

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

**BEFORE SHRI B.R. BASKARAN, ACCOUNTANT MEMBER
AND
SHRI PAVAN KUMAR GADALE, JUDICIAL MEMBER**

IT(T.P)A. No.36/Bang/2019
(Assessment Year: 2014-15)

M/s.Zynga Game Network India Pvt. Ltd.,
No.206, Logos Building,
M.G. Road, Bangalore-560 001

....Appellant

Vs.

Dy. Commissioner of Income Tax,
Circle 7(1)(2), Bangalore.

.....Respondent.

Assessee By:	Shri Sharath Rao, C.A.
Revenue By:	Shri Pradeep Kumar, CIT (D.R)

Date of Hearing :	07.11.2019
Date of Pronouncement :	22.01.2020

ORDER

PER SHRI PAVAN KUMAR GADALE, JM :

The assessee has filed an appeal against the final assessment order passed under Section 143(3) r.w.s. 144C(13) of the Income Tax Act, 1961 ('the Act') in pursuant to the directions of Dispute Resolution Panel (DRP) dt.20.09.2018. The assessee has raised Grounds of appeal and also Additional ground of Appeal which are as under :

A. TRANSFER PRICING:

1. The learned Assessing Officer ("learned AO"), learned Transfer Pricing Officer ("learned TPO") and the Honourable Dispute Resolution Panel ("Hon'ble DRP") grossly erred in adjusting the transfer price by INR 7,45,90,444/- of the Appellant's international transactions with its Associated Enterprises ("AEs") u/s 92CA of the Income-tax Act, 1961 ("the Act").
2. The learned AO/learned TPO/Hon'ble DRP erred in rejecting the TP documentation maintained by the Appellant by invoking provisions of sub-section (3) of 92C of the Act.
3. The learned AO/learned TPO/Hon'ble DRP erred in rejecting comparability analysis carried in the TP documentation and in conducting a fresh comparability analysis by introducing various filters in determining the Arm's Length Price ("ALP").
4. The learned AO/learned TPO/Hon'ble DRP erred in not considering the previous two years financial data of the comparable companies while determining the ALP.
5. The learned AO/learned TPO/Hon'ble DRP has grossly erred in not rejecting the following companies from the list of comparable companies:
 - Persistent Systems Limited
 - R S Software (India) Limited
 - Cigniti Technologies Limited
 - Thirdware Solutions Limited
6. The learned AO/learned TPO/Hon'ble DRP has grossly erred in rejecting companies that ought to have been included as comparable companies:
 - Akshay Software Technologies Limited
 - Cat Technologies Limited
 - Evoke Technologies Private Limited
 - Lucid Software Limited
 - Maveric Systems Limited
 - Sasken Communication Technologies Limited

- InfoMile Technologies Limited
 - Sagarsoft India Limited
7. The learned AO/learned TPO/ Hon'ble DRP erred in erroneously computing the operating margins of
- CG-VAK Software Exports Limited
 - R S Software Limited
 - Inexgen Games Technologies Private Limited
8. The learned AO/learned TPO/Hon'ble DRP erred in not allowing appropriate adjustment towards to the working capital differential existing between the Appellant vis-à-vis independent comparable companies.
9. The learned AO/learned TPO/Hon'ble DRP erred in not allowing appropriate adjustment towards to the risk differential existing between the Appellant vis-à-vis independent comparable companies.
10. Without prejudice to the above grounds, the learned AO/learned TPO erred in computing the transfer pricing adjustment, after giving effect to the Hon'ble DRP's direction, as INR 7,45,90,444/- instead of the correct adjustment amount of INR 6,48,10,494/-.

B. CORPORATE TAX:

11. Interest under section 234B of the Act:

The learned AO has erred in levying interest under section 234B of the Act amounting to Rs. 1,48,22,500 which is consequential in nature.

12. Interest under section 234C of the Act:

The learned AO has erred in computing interest under section 234C of the Act amounting to Rs. 5,11,717 on assessed income instead of returned income.

Additional Ground of Appeal :

13. *The TPO/AO/DRP while applying the minimum service revenue filter of one crores, has erred in not applying a cap on upper turnover filter for the arriving at companies comparable to the appellant for the purpose of determining the Arms Length Margin of the appellant."*

2. At the time of hearing, the learned Authorized Representative prayed for admission of Additional ground of Appeal and Revenue has no objections,

Accordingly additional ground of Appeal is admitted and Heard. Further LdAr Argued for exclusion of four comparables and inclusion of two comparables and Interest calculation under Section 234C of the Act and Supported with Chart and Paper Book.

3. The Brief facts of the case are that the assessee is 100% EOU under the STPI Scheme at Bangalore for carrying out software development activities and has a blend of software engineers, game designers and game managers and mainly in the business of software and Software Development Services. The assessee company has filed the Return of Income on 27.11.2014 with total income of Rs.18,36,09,584. Subsequently the case was selected for scrutiny and Notice under Section 143(2) and 142(1) of the Act along with questionnaire was issued. In compliance, the learned Authorized Representative appeared from time to time and Books of Accounts are furnished along with details. The assessee is engaged in the international business of software design and Software Development Services to its parent company Zyne, USA . The Assessing Officer found that the assessee has international transactions and with prior approval of Pri. CIT, the matter was referred to the Transfer Pricing Officer (TPO). The TPO dealt on the financial statements of assessee at para 2.2 and international transactions at 2.3 which are as under :

2.2. Financial statements:

2.2.1 The financials of the taxpayer for the F.Y. 2013-14 as per TP document are as under:

Particulars	Amount (In Rs) FY 2013-14
Income	
Income from operations	1099971917
Operating Revenue	1099971917
Expenditure	
Salaries, wages & other benefits to employees	580229381
Administrative Expenses	314299346
Depreciation	13649494
Foreign Exchange loss	55815341
Operating Cost	963993562
Operating Profit	135978355
OP/OC	14.11%
OP/OR	12.36%

2.2.2 The reconciled segmental financials of the taxpayer for the F.Y. 2013-14 as per TPO are as under:

Particulars	Amount (INR)
Income	
Income from operations	1099971917
Operating Revenue	1099971917
Expenditure	
Salaries, wages & other benefits to employees	580229381
Administrative Expenses	314299346
Depreciation	13649494
Foreign Exchange loss	55815341
Add: miscellaneous expenses	4159720
Add: Bank charges	158640
Operating Cost	968311922
Operating Profit	131659995
OP/OC	13.60%
OP/OR	11.97%

2.3 As per the Transfer Pricing (TP) document furnished for the FY 2013-14, the taxpayer company has entered into the following international transactions with its Associated Enterprises (AEs):

International transactions as per Form 3CEB

Particulars	Receivables/Received	Payables/Paid	Method
Provision of software development services	1106716524		TNMM
Reimbursement of expenses paid cost to cost basis		13093825	Other method
Outstanding receivables closely linked to Provision of software development services	109210183		TNMM
Unbilled revenue closely linked to Provision of software development services	16890316		TNMM
Total	1232817023	13093825	1245910848

The TPO examined the documentation of assessee and the international transactions in software development segment and the filters. The assessee has considered 22 companies as comparable on software development segment for Bench marking analysis. The international transactions are in respect of Software Development Services to its AEs. The assessee has adopted Transaction Net Margin Method (TNMM) as Most Appropriate Method (MAM) and the turnover of Software Development Segment is Rs.109.99 Crores and PLI on OP/OC is 13.60%. The TPO applied the filters on 22 comparables selected by the assessee in Software Development Segment and after considering the assessee objections, the TPO has selected final set of comparables in order at page 35 Para 16 which are as under :

16. FINAL SET OF COMPARABLES CONSIDERED BY THE TPO:

After considering the objections of the taxpayer to the comparable proposed in the show-cause notice, perusal of relevant annual reports and examination of additional comparable suggested by the taxpayer on the touchstones of filters and functionality, the final set of comparable companies considered by the TPO, is as under

Sl. No.	NAME (M/s.)	OP/OC (in %)
1	Persistent Systems Ltd.	35.10%
2	R S Software (India) Ltd.	24.25%
3	Cigniti Technologies Ltd.	27.62%
4	S Q S India B F S I Ltd.	22.37%
5	Thirdware Solution Ltd.	44.68%
6	Dumadu Games Private Limited	1.78%
7	Appon Software Private Ltd.	16.28%
8	Inexgen Games Technologies Pvt. Ltd	0.30%
	Average	21.55%

The TPO computed the Arm's Length Price (ALP) at para 17.4 as under :

17.4. Computation of Arm's Length Price:

17.4.1 The arithmetic mean of the Profit Level indicators is taken as the arm's length margin. Please see Annexure 'A' for details of computation of PLI of the comparable. Based on this, the arm's length price of the services rendered by the taxpayer to its AE(s) is computed as under:

SWD Segment

Arm's Length Mean Margin on cost	21.55%
Operating Cost	968311922
Arm's Length Price(ALP) of operating Revenue (@ 121.55% of OC)	1176967922
Price Received	1099971917
Variation in Price	76996005
3% of price received	32999158
Shortfall being adjustment	7,69,96,005

The TPO passed the order under Section 92CA of the Income Tax Act, 1961 on 30.10.2017. The Assessing Officer after the receipt of TPO order under Section 92CA of the Act has passed Draft assessment order under Section 143(3) r.w.s. 144C(1) dt.6.12.2017 determining the total income of Rs.18,36,09,584. Aggrieved by the Draft assessment order, the assessee has filed objections in Form No.35A with the Dispute Resolution Panel (DRP) after considering the objections of the assessee and the findings of the TPO, DRP has excluded one comparable SQS India BFSI Limited and with other directions passed order under Section 144C(5) of the Act on 29.9.2018. Subsequently TPO/AO based on the directions recomputed the ALP with final TP adjustment in Software Development Segment of Rs.7,45,90,444 and assessed the total income of Rs.25,82,00,028 and passed order under Section 143(3) r.w.s. 144C(13) of the Act dt.30.10.2018. Aggrieved by the order, the assessee has filed an appeal with the Tribunal.

4. At the time of hearing, the learned Authorised Representative has restricted his arguments for exclusion of four comparables and inclusion of two comparables and filed chart. Contra, the learned Departmental Representative supported the TPO order and filed written submissions.

5. We heard the rival contentions and perused the material on record. The learned Authorised Representative argued first on the comparables to be excluded

in Software Development Segment for determination of ALP. The learned Authorised Representative made submissions in respect of exclusion of -

(i) Persistent System Limited. We find the turnover of the comparable is Rs.1184.11 Crores and the margin is 35.10%. The company is functionally different as it provides complete life cycle services and has specialized software product and technology innovation. The information under Section 133(6) of the Act was furnished in respect of outsource product development which is different from Software Development Services. Further entire revenue of the comparable company is from outsourced product development and has presence of intangibles, brand ownership and provision of applied solutions and further holds proprietary products. A new business unit was established in the said year exclusively for the product business engaged in R & D and also has onsite activities and no segmental information is available. During the year there are extraordinary events of acquisitions of cloud squads and fails the turnover filter of more than Rs.200 Crores. The learned Authorised Representative relied on co-ordinate Bench decision of Nielsen Sports (India) Pvt. Ltd. vs Dcit in IT(TP)A No.196/Bang/2017 and In LG Soft India Pvt. Ltd. Vs. DCIT in IT(TP)A No.3122/Bang/2018 for the Assessment Year 2014-15 Dt.28.5.2019 the tribunal has at page 3 Para 7 & 7.1 held as under :

“ 7. In AY 2008-09, the co-ordinate bench has excluded M/s Persistent Systems Ltd also by following the decision rendered in the case of 3DPLM Software Solutions

Ltd (supra), where in it was held that M/s Persistent Systems Ltd is engaged in product development and product design services while the assessee is a software development service provider. Further, the segmental details were not available.

7.1 It was stated that there is no change in facts. Accordingly, following the decision rendered in the assessee's own case in AY 2008-09, we direct exclusion of M/s Persistent Systems Ltd."

(ii) R S Software India Limited turnover is Rs.351.88 Crores with margin of 28.25%. The ld. AR submitted that it is functionally different as the company offers life cycle management services and is involved in providing quality assurance services which include testing services along with maintenance and support statistical data analysis, Further owns products and brands and has presence outside India. Out of total turnover of Rs.284.39 Crores, foreign branch expenditure is Rs.203.37 Crores, and fails the turnover filter of more than Rs.200 Crores. The comparable was excluded in the case of Nielsen Sports (India) Pvt. Ltd. in IT(TP)A No.196/Bang/2017 (supra).

(iii) Cignity Technologies Limited;- where the turnover is Rs.54.63 Crores and margin is 27.62%. The company is functionally dissimilar and offers publication net work services and solutions and has expanded the business operations in Australia and UK .The Company has extraordinary events with acquisition of Two Companies. The learned Authorised Representative relied on decision of M/s LG Soft Tech Ltd. Vs. DCIT (supra) and we found the Co- ordinate Bench of Tribunal has observed at page 4 para 9 which read as under :

“ 9. We have noticed that the assessee seeks exclusion of M/s Cigniti Technologies Ltd. It is pertinent to note that the assessee itself had selected this company as a comparable and it has urged for exclusion of the same only before Ld DRP. The Ld A.R submitted that the Ld DRP did not address the same. The Ld A.R submitted that M/s Cigniti Technologies Ltd is a Testing company and hence it cannot be considered as a comparable. However, we notice that this contention has been raised by the assessee for the first time before Ld DRP and there was no occasion for the TPO to examine the same. Accordingly we restore this comparable to the file of AO/TPO for examining it afresh.”

(iv) The fourth comparable to be excluded is Third ware Solutions Limited where the turnover of Rs.206.75 Crores and the margin is 44.68%.The comparable is functionally different and has diversified activities and earns revenue from export of services, transcription and provides consultancy services and there is no segmental data.Further delivery locations are outside India and has an extraordinary events and fails the turnover filter of more than Rs.200 Crores. The learned Authorised Representative relied onM/S LG Soft Private Ltd. (supra) and Nielsen Sports (India) Pvt. Ltd. (supra). We found that the Tribunal in the case of LG Soft Pvt Ltd. (supra) has observed at page 4 paras 8 & 8.1 as under :

“ 8. We also notice that in AY 2008-09, the co-ordinate bench has excluded M/s Thirdware Solutions Ltd also by following the decision rendered in the case of 3DPLM Software Solutions Ltd (supra), where in it was held that M/s Thirdware solutions Ltd is engaged in product development and earns revenue from sale of licenses and subscription. Further, the segmental details were not available.

8.1 It was stated that there is no change in facts. Accordingly, following the decision rendered in the assessee's own case in AY 2008-09, we direct exclusion of M/s Thirdware Solutions Ltd.”

Considering the facts, findings and judicial decisions, we are of the opinion that the following Three comparables are to be excluded from the list of comparables for determination of ALP by the TPO.

- (i) Persistent Systems Ltd.
- (ii) R S Software (India) Ltd.
- (iii) Thirdware Solutions Ltd. And
- (iv) Cignity Technologies Ltd is restored to the file of TPO for fresh consideration.

The learned Authorized Representative argued for inclusion of two comparables. The first company to be included is Evoke Technologies Limited where the turnover is Rs.45.46 Crores and the margin is at 10.64%. The company is functionally comparable and rendered software services and passes all the filters of TPO and the data is available in public domain and is a sub-set of an entity. DRP has interpreted exports at 20.34% which is incorrect as the export revenue is mainly From U S A. We found the DRP has dealt on the comparable at page 9 of the order. The learned Authorized Representative demonstrated the Annual Report at page 1253 and page 1254 of Paper Book, where the revenue from Software Development Services has been disclosed. The learned Authorised Representative argued on second comparable to be included is CAT Technologies Ltd. where the turnover is Rs.4.09 Crores and the company is functionally comparable and the

revenue is derived entirely from provisions of IT Services referred at page 1205 of Paper Book and has not earned any income from medical transcription services. There is no segmental information as all the income is earned from provision of IT Services and qualifies the export turnover filter. Whereas the DRP has considered the comparable at page 9 of DRP order that it is in medical transcription business. And was rejected . Considering the material facts, DR, and the information in Annual Report, we are of the opinion that these facts have to be dealt in detail by the TPO and Accordingly Restore these two comparables i.e. Evoke Technologies Ltd. and CAT Technologies Ltd. to the file of the TPO for fresh adjudication and examination.

6. The learned Authorised Representative has argued on the calculation of interest under Section 234C, we direct the Assessing Officer to calculate Interest as per the provisions of law.

7. In the result, the appeal of the assessee is partly allowed for statistical purposes.

Order pronounced in the open court on 22nd Jan., 2019.

Sd/-

(B.R. BASKARAN)
ACCOUNTANT MEMBER

Sd/-

(PAVAN KUMAR GADALE)
JUDICIAL MEMBER

Dated: 22.01.2019.

*Reddy GP

Copy to

1. The appellant
2. The Respondent
3. CIT (A)
4. Pr. CIT
5. DR, ITAT, Bangalore.
6. Guard File

By order

Assistant Registrar
Income-tax Appellate Tribunal
Bangalore