

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

**BEFORE SHRI N. V. VASUDEVAN, VICE PRESIDENT AND
SHRI A. K. GARODIA, ACCOUNTANT MEMBER**

IT(TP)A Nos. and Assessment year	Appellant	Respondent
230/Bang/2015 2010-11	M/s. Emulex Communications Pvt. Ltd., Millenium Towers-C, 3 rd Floor, 'The Millenia' 1 & 2, Murphy Road, Ulsoor, Bengaluru – 560 008. PAN : AACCA 9990 L	Income-tax Officer, Ward – 2(1)(4), Bengaluru.
152/Bang/2015 2010-11	Income-tax Officer, Ward – 2(1)(4), Bengaluru.	M/s. Emulex Communications Pvt. Ltd., Bengaluru – 560 008. PAN : AACCA 9990 L

Revenue by	:	Shri. C. H. Sundar Rao, CIT-DR(ITAT)(Bengaluru)
Assessee by	:	Shri. T. Suryanarayana, Advocate

Date of hearing	:	06.11.2019
Date of Pronouncement	:	08.11.2019

ORDER

Per N. V. Vasudevan, Vice President:

IT(TP)A No. 152/Bang/2015 is an appeal by the Revenue while IT(TP)A No.230/Bang/2015 is an appeal by the Assessee. Both these appeals are directed against the final order of assessment dated 24.12.2014 passed by the Income Tax Officer, Ward-2(1)(4), Bengaluru, u/s.143(3) read with Sec.144C(13) of the Income Tax Act, 1961 (Act).

2. Grounds of appeal 4 to 7 raised by the Revenue in its appeal and Gr.No. 1 to 4 raised by the Assessee in the revised grounds of appeal, in its appeal are with regard to the determination of Arm's Length Price (ALP) in respect of an international transaction between the Assessee and its Associated Enterprise of rendering Software Development Services (SWD Services). These grounds reads as follows:

Revenue's appeal:

1. *On the facts and in the circumstances of the case, the Hon'ble Dispute Resolution Panel was not justified in giving direction to the TPO to exclude M/s ICRA Techno Analytics Ltd as a comparable, without considering the discussion made by the TPO in respect of the comparable company in the TP order*
2. *On the facts and in the circumstances of the case, the Hon'ble Dispute Resolution Panel was not justified in giving direction to the TPO to exclude M/s Infosys Ltd and M/s Tata Elxsi Ltd as a comparable without considering the facts discussed in the case of the taxpayer by the TPO in respect of the comparable company in the TP Order.*
3. *On the facts and in the circumstances of the case, the Hon'ble Dispute Resolution Panel was not justified in excluding INFOSYS Ltd and Tata Elxsi Ltd as a comparable on the basis of decision in a different case when in TP rejection or acceptance of a comparable in a case on the basis of its appropriateness / inappropriateness in some other is not possible.*
4. *On the facts and in the circumstances of the case, the Hon'ble Dispute Resolution Panel was not justified in giving direction to the TPO to exclude M/s Persistent Systems & Solutions Ltd, M/s Think Soft Global Services Ltd, R.S.Software (India) ltd and Persistent Systems Ltd as a comparable, without considering the discussion made by the TPO in respect of the comparable company which was accepted by the taxpayer during the TP proceedings.*

Assessee's appeal:

1. *That the order of the learned Income-tax Officer, Ward 2(1)(4), Bangalore ("Assessing Officer" or "AO") pursuant to the direction of the learned Dispute Resolution Panel (Panel') to the extent prejudicial to the Appellant, is bad in law and liable to be quashed.*
2. *That the learned AO/learned Panel erred in upholding the learned Transfer Pricing Officer's ("TPO") approach of rejecting the Transfer Pricing ("TP") documentation maintained by the Appellant;*
3. *That the learned AO/learned Panel erred in upholding the learned TPO's approach of considering certain expenses, which have been disallowed while computing the total income for the purpose of Income-tax, as a part of operating cost base which leads to double taxation*
4. *That on the facts and circumstances of the case, the learned AO/learned Panel erred in;*

(a) Upholding the rejection of comparability analysis of the Appellant in the TP documentation and accepting the fresh comparability analysis performed by the learned TPO with application of certain arbitrary/modified filters

(b) Arbitrarily arriving at a set of companies as comparable for the services rendered by the Appellant, on rejecting/not considering companies that are otherwise functionally comparable to the Appellant like Persistent Systems and Solutions Ltd., R S Software (India) Ltd., Thinksoft Global Services Ltd., Akshay Software Technologies Ltd., LGS Global Ltd. and Cat Technologies Ltd., and on inclusion of Kals Information Systems Ltd. that otherwise fails the test of comparability.

(c) Disregarding application of multiple year/prior year date as used by the Appellant in the TP documentation and holding the current year (i.e. Financial Year 2009-10) data for companies should be used comparability

Upholding the learned TPO's approach of using data as at the time of assessment proceedings, instead of that available as on the date of preparing the TP documentation for

comparable companies while determining the arm's length price

(e) Upholding the TPO's approach of not providing Risk Adjustment and thus ignored the limited risk nature of the services provided by the Appellant and in not providing an appropriate adjustment towards the risk differential. even when full-fledged entrepreneurial companies are selected as comparables.

3. The Assessee is a company registered under the provisions of the Companies Act, 1956 and is a subsidiary of Emulex International Ltd. (which holds 99.998% shares) and Emulex Corporate Services Corpn. (which holds 0.002% shares). The Assessee company is engaged in providing SWD services to its affiliates, for which it received a consideration of Rs.29,54,66,768/- during the previous year relevant to the assessment year 2010-11. Since the transaction of provision of Software service by the Assessee was an international transaction, income from such international transaction has to be determined having regard to Arm's Length Price (ALP) as laid down in the provisions of Sec.92 of the Act.

Net margin on cost earned by the Assessee (as reflected in the TP order):

Operating Income	Rs.29,54,66,768/-
Operating Expenses	Rs.26,79,44,050/-
Operating Profit/Loss(Op. Income —Op. Expenses)	Rs.2,75,22,718/-
Operating/Net margin (OP/OC)	10.27%

4. In support of the claim that the price paid in the international transaction is at Arm's length, the Assessee filed a transfer pricing study in which the Assessee chose Transaction Net Margin Method (TNMM) as the most appropriate method for determination of ALP. The Assessee chose profit level indicator (PLI) for the purpose of comparison as Operating Profit/Operating cost. The Assessee selected 16 companies as comparable companies and computed the

arithmetic mean of the profit margins (OP/OC) of those companies was at 13% which was much lower than the profit margin of the Assessee which was within the permissible range of (+) /(-) 5% range to the profit margins of the comparable companies and hence the Assessee claimed that the price received in the international transaction was at Arm's Length.

5. On a reference by the Assessing Officer ("AO") under Section 92CA of the Act to the TPO, the TPO passed an order dated 29.01.2014, rejecting the Transfer Pricing ("TP") study maintained by the Assessee and made a TP adjustment of Rs. 4,77,69,560/-. The TPO accepted TNMM as the most appropriate method and also the PLI of OP/OC. The TPO selected 11 comparable companies and determined the ALP as follows:

Comparables selected by TPO and their arithmetic mean:

SI No.	Comparables Selected by TPO	NCP Margins as per TPO Order (%) (WC- Unadj)	NCP Margins as per TPO Order (%) (WC - Adj)
1.	ICRA Techno Analytics Ltd.(seg)	24.94	31.53
2.	Infosys Ltd.	44.98	51.55
3.	Kals Information SystemsLtd.	34.41	37.27
4.	Larsen &Tubro Infotech Ltd	19.33	26.37
5.	Mindtree Ltd. (Seg)	14.83	19.67
6.	Persistent Systems and Solutions	13.58	22.06
7.	Persistent Systems Ltd.	30.35	34.92
8.	R S Software (India) Ltd.	10.29	17.42
9.	Sasken Communication	17.36	23.40
10.	Tata Elxsi (Seg)	20.93	24.09
11.	Thinksoft Global Services Ltd.	17.05	20.88
	Arithmetical Mean	22.71	28.11

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

Arm's length mean margin	22.71%
Less: Working capital adjustment	(-)5.39%
Adjusted mean margin of the comparables	28.1%
Operating cost	Rs.26,79,44,050/-
Arm's Length Price (ALP): 128.1% of Operating Cost	Rs.34,32,36,328/-
Price Received	Rs.29,54,66,7686/-
Short fall being adjustment u/s. 92CA	Rs.4,77,69, 560/-

The aforesaid shortfall, consequent to determination of ALP, was added to the total income of the Assessee in the draft order of assessment passed by the AO.

6. Against the proposal to make addition as above in the draft assessment order, the Assessee filed objections before the Dispute Resolution Panel (DRP). Briefly the directions issued by the DRP are as follows-

- (i) The DRP directed exclusion of ICRA Techno Analytics Ltd., Infosys Technologies Ltd., Tata Elxsi Ltd. and Persistent Systems Limited.
- (ii) The DRP did not accept the contention that KALS Information System Ltd. ought to be excluded;
- (iii) The DRP directed exclusion of Persistent Systems and Solutions Ltd., and Thinksoft Global Services Ltd. on the erroneous basis that the Assessee had sought exclusion of the same.
- (iv) The DRP *suo motto* directed exclusion of R S Software (India) Ltd. on the ground that it is predominantly engaged in onsite software development.

- (v) The DRP accepted the Assessee's contention that certain expenses which had been disallowed whilst computing the total income for the purposes of income-tax, ought not be treated as part of the operating cost.
- (vi) The errors pointed out in computing the working capital adjustment were directed to be rectified.

7. The comparable companies that remained after the order of the DRP were:

Sl. No.	Name of the Company
1.	KALS Information Systems Ltd.
2.	Sasken Communication Technologies Ltd.
3.	Mindtree Ltd.
4.	Larsen & Toubro Infotech Ltd

Pursuant to the DRP's directions, the AO passed the final assessment order wherein the TP adjustment stood reworked to Rs. 2,64,41,213/-.

8. The Revenue, in ground nos. 4 to 7 has challenged exclusion by the DRP of the following companies, viz., :

- Infosys Technologies Ltd.,
- ICRA Techno Analytics Ltd.,
- Tata Elxsi Ltd.
- Persistent Systems Limited,
- Persistent Systems & Solutions Ltd.,
- R S Software (India) Ltd. and
- Thinksoft Global Services Ltd.

9. In its appeal, the Assessee seeks the following relief:
- (i) The AO/TPO erred in considering certain expenses as part of the operating cost whilst computing the margin of the Assessee, despite the DRP's directions to the contrary. **(Revised Ground No. 3)**
 - (ii) KALS Information Systems Ltd. is not comparable to the Assessee and ought to be excluded from the list of comparables. **(Ground No. 4(b)):**
 - (iii) The DRP erred in *suo moto* excluding following companies which are comparable to the Assessee and ought to be included in the list of comparable companies **(Ground No. 4(b))**:
 - i) Persistent Systems and Solutions Ltd.:
 - ii) R S Software (India) Ltd.; and
 - iii) Thinksoft Global Services Ltd.
 - iv) That LGS Global Limited and Cat Technologies Limited are comparable to the Assessee and ought to be included in the list of comparables **(Ground No. 4(b))**
10. We will deal with each of the above issues. As far as the plea of the Revenue for exclusion of ICRA Techno Analytics Ltd., Infosys Ltd., Tata Elxsi Ltd., and Sasken Communication and technologies Ltd., our attention was drawn to an order passed by ITAT Bangalore in the case of a SWD services provider such as the Assessee for the very same AY 2011-12 in the case of [2016] 70 taxmann.com 299 (Bangalore - Trib.)Deputy Commissioner of Income-tax, Circle-3(1)(2), Bangalore v. Electronics for Imaging India (P.) Ltd. For (AY 2010-11). In the aforesaid order, the Tribunal has upheld exclusion of the

aforesaid four companies, which the revenue seeks to include as comparable companies. The following are the relevant observations of the Tribunal on the comparability of the aforesaid four companies:

“(1) ICRA Techno Analytics Ltd. (seg)

14. At the outset, we note that apart from having the related party revenue at 20.94% of the total revenue, this company was also found to be functionally not comparable with software development services segment of the assessee. The DRP has given its finding at pages 13 to 14 as under:—

"Having heard the contention, on perusal of the annual report, it is noticed by us that the segmental information is available for two segments i.e., services and sales. However, it is evident from the annual report that the service segment comprises of software development, software consultancy, engineering services, web development, web hosting, etc. for which no segmental information is available and therefore, the objection of the assessee is found acceptable. Accordingly, Assessing Officer is directed to exclude the above company from the comparables."

15. We find that the facts recorded by the DRP in respect of business activity of this company are not in dispute. Therefore, when this company is engaged in diversified activities of software development and consultancy, engineering services, web development & hosting and substantially diversified itself into domain of business analysis and business process outsourcing, then the same cannot be regarded as functionally comparable with that of the assessee who is rendering software development services to its AE.

16. In view of the above facts, we do not find any error or illegality in the findings of the DRP that this company is functionally not comparable with that of a pure software development service provider.

(2) Infosys Ltd.

17. The assessee objected against the selection of this company on the ground that this company has a big name and brand value and therefore it has a bargaining power. It also contended that the turnover of this company is Rs. 21,140 crores, which is 442 times higher than the assessee.

18. *The DRP accepted the objections of the assessee and by following the decision of the Delhi Benches of the Tribunal in the case of Agnity India Technologies (P.) Ltd. v. ITO [2015] 58 taxmann.com 167/154 ITD 293 (Delhi - Trib.), directed the TPO to exclude this company from the list of comparables.*

19. *We have heard the ld. DR as well as ld. AR and considered the relevant material on record. We note that in the case of Agnity India Technologies (P.) Ltd. (supra), the Delhi Bench of the Tribunal has considered the comparability of this company and the findings of the Delhi Bench of the Tribunal has been confirmed by the Hon'ble Delhi High Court. The Hon'ble Delhi High Court has observed that this company having brand value as well as intangible assets cannot be compared with an ordinary entity provide captive service. We further note that this company provides end to end business solutions that leverage cutting edge technology thereby enabling clients to enhance business performance. This company also provides 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 service. In addition, the company offers software product for banking industry. Thus, this company is engaged in diversified services including design as well as technical consultancy, consulting, re-engineering, maintenance, systems integration as well as products for banking industry.*

20. *In view of the above facts that Infosys Ltd. having a huge brand value and intangibles as well as having bargaining power, the same cannot be compared with the assessee who is providing services to its AE.*

(5) Sasken Communication Technologies Ltd.

21. *The assessee raised objection that this company has revenue from software services, software products and other services. The DRP has come to the conclusion that this company earned revenue from 3 segments. However, no segmental information is available. Accordingly, the DRP directed the AO to exclude this company from the comparables.”*

22. *We have heard the ld. DR as well as ld. AR and considered the relevant material on record. The DRP has reproduced the break-up of revenue in the impugned order as under:-*

Amount in Rs. lakhs

	<i>Year ended March 31, 2010</i>	<i>Year ended March 31, 2009</i>
<i>Software Services</i>	37,736.22	40,531.20
<i>Software products</i>	2,041.00	6,146.43
<i>Other services</i>	372.77	1,297.05
<i>Total revenues</i>	40,150.89	47,974.68

23. Thus, there is no dispute that this company earns revenue from 3 segments. However, the segmental operating margins are not available. Therefore, in the absence of segmental relevant data and particularly operating margins, this composite data cannot be considered as comparable with the assessee for software development services segment. Accordingly, we do not find any error or illegality in the findings of the DRP.

(6) *Tata Elxsi Ltd.*

24. The assessee has raised objections against this company on the ground that the company is functionally different from the assessee. Though the TPO has considered the software development and services segment of this company as comparable to that of assessee, however, the assessee contended that even within the software segment, this company is engaged in diverse activities. The assessee placed reliance on the information in the annual report under the Directors Report and submitted before the DRP that even under the software development services segment, this company is engaged in various diversified activities including product design service, innovation design, engineering service, visual computing labs, etc. The assessee also placed reliance on the decision of Mumbai Bench of the Tribunal in the case of *Telcordia Technologies India (P.) Ltd. v. Asstt. CIT [2012] 137 ITD 1/22 taxmann.com 96*.

25. The DRP found that this company is not functionally comparable with assessee company as it is engaged in diversified activities even in the software development services. The DRP has followed the decision of the Mumbai Bench of the Tribunal in the case of *Telcordia Technologies India (P.) Ltd. (supra)*.

26. We have heard the Id. DR as well as Id. AR and considered the relevant material on record. We find that this company even in the software development segment is engaged in diversified activities of product design services, innovation design, engineering services, visual computing labs, etc. We further note that in the case of *Telcordia*

Technologies India (P.) Ltd. (supra), the Mumbai Bench of the Tribunal vide its order dated 11.5.2012 in para 9.7 has held as under:—

"7.7 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 as fit for comparability analysis for determining the arm's length price for the assessee, hence, should be excluded from the list of comparable parties."

33. No contrary view has been brought to our notice regarding comparability of this company with that of a pure software development service provider. Accordingly, in view of the decision of the Mumbai Bench of the Tribunal in the case of Telcordia Technologies India (P.) Ltd. (supra), we do not find any reason to interfere with the finding of the DRP."

11. Respectfully following the aforesaid decision, we hold that the aforesaid four companies were rightly regarded as not comparable companies with the Assessee by the DRP and hence, we find no merits in the relevant grounds of appeal of the revenue.

12. In Ground No.7 of its appeal, the revenue has challenged the exclusion of Persistent Systems Ltd. [Persistent Systems' for short], Persistent Systems and Solutions Ltd. ["Persistent Systems and Solutions"]. Thinksoft Global Services Ltd. [-Thinksoft"] and RS Software Ltd. ["RS"]. The Assessee had not objected to the inclusion of Persistent Systems and Solutions, Thinksoft and RS Software Ltd., before the DRP and therefore, to that extent ground no. 7 raised by the Revenue is allowed.

13. As far as exclusion of Persistent Systems Ltd., is concerned, our attention was drawn to an order passed by ITAT Bangalore in the case of a SWD services provider such as the Assessee for the very same AY 2011-12 in the case of [2016] 70 taxmann.com 299 (Bangalore - Trib.)Deputy Commissioner of Income-tax, Circle-3(1)(2), Bangalore v. Electronics for Imaging India (P.) Ltd. For (AY 2010-11). In the aforesaid order, the Tribunal has upheld exclusion of the aforesaid company with the following observations:

“(4) Persistent Systems Ltd.

24. We have heard the ld. DR as well as ld. AR and considered the relevant material on record. The assessee raised objections against selection of this company on the ground that this company is functionally not comparable as engaged in the product development. The segmental information for services and product is not available. Further, the assessee has also pointed out that there was an acquisition and restructuring during the year under consideration.

25. The DRP has noted the fact that this company has reported the entire receipt from sales and software services and product. Therefore, no segmental information was found to be available for sale of software services and product. Further, the DRP has noted that as per Note 1 of Schedule 15, this company is predominantly engaged in outsource software development service. Apart from the revenue from software services, it also earns income from licence of products, royalty on sale of products, income from maintenance contract, etc. These facts recorded by the DRP has not been disputed before us.

26. Therefore, when this company is engaged in diversified activities and earning revenue from various activities including licencing of products, royalty on sale of products as well as income from maintenance contract, etc., the same cannot be considered as functionally comparable with the assessee. Further, this company also earns income from outsource product development. In the absence of any segmental data of this company, we do not find any error or illegality in the findings of the DRP that this company cannot be compared with the assessee and the same is directed to be excluded from the set of comparables.”

14. Respectfully following the aforesaid decision, we hold that the aforesaid company was rightly regarded as not comparable company with the Assessee by the DRP and hence, we find no merits in the relevant grounds of appeal of the revenue.

15. The Assessee in its appeal in Gr.No.4(b) sought exclusion of KALS Information Systems Ltd. our attention was drawn to an order passed by ITAT Bangalore in the case of a SWD services provider such as the Assessee for the very same AY 2011-12 in the case of [2016] 70 taxmann.com 299 (Bangalore - Trib.) Deputy Commissioner of Income-tax, Circle-3(1)(2), Bangalore v. Electronics for Imaging India (P.) Ltd. For (AY 2010-11). In the aforesaid order, the Tribunal has upheld exclusion of the aforesaid company with the following observations:

“(3) KALS Information Systems Ltd.

21. The assessee raised objections against this company on the ground that this company is engaged in the development of software and software products. Further, this company consists of STPI unit and also having a training centre engaged in training of software professionals on online products. Thus, when this company is having revenue from software services as well as software product, the same cannot be considered as comparable with software development service providing company.

22. The DRP has directed the AO to exclude this company from the list of comparables by taking note of the fact that there were inventories in the books of accounts of this company which shows that this company is in the software product business. Further, by following the decision of this Tribunal in the case of Trilog E-Business Software India (P.) Ltd. v. Dy. CIT [2013] 140 ITD 540/29 taxmann.com 310 (Bang. - Trib.), this company was found to be not comparable with that of the assessee.

23. We have heard the ld. DR as well as ld. AR and considered the relevant material on record. The ld. DR has not disputed the fact that comparability of this company has been examined by this Tribunal in a series of decisions including in the case of Trilog e-business Software India (P.) Ltd. (supra). We further note that in the balance sheet of this company as on 31.3.2010, there are inventories of Rs. 60,47,977. Therefore, when this company is in

the business of software products, the same cannot be compared with a pure software development services provider. Accordingly, we do not find any error or illegality in the impugned findings of the DRP.”

16. Respectfully following the aforesaid decision, we hold that the aforesaid company ought to have been regarded as not comparable company with the Assessee by the DRP and hence, we find merits in the relevant grounds of appeal of the Assessee and allow the same.

17. In ground No.4b, the assessee has sought inclusion of LGS Global Ltd., and CAT Technologies Ltd., as a comparable company. As far as these 2 companies are concerned, the TPO rejected LGS Global Ltd., as a comparable company on the ground that the exports sales were less than 75% of the total revenue. Before the DRP, the assessee pointed out that the ratio of export sales to total sales was 98.7% and that this company was functionally comparable to SWD services company. The submissions made by the assessee to the DRP in this regard are contained in pages 180 to 182 and 231 to 232 of the assessee's Paper Book. The DRP did not adjudicate the inclusion of this company. The learned DR, in his submission, pointed out that this company should also be tested on the basis of functional comparability, if the comparability of this company is restored to the TPO for fresh consideration. Similarly, the learned Counsel pointed out that CAT Technologies Ltd., was rejected by the TPO for the reason that the details of related party transactions were not available. The plea of the assessee was that in the Annual Report, there was a column for reporting related party transaction, but no transactions had been reported. It is a plea of the assessee that there were no related party transaction and that is the reason why the Annual Report did not give details of any related party transaction. The submissions made before the TPO were reiterated before the DRP. But the DRP did not adjudicate on the basis of the comparability of this company. The learned

DR pointed out that this company should also be compared on the basis of functional comparability. The learned Counsel for the assessee submitted that the comparability of the aforesaid two companies can be remanded to the TPO for fresh consideration and that the functional comparability of these two companies can also be considered by the TPO.

18. We have considered the rival submissions and are of the view that the comparability of the aforesaid two companies not having been adjudicated in the proper perspective by the TPO and the DRP and it would be just and appropriate to remand the question of deciding comparability of these two companies (including functional comparability which was insisted by the learned DR before us) to the TPO for fresh consideration, after due opportunity to the assessee. We hold and direct accordingly.

19. The learned Counsel for the assessee filed before us a letter in which he has sought modification of the ground No.3 in the revised grounds of appeal which we have extracted in the earlier part of this order. The modified ground is as follows:

"3. That the learned AO/TPO erred in including expenses relating to employee stock compensation amounting to Rs.1,71,42,773/- and provision for service tax amounting to Rs. 42,05,352/- in the operating costs while computing the operating margin, despite the DRP's directions holding them to be non-operating in nature."

20. The dispute raised in the aforesaid ground of appeal is with regard to computing of the operating margin of the assessee. While computing the operating margin of the assessee, the TPO included expenses related to employee stock option compensation amounting to Rs. 1,71,42,773/- and provision for service tax amounting to Rs. 42,05,352/- as part of the operating costs while computing the operating margin of the assessee. In its objections before the DRP, the assessee submitted that the aforesaid expenses are not part of the operating

costs and therefore they should not be considered as operating expenses while arriving at the operating margin of the assessee. The DRP on such submission, gave the following directions:

“3.11: Computation of operating cost and operating margin:

It is submitted that the TPO has excluded employees stock compensation, provision for service tax and foreign exchange loss as non-operating cost, and excluded 'other income' from the operating revenue.

Having heard the assessee, we are of the view that foreign exchange gain/loss are operating in nature in case of export business. The Assessing Officer is directed to include the same as cost/income in case of assessee as well as comparables. Other items are extra-ordinary items and hence non-operating in nature. The other income, if not related to business operations, but interest on FDs etc, has rightly been excluded by the TPO from operating revenue. IT is directed accordingly.”

21. In the order giving effect to the directions of the DRP, the TPO did not exclude the aforesaid two items of expenses while computing the operating margin of the assessee. Ground No.3 is raised by the assessee against such action of the TPO.

22. We have heard the rival submissions and we find that the assessee has worked out the operating profit margin in its TP study at 10.27% and considered a sum of Rs.26,79,44,050/- as operating expenses. As to whether this operating expenses so considered by the assessee includes the employee's stock compensation and provision for service tax or not is not clear from the financials. The DRP, in its directions has observed that the TPO has considered employee's stock compensation and provision for service tax as non-operating cost. At the same time, the DRP has also given a direction that these items of expenditure are non-operating in nature. In the given facts and circumstances of the case, we are of the view that it would be just appropriate to set aside to remand the question

of determination of operating profit margin of the assessee to the TPO for fresh consideration after analysis of the operating expenditure considered by the assessee while working out its operating profit margins in the TP analysis. We hold and direct accordingly.

23. The TPO is directed to compute the ALP as per the directions contained in this order, after given opportunity of being heard to the assessee. No other arguments were advanced on the transfer pricing adjustment, except the issues dealt with in the earlier paragraphs.

24. The other non transfer pricing issues that arise for consideration in these appeals are ground Nos.2 and 3 raised by the Revenue in its appeal. The Assessee claimed deduction u/s.10A of the Act of a sum of Rs.4,34,89,367/- . The AO computed deduction under Section 10A of the Act, by reducing only from the export turnover: (1) a sum of Rs. 9,89,323/- being communication charges; and (2) a sum of Rs. 27,55.889/- being travel expenditure incurred in foreign currency. In this manner, the AO recomputed the eligible deduction at Rs. 4,29,26,933 /- as opposed to Rs. 4.34,89,367/- claimed by the Assessee. In its objections before the DRP, the Assessee contended that in the first place, the aforesaid expenses should not be reduced from its export turnover while computing the deduction available to it under Section 10A. In the alternative, it contended that if the said expenses were to be reduced from its export turnover, then they should also be reduced from its total turnover inter alia in terms of the decision of the Hon'ble High Court of Karnataka in C/T v. Tata Elxsi Ltd. [2012] 349 ITR 98 (Kar). The DRP allowed the alternate contention and directed the AO to recompute the deduction by reducing the expenses both from the export turnover as well as the total turnover. The Revenue is ground Nos. 2 and 3 of its appeal is challenging the above direction of the DRP.

25. We are of the view that the direction of the DRP is correct and is in accordance with the decisions of the Hon'ble High Court of Karnataka in CIT v. Tata Elxsi Ltd., reported at [2012] 349 ITR 98 (Kar) which has since been affirmed by the Hon'ble Supreme Court vide its order dated 24.04.2018 in C/T v. HCL Technologies Ltd. (reported at [2018] 404 ITR 719 (SC)). Consequently, ground Nos.2 and 3 by the Revenue are dismissed.

26. The other grounds which require consideration in assessee's appeal are ground Nos.5 and 6 which are grounds relating to non granting MAT credit u/s.115JAA of the Act brought forward from AY 2008-09 and the ground relating incorrect credit for advance tax paid for AY 2010-11 taken into consideration by the AO, respectively.

27. As far as Gr.No.5 is concerned, the facts are that for assessment year 2010-11, the Assessee was entitled to credit of brought forward MAT from the year 2008-09 amounting to Rs. 16,42,956/-. Out of the same, MAT credit of Rs. 11,44,678/- was set-off in assessment year 2009-10. Accordingly, the assessee had brought forward MAT credit of Rs. 4,98,278/- for AY 2010-11. However, in the final assessment order, the AO did not grant the same. We are of the view that it would be just and appropriate to direct the AO to grant the MAT credit to the extent available.

28. As far as Gr.No.6 is concerned, the facts are that the AO in his final assessment order has considered the amount of advance tax paid by the Assessee as Rs.33,74,001, as against Rs.73,35,001/-, without providing any reason whatsoever. It is pertinent to note that the AO in his draft assessment order has rightly considered Rs.73,35,001/- as advance tax paid by the Assessee. Therefore, it is the prayer of the Assessee that the AO be directed to consider the advance tax paid by the Assessee of Rs.73,35,001/- as against Rs.33,74,001/- considered in the final assessment order. We are of the view that a direction to the AO to

verify this aspect and give appropriate adjustment of advance tax paid would be just and sufficient. We hold and direct accordingly.

29. The other ground of appeal in the assessee's appeal regarding levy of interest is purely consequential and the AO is directed to consequential effect.

30. In the result, appeal by the assessee and the Revenue are partly allowed.

Order pronounced in the open court on this 8th day of November, 2019.

Sd/-
(A.K.GARODIA)
Accountant Member

Sd/-
(N. V. VASUDEVAN)
Vice President

Bangalore.

Dated: 8th November, 2019.

/NS/*

Copy to:

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|---------------|---------------|
| 1. Appellants | 2. Respondent |
| 3. CIT | 4. CIT(A) |
| 5. DR | 6. Guard file |

By order

Assistant Registrar,
ITAT, Bangalore.