that Persistent is a software product company and has released over 3000 products over five years. The Appellant has also submitted in detail the differences between a software product company and a software services company. The Appellant, relying on Mumbai Tribunal decision, Roche Diagnostic P Ltd (supra) has contended that in the absence of segmentation, Persistent cannot be considered as a comparable company.

7.13.57 The submission of the Appellant has been examined. It is observed from the financial statements of Persistent (page no. 18 and 19) that the company is not just engaged in software development services but is also a software product company. Further, the distinction between a product based company such as Persistent and a software development service company like the Appellant was brought to our attention (page 51 of the submission). It is observed that product based companies like Persistent undertake significant functions such as conceptualizing, designing, coding etc. while the Appellant which is a captive service unit of the AE performs routine functions and does not undertake functions such as conceptualization and designing. Further, the Appellant has brought to my attention on page 21 and 67 of the annual report that Persistent is engaged in diversified service in the nature of Research, usability engineering, Prototyping, Development, Testing & QA, Performance engineering, Porting, Documentation, Training, Sales support, Deployment, Technical support and Maintenance

7.13.58 The Appellant submitted that Persistent is engaged in product development and diversified activities and the annual report does not provide the segmental details of the software development service alone. Therefore, the Appellant argued that following the principle enunciated in the decision of the Mumbai Tribunal in the case of Roche Diagnostic P Ltd ('supra) that in the absence of segmental details / information a company cannot be taken into account for comparability analysis, Persistent cannot be considered as comparable. Further, the Appellant has also relied upon the Delhi Tribunal and Bangalore Tribunal in the case of Saxo India Pvt Ltd (ITA No. 6148/ Del/2015) and 3DPLM Software Solutions Ltd. {IT(TP)A No. 1303/ Bang/2012} respectively.

7.13.59 Based on facts, it is observed that Persistent is engaged in product development and does not have segmented profitability in respect of its software development service. In the absence of profitability of the software development service, Persistent cannot be considered as a comparable company. The Hon'ble Jurisdictional Tribunal decision in the case of Roche Diagnostic F Ltd ('supra) has been examined and I find that a similar view has been upheld by the Hon'ble Tribunal. Further, in the case of Saxo India Pvt Ltd (supra) and 3DPLM Software Solutions Ltd (supra) it is observed that the Hon'ble Tribunal has analysed the financials of Persistent and concluded it to be not comparable. The relevant extracts from the judicial precedents are reproduced below.

Saxo India Pvt Ltd (supra)

"After considering the rival submissions and perusing the relevant material on record, we find that the Annual report of this company is available in the paper book with its Profit and loss account at page 1025. Schedule of Income indicates its operating revenue from software development, hardware maintenance, information technology, consultancy etc. Revenue from hardware maintenance stand at R. 3.92 crore, which has been considered by the Transfer Pricing Officer himself as sale of products. **Such sale of products constitutes 15% of total revenue. There is no segmental information available as regards the revenue from sale of products and revenue from software development segment. As the assessee is simply engaged in rendering software development services and there is no sale of any software products, this company, in our considered opinion, ceases to be comparable. It is obvious that from the common pool of income from both the streams of software products and software services, one cannot deduce the revenue from software services and no one knows the impact of revenue from Products on the overall kitty of profit, which may be significant. Since no segmental data of this company is available indicating operating profit from software development services, we order to exclude this company from the list of comparables.**"

3DPLM Software Solutions Ltd (supra)

"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"

7.13.60. Based on above facts and respectfully following judicial precedents, the TPO is directed to exclude Persistent from the set of comparables for the year under consideration.

(iii) Tata Elxsi Ltd ('Tata Elxsi')

7.13.61 The Appellant has submitted that Tata Elxsi is engaged in two segments i.e. Software Development and Services and System Integration and therefore the TPO has erroneously considered Tata Elxsi at entity level. Further, the Appellant, referring to extracts from the annual report highlighted that under the Software Development and Services segment, provides software development services, product designing services, innovation design engineering services and visual computing services. The TPO rejected the contentions of the Appellant by stating that the company is broadly in software development segment and hence considered it as a comparable.

7.13.62 The Appellant, relying on the Mumbai Tribunal decision in the case of Telcordia Technologies India Pvt Ltd (hA No. 7821/Mum/2011) argued that even at segmental level, the Software Development & Services segment of the company comprises of three activities, of which the first activity appears to be only partly comparable (as it includes a non-comparable activity of hardware design), whereas the other two activities (Innovation design engineering, and (Visual computing lab) are clearly not comparable to the services rendered by the Appellant. The Appellant also argued that Tata Elxsi undertakes substantial R&D activities and therefore have developed intellectual rights and software products, resulting in higher profits. In this regard, attention was drawn to page no. 14 and 18 of the annual report of Tata Elxsi.

7.13.63 The detailed submissions of the Appellant has been examined. From the details on record, it is observed that this company is predominantly engaged in product designing services and not purely software development services. The details on page 15 of 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 Appellant.

7.13.64 Further, as highlighted by the Appellant, the Mumbai Tribunal decision in the case of Telcordia Technologies India Pvt Ltd (supra) has held Tata Elxsi is not a software development service provider and therefore is not functionally comparable. The Hon'ble Mumbai Tribunal decision in case of Telcordia Technologies India Pvt Ltd (supra) was examined and it was noted that the Hon'ble Tribunal directed Tata Elxsi to be excluded from the comparables. The relevant extracts of the decision is reproduced below.

"From the facts and material on record and submissions made by the learned AR, it is seen that the 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 AR 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 fit for comparability analysis for determining the arms length price for the assessee, hence, should be excluded from the list of comparable parties."

7.13.65. Further, it is also noticed that the above view of the jurisdictional Tribunal is also supported by various other Tribunal decisions. Relevant extracts from these decisions are provided below.

3DPLM Software Solutions Ltd. [IT(TP)A No. 1303/Bang/2012]

"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.

The Hon'ble Mumbai Tribunal in the case of Telecordia Technologies India Pvt. Ltd. Vs ACIT (ITA No. 782 1/Mum/201 1) has held that Tate Elxsi Ltd. is not a software development service provider and therefore it is not functionally comparable.

....

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."

Sun Life India Service Centre Pvt. Ltd. LITA No.1489/Del/20141

"From the above narration of actual position extracted from the Annual report of this company, it can be seen that this company is also engaged in sale of software products/solutions and has its own intangibles.

...

Since the overall profit of this company includes the effect of profit from sale/licensing of software products/solutions and there is no measure to isolate such profit from the overall profit of software development segment, we hold that this company at an entity level cannot be considered as comparable with the assessee's 'Software development and maintenance' segment. This company is, therefore, directed to be excluded.

7.13.66 Considering the above facts and respectfully following the jurisdictional Tribunal, the TPO is directed to exclude Tata Elxsi from the list of comparables.

(iv) Kals Information Systems Ltd ('Kals')

7.13.67 The Appellant has contended that Kals is not comparable as it is not just engaged in software development services but is also engaged in development of software products. The TPO has rejected the contentions of the Appellant stating that the company qualifies all the filters.

7.13.68 The Appellant drew attention to page 21 of annual report of Kals in support of its contentions that apart from software service, Kals is also engaged in development of software product unlike the Appellant which is engaged in rendering only software development services. In this regard, the Appellant highlighted the Pune Tribunal decision in case of TIBCO Software India Pvt. Ltd. [ITA No.2536/PN/2012] and Mumbai Tribunal decisions in case of Nethawk Networks India Pvt Ltd (ITA No. 7633/M/2012) and Prana Studios Pvt Ltd (ITA No. 2077/Mum/2014)

7.13.69 It is observed from the annual report that Kals is engaged in software product development activities and considering that the

Appellant is engaged in software services, Kals is to be excluded. Further, the judicial precedents relied upon by the Appellant have been examined and the relevant extracts from these decisions are provided below.

TIBCO Software India Pvt. Ltd. (supra)

*the material relied upon by the assessee before the lower authorities, copies of which have also been placed in the Paper Book filed before us, supports the assertions of the assessee that **the said concern is engaged in development and sale of software product, etc., which is distinct from the software development services rendered by the assessee to its associated enterprise.** Thus, we are inclined to uphold the plea of the assessee that the M/s Kals Information System Ltd. (applications software segment) is functionally incomparable to the assessee."*

Nethawk Networks India Pvt Ltd

*"Considering all the information available in public domain, we are of the opinion that this case cannot be considered as a good comparable. As such, **the fact that the company is producing the ERP software products called Shine, the internationally proven ERP software and other software products called Docuflo (Document Management Software) etc are brought revenue to the assessee in the year under consideration. Therefore, considering the absence of data as well as the unfavourable FAR analysis to the TPO, this case cannot be considered as comparable. We direct the AO to exclude the same from the list of comparables"***

Prana Studios Pvt Ltd (ITA No. 2077/Mum/2014)

"the taxpayer is a captive service provider, providing purely software services in the context of 3D animation to its A.E. KALS is engaged in development of software and software products and also running a training centre for training of software professionals. This company offers variety of software products in the area of web solutions, e-commerce, software consultants, content management [-RP applications etc. Its functional profile is quite different from the taxpayer, which is purely providing software services in the field of 3D animation. Accordingly, this company cannot be considered a comparable."

7.13.70 Further, the Appellant has also argued that segmented financials between software products and services is unavailable and therefore Kals is to be excluded. In this regard, the Appellant has relied upon the Mumbai Tribunal decision of Roche Diagnostics India P. Ltd (supra).

7.13.71 The submission of the Appellant has been examined and I find merit in the argument of the Appellant that in the absence of segmented financials indicating the profitability of the software development services, Kals is to be excluded. In this regard, it is observed that this view is also supported by the jurisdictional tribunal decision in the case of Roche Diagnostics India P. Ltd (supra) and Delhi Tribunal decisions such as Saxo India Pvt Ltd (supra)

7.13.72 Accordingly, based on facts and respectfully following judicial precedents, the TPO is directed to exclude Kals from the comparables.)”

6.5. With regard to working capital adjustments, the Id. CIT(A) by placing reliance on the following decisions directed the Id. TPO to grant working capital adjustment to the assessee in respect of final comparables that are to be decided pursuant to his order:-

- ACI Worldwide Solutions Pvt. Ltd (ITA No. 651/Bang/2012)
- Sun Life India Service Centre Pvt. Ltd (ITA No.1489/Del/2014)
- Apigee Technologies (India) Pvt. Ltd (ITA No. 870/Bang/2013)
- OSI Systems Pvt Ltd (ITA No. 683/Hyd/2014)
- Mercer Consulting (India) Pvt. Ltd (ITA No.966/Del/2014)
- Agilent Technologies International Pvt. Ltd (ITA No. 1837/Del/2014)
- Apigee Technologies (India) Pvt. Ltd (ITA No.870/Bang/2013)

7. Aggrieved, the revenue is in appeal before us on the grounds reproduced hereinabove.

8. We have heard the rival submissions. We find that the assessee by furnishing the single year data being the contemporaneous data for the F.Y.2009-10 and applying the said data on the set of 19 comparables

chosen by it, had arrived at the mean operating margin of the comparables i.e. PLI of 8.24%, as against its operating margin of 8.03% during the year under consideration. Accordingly, the assessee had claimed that its international transaction in respect of software development segment was at arm's length. We find that there is no dispute with regard to selection of tested party and TNMM being adopted as MAM. We find that the Id. TPO had selected 8 out of 16 comparables selected by the assessee in its TP study and had further selected 10 more companies to the list of comparables and arrived at the arithmetic mean of these 18 comparables at 22.77% as against the assessee's margin of 8.03% and accordingly, made an adjustment of Rs.3,05,36,495/- to the income of the assessee under software development segment.

8.1. The dispute before us is only with regard to inclusion and exclusion of certain comparables. The primary dispute lies with regard to exclusion of three comparables viz. Infosys Ltd, Wipro Ltd and L & T Infotech Ltd. from the final list of comparables chosen by the Id. TPO. From the elaborate consideration of transfer pricing dispute by the Id. CIT(A) as reproduced hereinabove, it could be safely concluded and inferred that the Id. CIT(A) had excluded Infosys Ltd, L & T Infotech Ltd. and Wipro Ltd. from the list of comparables chosen by the Id. TPO on various parameters as detailed supra. Hence, the arguments made by the Id. DR and in the ground No.1 raised by the revenue that those three comparables were sought to be excluded only due to higher turnover is not acceptable and deserves to be dismissed.

8.2. We also find that the Id. DR before us did not object to the exclusion of Infosys Ltd, Wipro Ltd and L & T Infotech Ltd from the list of comparables chosen by the Id. TPO due to higher turnover but had only

sought to address the dispute that applying the same turnover filter, three more comparables i.e. LGS Global Ltd, Sasken Communication Technologies Ltd and Mindtree Ltd should also be excluded due to large-scale of operations from the final list of comparables. We find that these three comparables were sought to be included by the Id. TPO and which has not been disputed by the assessee. Moreover, the exclusion of these three comparables i.e. LGS Global Ltd, Sasken Communication Technologies Ltd and Mindtree Ltd does not emanate out of the orders of the lower authorities. Hence, we hold that the Id. DR is only trying to improve the case of the revenue which cannot be done before the Tribunal, which exercises only appellate jurisdiction. Accordingly, the ground No.1 raised by the revenue is dismissed.

9. With regard to exclusion of comparables i.e. Thirdware Solutions Ltd, Persistent Systems Ltd, Tata Elxsi Ltd and Kals Information Systems Ltd. from the final set of comparables as directed by the Id. CIT(A) on the ground of functional dissimilarities, the Id. DR argued that anything related to automizing the operations in digital format tantamount to software development and accordingly, non-availability of break-up of revenue from software services and sale of software products does not affect comparability. We find that main crux of the argument of the Id. DR is that software development and sale of software products are both one and the same and cannot be construed as separate and distinct activity per se. We find that the Id DR argued admitted the fact that there is no segmental break up of revenue in respect of sale of software products and revenue derived from software development in respect of the aforesaid comparables in the annual reports of the respective comparables, but nevertheless, the same would not affect the comparability with the assessee , as according to him, both the software

development and sale of software products are one and the same activity. We are unable to persuade ourselves to accept this argument of the Id. DR that there is no difference between company engaged in software development and company engaged in sale of software products. We find that the Hon'ble Jurisdictional High Court in the case of CIT vs. PTC Software (I) Pvt.Ltd. in Income Tax Appeal No.732 of 2014 dated 26/09/2016 had addressed this issue in the context of exclusion of Kals Information Systems Ltd. and Helios and Matheson Information Technology Ltd. Specific question raised before the Hon'ble Jurisdictional High Court in this regard is as under:-

“(ii) Whether on the facts and circumstances of the case, the Tribunal erred in excluding KALS Information Solutions Ltd. and M/s. Helios & Matheson Information Technology Ltd. from the list of comparables on the basis of previous years documentations of the assessee without verifying the functions performed by the comparables in the year under consideration ?”

9.1. The Hon'ble Jurisdictional High Court addressed the aforesaid question by observing as under:-

“10. Re. Question (ii) :

a) M/s. KALS Information Solutions Ltd. (KALS Ltd.) and Helios & Matheson Information Technology Ltd. (Helios & Matheson Ltd.) were included by the TPO in his comparability analysis. The grievance of the respondent assessee before the Tribunal was that both are functionally different from the respondent assessee and, therefore, could not be used as comparables. The respondent assessee pointed out that KALS Ltd and Helios & Matheson Ltd. are engaged in the business of selling of software products while the respondent assessee renders software services to its holding company.

(b) The Tribunal in the impugned order records that for the preceding assessment year i.e. A.Y. 2006-07, the TPO had found that KALS Ltd. and Helios & Matheson Ltd. were functionally not comparable with the respondent assessee. In the subject assessment year also, on the basis of Annual Report, it was noted that the KALS was engaged in selling of software products which is different from the activity undertaken by the

respondent assessee, namely, rendering of software service to its holding company. Further, the impugned order also records that no attempt was even made by the Revenue before it to bring on record any change in the nature of activities carried out by KALS Ltd. and Helios & Matheson Ltd. in the subject assessment year, making them functionally comparable to the respondent assessee. In the aforesaid facts, the Tribunal rendered a finding of fact that KALS Ltd. and Helios & Matheson Ltd. are not comparable with the respondent assessee.

(c) Even before us, no submissions were advanced justifying the order of the Assessing Officer that the services rendered by KALS Ltd. and Helios & Matheson Ltd. are comparable for the subject assessment year with that of the respondent assessee.

(d) In the above view, as the findings of the Tribunal being one of the fact which has not been shown to be perverse, the question as proposed does not give rise to any substantial question of law. Thus, not entertained.”

9.2. Respectfully following the aforesaid decision of Hon'ble Jurisdictional High Court, we hold that sale of software products and software development services are separate and distinct and accordingly, the arguments advanced by the Id. DR are rejected in this regard. Accordingly, the aforesaid comparables i.e Thirdware Solutions Ltd, Persistent Systems Ltd, and Kals Information Systems Ltd. deserves to be excluded from the list of comparables which had been rightly directed by the Id. CIT(A) for exclusion. With regard to exclusion of Tata Elxsi Ltd, we find from 895 to 898 of the paper book, there is no segmental data available in the annual report of the said comparable and we also find that they have got their own research and development which makes it functionally uncomparable with that of the assessee, among others, in as much as the assessee herein before us believes on research and development supplied by AE, which fact is not in dispute before us.

9.3. We also find that the Hon'ble Delhi High Court in the case of PCIT vs. CashEdge India Pvt.Ltd in ITA No.279/2016 dated 04/05/2016 had

endorsed the view taken by the Tribunal that Persistent Systems Ltd was involved in software development, software products and marketing and perhaps more importantly, published segmental data was not available. Accordingly, the said comparable has been rightly excluded by the Tribunal as per Hon'ble Delhi High Court. Accordingly, the ground No.2 raised by the revenue is dismissed.

10. With regard to working capital adjustment sought by the assessee, we find the entire workings of working capital adjustment had been furnished before the Id. TPO by the assessee which are enclosed in page 300 of the paper book. Hence, the Id. TPO ought to have considered the same on the list of comparables chosen by him while determining the ALP of the international transactions. Hence, we hold that the Id. CIT(A) had rightly directed the Id. TPO to grant working capital adjustment on the final set of comparables pursuant to the order of the Id CIT(A). We do not deem it fit to interfere in the said order of the Id CIT(A). Accordingly, the ground No.3 raised by the revenue is dismissed.

11. With regard to exclusion of Teledata Marketing Solutions Ltd, the decision rendered by us in ground No.2 on functional dissimilarity and absence of segmental data will hold good for this comparable also. Accordingly, the ground No.4 raised by the revenue is dismissed.

Corporate Tax Issue:-

12. The only corporate tax issue to be decided in this appeal is as to whether the Id. CIT(A) was justified in allowing the claim of assessee for service tax refund for the eligible unit for the purpose of claiming deduction u/s.10A of the Act in the facts and circumstances of the case.

12.1. We have heard rival submissions. We find that assessee had claimed service tax refund of Rs.22,45,475/- for its EDEC Mohali division which unit is eligible for deduction u/s.10A of the Act and accordingly, computed deduction of proceeds u/s.10A of the Act. We find that the Id. AO rejected the claim of deduction u/s.10A of the Act to the tune of Rs.22,45,475/- pertaining to the refund of service tax of EDEC unit. Similarly, the assessee has claimed service tax refund of Rs.28,13,031/- for its FCEC Chennai unit u/s.10A of the Act which was rejected by the Id. AO on the ground that they do not have any nexus with the activities which qualified for deduction u/s.10A of the Act. We find that the reasoning given by the Id. AO for rejection of claim of deduction u/s.10A of the Act is same for both the eligible units stated supra. It is not in dispute that service tax was paid by the assessee in earlier years for these eligible units and claimed as deduction, pursuant to which the claim of deduction u/s.10A of the Act had indeed been reduced to that extent. When the said service tax had been refunded to the assessee during the year under consideration, and also in view of the fact that the said eligible unit still continues for claim of deduction u/s.10A of the Act during the year under consideration, there is no reason to disturb the claim of deduction u/s.10A of the Act for the same. Moreover, we find from the provisions of Section 10A (4) of the Act that the entire profits of the eligible undertaking are entitled for deduction u/s.10A of the Act and there is no scope for exclusion of the service tax refund as not eligibel for deduction u/s 10A(4) of the Act. For the sake of convenience, the relevant provisions of Section 10A(4) of the Act are reproduced hereunder:-

“(4) For the purposes of sub-sections (1) and (1A), the profits derived from export of articles or things or computer software shall be the amount which bears to the profits of the business of the undertaking, the same

proportion as the export turnover in respect of such articles or things or computer software bears to the total turnover of the business carried on by the undertaking.”

12.2. We also find that the reliance placed on the Special Bench of Indore Tribunal in the case of Maral Overseas Ltd. vs. Additional CIT reported in 136 ITD 177 (Indore Tribunal) also supports the case of the assessee in this regard. Accordingly, we find no infirmity in the order of the Id. CIT(A) in granting relief to the assessee. Accordingly, the ground No.5 raised by the revenue is dismissed.

13. In the result, appeal of the revenue is dismissed and appeal of the assessee is allowed for statistical purposes.

Order pronounced in the open court on this 09/10/2019

Sd/-
(RAVISH SOOD)
JUDICIAL MEMBER

Mumbai; Dated
KARUNA, *sr.ps*

Sd/-
(M.BALAGANESH)
ACCOUNTANT MEMBER

09/10/2019

Copy of the Order forwarded to :

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

//True Copy//

(Asstt. Registrar)
ITAT, Mumbai