

IN THE INCOME TAX APPELLATE TRIBUNAL
“C” BENCH : BANGALORE

BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT
AND SHRI D.S. SUNDER SINGH, ACCOUNTANT MEMBER

IT(TP)A No.113/Bang/2018
Assessment year: 2012-13

AMD India Private Limited, No.102 & 103, Export Promotion Industrial Park, Whitefield Road, Bengaluru – 560 066. PAN: AAECA 6756C	Vs.	The Income Tax Officer, Ward 1(1)(3), Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	Shri Padamchand Khincha, CA
Respondent by	:	Shri Pradeep Kumar, CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	02.12.2019
Date of Pronouncement	:	05.12.2019

ORDER

Per N.V. Vasudevan, Vice President

IT(TP) A.No.113/Bang/2017 is an appeal by the assessee against the order dated 16/12/2016 passed by ITO, Ward 1(1)(3) u/s 143(3) r.w.s 144C(13) of the Income Tax Act, 1961 (the Act) relating to assessment year 2012-13.

2. The first issue that arises for consideration in this appeal is with regard to determination of Arm's Length Price (ALP) in respect of international transaction of rendering of Software Development Services by the Assessee to its Associated Enterprise (AE). The Assessee is a company engaged in the business of providing contract Software Development Services (SWD Services). The Assessee rendered SWD services to its AE. The transaction of rendering software development services by the Assessee to its AE was a transaction with an Associated Enterprise (AE) and was therefore an international transaction. As per the provisions of Sec.92 of the Act, income from international transaction has to be computed having regard to Arm's Length Price (ALP).

3. It is not in dispute between the Assessee and the revenue that the Transaction Net Margin Method (TNMM) was the Most Appropriate Method (MAM) for determination of ALP and that the profit level indicator to be adopted for comparison of the Assessee's profit with that of comparable companies was Operating Profit/Total Cost (OP/TC). The OP/TC of the Assessee was 12.77%. The Assessee in its TP study selected 8 comparable companies whose arithmetic mean of OP/TC was comparable with the profit margins of the Assessee and was acceptable. It was claimed by the Assessee that the price charged by it in the international transaction was at Arm's Length. The Transfer Pricing Officer (TPO) to whom the determination of ALP was referred by the AO, selected 10 companies as comparable companies with the Assessee. Thus a final set of 10 comparable companies was chosen by the TPO as comparable companies. The arithmetic mean of profit margin of these companies after and before adjustment towards working capital adjustment selected by TPO was as follows:

Sl. No.	Name of the Company	Mark-up on Total Costs (WC-unadj) (in %)
1.	Datamatics Global Services Ltd.	14.57
2.	Genesys International Corpn. Ltd.	30.09
3.	ICRA Techno Analytics Ltd.	17.24
4.	Infosys Ltd.	43.10
5.	Larsen & Toubro Infotech Ltd.	25.47
6.	Mindtree Ltd.	15.01
7.	Persistent Systems Ltd.	27.20
8.	RS Software (India) Ltd.	15.34
9.	Sasken Communication Technologies Ltd.	12.15
10.	Spry Resources India Pvt. Ltd.	26.18
	AVERAGE MARK-UP	22.63

4. Based on the above average arithmetic mean of profit margin of the comparable companies, the TPO computed the ALP of the international transaction of rendering of SWD services by the Assessee to its holding company as follows:-

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

Arm's Length Mean Mark-up	22.63%
Less: Working Capital Adjustment	2.57%
Adjusted mean mark-up of the comparables	20.06%
Operating Cost	Rs121,19,54,144
Arm's Length Price – 120.06% of Operating Cost	Rs145,50,72,145
Price Received	Rs131,23,18,343
Shortfall being adjustment u/s. 92CA	Rs14,27,53,802
Arm's Length Mean Mark-up	22.63%
Less: Working Capital Adjustment	2.57%
Adjusted mean mark-up of the comparables	20.06%
Operating Cost	Rs121,19,54,144
Arm's Length Price – 120.06% of Operating Cost	Rs145,50,72,145
Price Received	Rs131,23,18,343
Shortfall being adjustment u/s. 92CA	Rs14,27,53,802

5. The difference between the price charged by the Assessee and the ALP determined by the TPO viz., Rs.14,27,53,802/- was added to the total income by the AO in his draft assessment order dated 22.3.2016 as addition on account of shortfall being adjustment u/s.92CA of the Act.

6. The Assessee filed objections to the draft assessment order by the AO before the Disputes Resolution Panel (DRP). The DRP in its directions dated 30.11.2016 gave some directions and consequently the addition proposed by the TPO was reduced by Rs.5,76,37,917/-. The DRP excluded 6 out of the 10 comparable companies chosen by the TPO but chose to retain 4 comparables chosen by the TPO for the following reasons:-

“ On giving effect to the above directions, the following companies are retained as comparables:-

Sl.No.	Names of the companies	Margin after working capital adjustment
1	L & T Infotech Ltd.	24.89%
2	MindTree Ltd.	14.10%
3	Persistent Systems Ltd.	26.31%
4	R S Software (India) Ltd.	16.94%
	Mean Margin	20.56%

The above adjusted mean margin of 20.56% is higher than the adjusted mean margin of 20.06% computed by the TPO based on the ten comparables. In such circumstances, we are of the view that larger set of the comparables takes care of differences, if any, and therefore we uphold the set of the comparables selected by the TPO.”

7. Pursuant to the directions of the DRP, the AO passed the final assessment order wherein the TP adjustment stood reworked at a lesser figure than what was originally suggested by the TPO. The AO passed a fair order of assessment making the addition on account of determination of

ALP by the TPO as modified by the DRP. Aggrieved by the addition made in the fair order of assessment, the Assessee has raised several grounds of appeal challenging the addition on several counts. However at the time of hearing the learned counsel restricted his arguments to exclusion of 5 comparables out of the 10 comparable companies that remain in the final list of comparable companies after the directions of the DRP viz., (a) Genesys International Corpn.Ltd., (b) ICRA Techno Analytics Ltd., (c) Infosys Ltd., (d) Larsen and Toubro Infotech Ltd., and (d) Persistent Systems Ltd. Another grievance of the Assessee on the determination of ALP is that the PLI of OP/OC chosen by the Assessee and accepted by the TPO was altered by the TPO by not considering the reversal of provision for service tax as operating income.

8. The learned counsel for the brought to our notice a decision of the ITAT Bangalore Bench in the case of CGI Information Systems & Management Consultants Private Ltd., Vs. ACIT IT(TP) A.No.183/Bang/2017 for AY 2012-13 order dated 11.4.2018 wherein 4 out of the aforesaid five comparable companies viz., (a) Genesys International Corpn.Ltd., (b) Infosys Ltd., (c) Larsen and Toubro Infotech Ltd., and (d) Persistent Systems Ltd. were excluded by the ITAT. The functional profile of the Assessee in this appeal and that of the Assessee in the decision cited by the learned counsel for the Assessee is the same. The following were the relevant observations of the Tribunal:-

“28. The learned counsel for the Assessee submitted before us that the comparability of the 3 companies out of the aforesaid 4 companies which the Assessee seeks to exclude from the list of comparable companies chosen by the TPO viz., Infosys Ltd., Larsen & Toubro Infotech Ltd. and Persistent Systems Ltd., were considered by the ITAT Delhi Bench in the case of Agilis Information Technologies India (P) Ltd. Vs. ACIT (2018) 89 taxmann.com 440 (Delhi-Trib.) for the same AY 2012-13. In this regard it was submitted that the functional profile of the Assessee

is same as that of the Assessee in the case of Agilis Information Technologies India (P) Ltd., is identical in as much as the said company was also involved in providing SWD services to its AE and the TPO had chosen 16 comparable companies out of which 6 companies chosen by the TPO in the case of the Assessee for the purpose of comparability were the same. His submission was that the decision rendered by the Tribunal in the case of Agilis Information Technologies India (P) Ltd., (supra) would be equally applicable to the Assessee in the present case also. The learned DR submitted that the DRP in its directions has merely accepted with the reasoning of the TPO and therefore the issue of exclusion of these companies should be directed to be examined afresh by the DRP.

29. We have considered the rival submissions. In the case of Agilis Information Technologies India (P) Ltd., (supra), this Tribunal considered the comparability of the 3 companies which the Assessee seeks to exclude from the final list of comparable companies chosen by the TPO. The functional profile of the Assessee and that of the Assessee in the case of Agilis Technologies India (P) Ltd., is identical in as much as the said company was also involved in providing SWD services to its AE and the TPO had chosen some comparable companies which were also chosen by the TPO in the case of the Assessee for the purpose of comparability. In the aforesaid decision the Tribunal held on the comparability of the 3 companies which the Assessee seeks to exclude as follows:

(a) **Infosys Ltd.**, was excluded from the list of comparable companies by following the decision of the Hon'ble Delhi High Court in the case of CIT Vs. Agnity India Technologies (2013) 36 taxmann.com 289 (Delhi). The discussion is contained in paragraphs 4.5 to 4.7 of the Tribunal's order. The Tribunal accepted that Infosys Ltd. is a giant risk taking company and engaged in development and sale of software products and also owns intangible assets and therefore not comparable with a software development service provider such as the Assessee in that case.

(b) **Larsen & Toubro Infotech Ltd.**, was excluded from the list of comparable companies by relying on the decision of the Delhi Bench of ITAT in the case of Saxo India (P) Ltd. Vs. ACIT

(2016) 67 taxmann.com 155 (Del-Tri). The discussion is contained in paragraphs 4.8 to 4.10 of the Tribunal's order. The Tribunal held that L & T Infotech Ltd., was a software product company and segmental information on SWD services was not available. The Tribunal also noticed that the appeal filed by the revenue against the tribunal's order was dismissed by the Hon'ble Delhi High Court in ITA No.682/2016.

(c) **Persistent Systems Ltd.**, was excluded from the list of comparable companies on the ground that this company was a software product company and segmental information on SWD services was not available. The Tribunal in coming to the above conclusion referred to the decision rendered by ITAT Delhi Bench in the case of Cash Edge India Pvt.Ltd. Vs. ITO ITA No.64/Del/2015 order dated 23.9.2015 and the decision of Hon'ble Delhi High Court in the case of Saxo India Pvt.Ltd. (supra). The findings in this regard are contained in Paragraphs 4.14 to 4.16 of its order.

30. Respectfully following the decision of the Tribunal we hold that the aforesaid 3 companies be excluded from the final list of comparable companies for the purpose of arriving at the arithmetic mean of comparable companies for the purpose of comparison with the profit margins. In this regard we are also of the view that the plea of the learned DR for a remand of the issue to the DRP on the ground that the DRP has not given any reasons in its directions cannot be accepted. The DRP has endorsed the view of the TPO in its directions and therefore the reasons given by the TPO should be regarded as the conclusions of the DRP.

31. The learned DR next submitted that **Genesys International Corporation Ltd.**, should be excluded from the list of comparable companies. The comparability of this company with the Assessee has been discussed by the TPO in page-11 of his order. The Assessee objected to inclusion of this company in the list of comparable companies for the reason that this company is functionally different and owns intangible assets which are peculiar only when the Assessee owns software products. The objections of the Assessee are contained in its letter dated 22.12.2015 addressed to the TPO and in annexure-B to the said letter. The relevant portion of the objection is at page 711-713 of the Assessee's paper book. According to the Assessee this

company is engaged in providing Geographical Information Services comprising of Photogrammetry, Remote Sensing, Cartography, Data Conversion, state of the art terrestrial and 3D geocontent including location based and other computer based related services. Page-38 of the Annual report 2012 containing the above description was brought to the notice of the TPO. Attention of the TPO was invited to the directors report to the shareholders at page ii of the annual report 2012, wherein the Directors have informed the shareholders that the company continued in its journey to be innovators and leaders in the fields of location based services related geo platforms and advanced survey techniques. There is no segmental reporting because it is stated in the annual report that this company is only in one segment viz., GIS based services and therefore there is no requirement of segmental reporting. It was also submitted that this company owns substantial intangibles equivalent to 10.42% of its total turnover.

32. The TPO however has regarded this company as a comparable company by observing that this company develops software for mapping and geospatial services and operates a few development centres in India. The company is predominantly into software development services. The intangibles in the possession of the company are only the GIS database which is only depreciation. It does not add significant value to the company.

33. The objections as put forth before the TPO were reiterated before the DRP. The DRP in paragraph 6.2.2 & 6.2.3 of its directions dealt with this issue as follows:

“6.2.2. The functions of the Assessee company have been examined in detail. A financial product on which the settlement system of bank runs is a real time system. It is very complex. Any bug or problem in it can crash the entire banking system of several nations. The Assessee’s claim of providing only basis software services is rejected.

6.2.3. The Panel holds that the software for financial product is much more complex than a geospatial software. Therefore, the panel holds that the Genesys is a valid comparable.”

34. The learned counsel for the Assessee submitted that the DRP has completely proceeded on wrong facts which does not either emanate from the order of the TPO or the submissions of the Assessee. He reiterated submissions made before the TPO and DRP. The learned DR relied on the order of the DRP/TPO.

35. We have given a careful consideration to the rival submissions. It is clear from the material brought to the notice of the TPO by the Assessee that this company renders mapping and geospatial services. In rendering such services it develops software. But that does not mean that this company is in the business of software development. The business profile of this company as per the annual report does not show that this company is into software development service. The only line of business that this company carries on is rendering GIS based services and this is clear from the annual report which specifies that since the company carries on only one line of business viz., GIS based services there is no need to give any segmental results. In the circumstances, we are of the view that there is no basis for the TPO to conclude that this company is predominantly into software development services. The presence of intangible assets is indicative of the fact that this company is not in software development services business. The TPO has overlooked this aspect and proceeded on the basis that the presence of intangible assets would not be significant. Rule 10B(2) of the Income Tax Rules, 1962 (Rules) specifically provides that for the purposes of sub-rule (1) of Rule 10B, the comparability of an international transaction with an uncontrolled transaction shall be judged with reference to the following, namely:—

(a) the specific characteristics of the property transferred or services provided in either transaction;

(b) the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;

In the given facts and circumstances, we are of the view that Genesys International Corporation Ltd., cannot be considered as a comparable company and the said company should be excluded from the final list of comparable companies. We hold accordingly.”

9. Respectfully following the decision of the Tribunal we hold that the aforesaid 4 companies be excluded from the final list of comparable companies for the purpose of arriving at the arithmetic mean of comparable companies for the purpose of comparison with the profit margins.

10. As far as the comparable company ICRA Techno Analytics Ltd., is concerned the said company was excluded by the DRP on the ground of functional comparability. Besides the above, the related party transaction in the case of the aforesaid company was more than 25% as is evident from page 1129 & 1130 of Assessee's paper book containing the financial statement of this company from capitaline database, which details are extracted at page 863 of Assessee's paper book which is objections filed by the Assessee before the DRP. In the circumstances, this company has to be excluded from the list of comparable companies. We hold accordingly.

11. As far as the request of the Assessee to compute the PLI of the Assessee by considering provision for service tax written back as part of the operating profit of the Assessee, the factual details are as follows:

“Assessee's Margin for Software Development Segment

Particulars	Amount (INR)
Total Operating Revenue	1,31,24,45,359
Add: Forex Gain considered as operating pursuant to DRP direction	2,94,35,226
Revised Total Operating Revenue	1,34,18,80,585
Operating Cost	1,21,19,54,144
Less: Reversal of provision for Service Tax (Note 1)	2,20,57,615
Revised Total Operating Cost	1,18,98,96,529
Operating Margins	15,19,84,056
OP/OC	12.77%

12. The Assessee is exporter of service and therefore eligible to claim refund of service tax input. Accordingly, the Assessee had passed receivable entry for certain categories of services tax input. However for certain categories of services tax input, the tax department denied refund of service tax. Accordingly the assessee made provision against service tax refund receivable and simultaneously filed appeal before appellate authorities for claim of refund. During the year under consideration, certain appellate orders were received granting refund for certain categories of service tax input. Based on such orders, the assessee reversed the provision by crediting profit and loss account. [Page 845-854 of PB-I (part II)].

13. In the TP order, the TPO has considered provision for doubtful debts as non-operating in nature. The DRP has upheld the action of the TPO.

14. The assessee submits that as the reversal of provision is linked to business activity, the same should be treated as operating in nature. In support of this, the assessee relies on the following decisions:

- i) Sony India (P.) Ltd. V. DCIT [2008] 114 ITD 448 (Delhi)
- ii) Logica Private Limited v. ACIT [2013] 36 taxmann.com 374 (Bangalore-Trib).

15. We have considered the submission of the learned AR on this issue and find that in the decision rendered in the case of *Sony India (P) Ltd. Vs. DCIT 114 ITD 448 (Delhi)*, this aspect has been considered and it was held that provisions written back in the P&L a/c should be regarded as forming part of the operating profit of the taxpayer. The relevant observations of the Tribunal are as follows:-

“**106.2** After considering facts and circumstances of the case, we do not see any good ground for not permitting the taxpayer to raise the ground before the Tribunal which is clearly arising out of the impugned order. As noted earlier, the Revenue has not challenged relevant part of the order of the CIT(A). Therefore, the objection now being taken by the learned Departmental Representative is not justified. On merit, we see no good reason to exclude provisions written back as not forming part of computing operating profit of the taxpayer. In our considered opinion, exclusion of above provision is based upon misconception of real nature of the entry generating income. It is not practically possible for a businessman to actually disburse all expenses incurred by it in the financial year and, therefore, a large number of business liabilities (manufacturing included) are provided in the accounts of a given year. It is elementary that there is no difference between actual disbursement of an expenditure or provision thereof. However, recovery of liability provided may become barred by limitation or for some other reasons, liability gets unenforceable or is reduced or ceases to exist with the passage of time. Therefore, it may be necessary to write back such a liability. But, it cannot follow that the liability was not expenditure of business or operating expense. Cessation of a liability is a taxable income under s. 41 of the IT Act. The underlying principle behind above provision is that Revenue takes back a benefit which it granted earlier, but which, due to subsequent events or changed circumstances should be charged to tax as "income". Statutory provision overrides general understanding that mere creation of a benefit to a taxpayer by admission or cessation of a debt or a liability should not result in an income. Thus, creation of unpaid liability and its write back is a normal incident of a business operation which is carried everywhere in accounts to have true picture of profits of the relevant period. If a liability has ceased to exist and is required to be accounted for and shown as income by the taxpayer and, in case it is not so shown the taxpayer can be subjected to a penal action under Indian regulations. In this connection, we can refer to decision of the Supreme Court in the case of CIT vs. S. Teja Singh (1959) 35 ITR 408 (SC). Having regard to statutory provisions, it cannot be said that provision or writing back of liability is not part of operating profit or would not be taken into consideration for computing the same. The aspect of liabilities

written off was ignored without considering nature and character of such liabilities. It would have been different if a finding was recorded that provision written back did not relate to business operations of the taxpayer. There is no suggestion on the above lines. Further, it is not the case of the Revenue that liabilities written back were wrongly provided for. It is a settled and well accepted proposition that adjustment can be made only on account of differences. It is not possible to believe that other comparable entities taken into consideration are not making and writing back provision of liabilities no more required. There is no material nor there is any finding to support action of the Revenue authorities. We can therefore make a general observation that all business enterprises are making and writing back liabilities as a normal incident of operating business. The expenses for which provisions were originally made were considered operating in nature and allowed in assessment. These provisions no longer required by the taxpayer during the year under review were reversed in the books of account as per mercantile system of accounting and shown as income. Therefore, on facts we do not see any justification for excluding provisions written back in the P&L a/c as not forming part of the operating profit of the taxpayer. Accordingly, claim of the taxpayer is accepted.”

16. Respectfully following the aforesaid decision, we hold that provision written back should be regarded as part of the revenue of the Assessee while determining PLI.

17. The TPO is directed to compute the ALP of the international transaction of rendering of SWD services in the light of the directions contained in this order, after affording the Assessee opportunity of being heard. No other grounds relating to Transfer Pricing adjustment, were pressed for adjudication.

18. The other issue that remains for consideration is the issue of grant of appropriate MAT credit. The issue has been dealt with by the DRP by directing the AO to allow MAT credit, if available, according to the provisions of Sec.115JAA of the Act. We are of the view that the said

directions are proper and we direct the AO to allow MAT credit as per the directions of the DRP.

19. The other grounds of appeal are either consequential or were not argued and hence calls for no adjudication.

20. In the result, the appeal is partly allowed.

Pronounced in the open court on this 05th day of December, 2019.

Sd/-

Sd/-

(D S SUNDER SINGH)
ACCOUNTANT MEMBER

(N V VASUDEVAN)
VICE PRESIDENT

Bangalore,
Dated, the 05th December, 2019.

/Desai S Murthy /

Copy to:

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

By order

Assistant Registrar
ITAT, Bangalore.